

CONVERGYS CORP
Form 10-Q
November 06, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____.

Commission File Number 1-14379

CONVERGYS CORPORATION

Incorporated under the laws of the State of Ohio

201 East Fourth Street, Cincinnati, Ohio 45202

I.R.S. Employer Identification Number 31-1598292

Telephone - Area Code (513) 723-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At October 31, 2007, there were 130,238,165 common shares outstanding, excluding amounts held in Treasury of 50,905,346.

PART I - FINANCIAL INFORMATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

AND COMPREHENSIVE INCOME

(Unaudited)

(Amounts in millions, except per share amounts)	Three Months		Nine Months	
	Ended Sept. 30, 2007	2006	Ended Sept. 30, 2007	2006
Revenues	\$ 703.7	\$ 702.7	\$ 2,130.6	\$ 2,069.8
Operating Costs and Expenses				
Cost of providing services and products sold	456.8	439.9	1,377.2	1,301.9
Selling, general and administrative	131.0	135.8	412.8	400.6
Research and development costs	18.9	22.0	57.6	63.8
Depreciation	28.5	33.3	86.8	98.4
Amortization	2.1	2.0	6.5	10.6
Restructuring charge	3.4		3.4	
Total costs and expenses	640.7	633.0	1,944.3	1,875.3
Operating Income	63.0	69.7	186.3	194.5
Equity in Earnings of Cellular Partnerships	2.2	4.2	7.8	7.1
Other Income, net	1.2	0.8	3.9	1.9
Interest Expense	(4.2)	(5.7)	(13.6)	(17.2)
Income Before Income Taxes	62.2	69.0	184.4	186.3
Income Tax Expense	20.4	23.8	60.2	64.6
Net Income	\$ 41.8	\$ 45.2	\$ 124.2	\$ 121.7
Other Comprehensive Income (Loss), net of tax:				
Foreign currency translation adjustments	\$ 5.5	\$ 2.6	\$ 14.0	\$ 5.8
Change related to pension liability			2.8	
Unrealized gains (losses) on hedging activities	6.1	3.5	36.2	(4.0)
Total other comprehensive income (loss)	11.6	6.1	53.0	1.8
Comprehensive Income	\$ 53.4	\$ 51.3	\$ 177.2	\$ 123.5
Earnings Per Common Share				
Basic	\$ 0.31	\$ 0.33	\$ 0.92	\$ 0.88
Diluted	\$ 0.30	\$ 0.32	\$ 0.89	\$ 0.86
Average Common Shares Outstanding				
Basic	133.7	138.0	135.6	138.8
Diluted	137.1	141.4	139.4	142.0

See Notes to Consolidated Financial Statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts In Millions)	(Unaudited)	
	September 30, 2007	December 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 116.9	\$ 235.9
Receivables, net of allowances of \$8.0 and \$12.0	591.5	545.6
Deferred income tax benefits	25.3	53.5
Prepaid expenses	38.8	37.3
Other current assets	81.8	57.9
Total current assets	854.3	930.2
Property and equipment, net	358.3	368.6
Goodwill, net	894.4	880.2
Other intangibles, net	44.3	49.9
Investment in Cellular Partnerships	51.3	49.5
Deferred charges	270.5	228.0
Other assets	36.4	33.9
Total Assets	\$ 2,509.5	\$ 2,540.3
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Debt maturing within one year	\$ 16.0	\$ 83.9
Payables, deferred revenue and other current liabilities	383.1	512.0
Total current liabilities	399.1	595.9
Long-term debt	259.2	259.6
Deferred income tax liability	69.9	43.9
Accrued pension liability	99.6	105.0
Deferred revenue and other long-term liabilities	158.7	80.8
Total liabilities	986.5	1,085.2
Shareholders Equity		
Preferred shares without par value, 5.0 authorized; none outstanding		
Common shares without par value, 500.0 authorized; 181.1 outstanding in 2007 and 179.6 outstanding in 2006	993.9	965.1
Treasury stock 49.9 shares in 2007 and 43.1 in 2006	(879.7)	(749.4)
Retained earnings	1,352.1	1,235.7
Accumulated other comprehensive income	56.7	3.7
Total shareholders equity	1,523.0	1,455.1
Total Liabilities and Shareholders Equity	\$ 2,509.5	\$ 2,540.3

See Notes to Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Amounts in millions)	Nine Months	
	Ended September 30, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 124.2	\$ 121.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	93.3	109.0
Deferred income tax expense	40.2	14.4
Cellular Partnerships results in excess of distributions	(7.8)	(7.1)
Stock compensation expense	19.1	20.9
Changes in assets and liabilities, net of effects from acquisitions:		
Change in receivables	(45.9)	(39.6)
Change in other current assets	0.4	6.7
Change in deferred charges, net	(31.0)	(50.0)
Change in other assets and liabilities	(5.1)	38.0
Change in payables and other current liabilities	(71.8)	24.1
Other, net	(4.6)	(3.9)
Net cash provided by operating activities	111.0	234.2
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(77.2)	(79.0)
Proceeds from disposal of property and equipment	0.3	4.6
Acquisitions	(2.8)	(6.8)
Sales of auction rate securities, net	30.0	
Return of capital from Cellular Partnerships	6.0	5.8
Net cash used in investing activities	(43.7)	(75.4)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of commercial paper and other debt, net	(68.3)	(58.6)
Excess tax benefits from share-based payment arrangements	2.9	3.1
Purchase of treasury shares	(127.6)	(63.4)
Issuance of common shares	6.7	14.5
Net cash used in financing activities	(186.3)	(104.4)
Net (decrease) /increase in cash and cash equivalents	(119.0)	54.4
Cash and cash equivalents at beginning of period	235.9	196.0
Cash and cash equivalents at end of period	\$ 116.9	\$ 250.4

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

(1) BACKGROUND AND BASIS OF PRESENTATION

Convergys Corporation (the Company or Convergys) is a global leader in providing customer care, billing and human resource services. For over twenty years, enterprises with a large number of customers and employees have turned to Convergys for support. By providing value-added billing, customer care and employee care solutions for our clients, the Company has developed a base of recurring revenues generally under multiple year contracts.

The Company reports three segments: (i) Customer Care, which provides outsourced customer service as well as professional and consulting service to in-house customer care operations; (ii) Information Management, which provides billing and information solutions; and (iii) Employee Care, which provides human resource business process outsourcing solutions.

These financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and, in the opinion of management, include all adjustments necessary for a fair presentation of the results of operations, financial position and cash flows for each period shown. All adjustments are of a normal and recurring nature. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted. Interim consolidated financial statements are not necessarily indicative of the financial position or operating results for an entire year. These interim financial statements should be read in conjunction with the audited financial statements and the notes thereto included in the Company's annual report on Form 10-K for the period ended December 31, 2006. Certain previously reported amounts have been reclassified to conform to current period presentation.

We file annual, quarterly, current reports and proxy statements with the SEC. These filings are available to the public over the Internet on the SEC's Web site at <http://www.sec.gov> and on the Company's Web site at <http://www.convergys.com>. You may also read and copy any document we file with the SEC at its public reference facilities in Washington, D.C. You can also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information relating to the operation of the public reference facilities. You can also inspect periodic and current reports, proxy statements and other information about Convergys at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

(2) RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This new Standard provides guidance for using fair value to measure assets and liabilities. The Standard also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other Standards require (or permit) assets or liabilities to be measured at fair value, but does not expand the use of fair value in any new circumstances. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the effects that SFAS No. 157 will have on its financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 allows entities to voluntarily choose, at specified election dates, to measure many financial and certain non-financial assets and liabilities at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, SFAS 159 specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. This Statement is effective as of the first fiscal year that begins after November 15, 2007. The adoption of this Standard will not have a material impact on the Company's financial statements.

(3) STOCK-BASED COMPENSATION PLANS

The Company's operating results for the three and nine months ended September 30, 2007 included long-term incentive plan expense of \$3.3 and \$20.1, respectively compared to \$7.7 and \$22.0, respectively, for the same periods in 2006. Long-term incentive plan expense includes both incentive plan expense that is paid in cash based on relative shareholder return as well as stock compensation expense.

Operating results for the three and nine months ended September 30, 2007 included stock compensation expense of \$6.7 and \$19.1, respectively, compared to \$7.7 and \$22.0, respectively, for the same periods in 2006. Included in the stock compensation expense of \$22.0 for the nine months ended September 30, 2006 was pretax compensation expense of \$0.9 (\$0.6, net of tax) related to the expensing of the Company's stock options due to the adoption of SFAS 123(R), Share-Based Payment.

Stock Options

A summary of stock option activity for the nine months ended September 30, 2007 is presented below:

Shares in Thousands	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Weighted Average Fair Value at Date of Grant (per share)
Outstanding at Jan. 1, 2007	12,828	\$ 28.69		
Exercised	(1,046)	14.83		
Forfeited/cancelled				