StarTek, Inc.
Form 10-Q
May 10, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2017
or
o 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 1-12793

StarTek, Inc.
(Exact name of registrant as specified in its charter)

Delaware	84-1370538
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer Identification No.)

8200 E. Maplewood Ave., Suite 100	
Greenwood Village, Colorado	80111
(Address of principal executive offices)	(Zip code)

(303) 262-4500
(Registrant’s telephone number, including area code)

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 x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definitions of “large accelerated filer,” “accelerated filer”, “smaller reporting company”, and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o
	(Do not check if a smaller reporting company)

Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

As of April 27, 2017, there were 15,898,694 shares of Common Stock outstanding.

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NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including the following:

- certain statements, including possible or assumed future results of operations, in “Management’s Discussion and Analysis of Financial Condition and Results of Operations”;
- any statements regarding the prospects for our business or any of our services;
- any statements preceded by, followed by or that include the words “may,” “will,” “should,” “seeks,” “believes,” “expects,” “anticipates,” “intends,” “continue,” “estimate,” “plans,” “future,” “targets,” “predicts,” “budgeted,” “projections,” “outlooks,” scheduled,” or similar expressions; and
- other statements regarding matters that are not historical facts.

Our business and results of operations are subject to risks and uncertainties, many of which are beyond our ability to control or predict. Because of these risks and uncertainties, actual results may differ materially from those expressed or implied by forward-looking statements, and investors are cautioned not to place undue reliance on such statements, which speak only as of the date thereof. Important factors that could cause actual results to differ materially from our expectations and may adversely affect our business and results of operations, include, but are not limited to, those items described herein or set forth in Item 1A. “Risk Factors” appearing in our Annual Report on Form 10-K for the year ended December 31, 2016 and this Quarterly Report on Form 10-Q for the quarter ended March 31, 2017. Unless otherwise noted in this report, any description of "us," "we," or "our," refers to StarTek, Inc. ("STARTEK") and its subsidiaries.

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

STARTEK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended March 31,	
	2017	2016
Revenue	$77,652	$78,035
Cost of services	67,638	69,647
Gross profit	10,014	8,388
Selling, general and administrative expenses	7,882	7,781
Impairment losses and restructuring charges, net	—	12
Operating income	2,132	595
Interest and other income (expense), net	(367)	(439)
Income before income taxes	1,765	156
Income tax expense (benefit)	(28)	125
Net income	$1,793	$31
Other comprehensive income, net of tax:		1
Foreign currency translation adjustments	(14)	21
Change in fair value of derivative instruments	446	258
Comprehensive income	$2,225	$310
Net income per common share - basic	$0.11	$0.00
Weighted average common shares outstanding - basic	15,815	15,699
Net income per common share - diluted	0.11	$0.00
Weighted average common shares outstanding - diluted	16,995	15,956

See Notes to Consolidated Financial Statements.

STARTEK, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(Unaudited)

	March 31, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$1,364	$1,039
Trade accounts receivable, net	54,639	60,179
Prepaid expenses	2,546	2,140
Other current assets	1,492	1,670
Total current assets	$60,041	$65,028
Property, plant and equipment, net	20,784	23,276
Deferred income tax assets	338	333
Intangible assets, net	6,412	6,697
Goodwill	9,077	9,077
Other long-term assets	2,408	2,397
Total assets	$99,060	$106,808
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$7,095	$7,612
Accrued liabilities:		
Accrued employee compensation and benefits	10,345	13,767
Other accrued liabilities	2,696	2,083
Line of credit	—	26,025
Derivative liability	560	980
Other current debt	2,446	2,740
Other current liabilities	889	1,157
Total current liabilities	$24,031	$54,364
Line of credit	20,719	—
Deferred rent	971	1,151
Deferred income tax liabilities	564	499
Other debt	4,889	5,500
Other liabilities	589	550
Total liabilities	$51,763	$62,064
Commitments and contingencies		
Stockholders' equity:		
Common stock, 32,000,000 non-convertible shares, $0.01 par value, authorized; 15,898,694 and 15,811,516 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively	$159	$158
Additional paid-in capital	80,887	80,560
Accumulated other comprehensive income (loss)	383	(49)
Accumulated deficit	(34,132)	(35,925)
Total stockholders' equity	$47,297	$44,744
Total liabilities and stockholders' equity	$99,060	$106,808

See Notes to Consolidated Financial Statements.

STARTEK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2017	2016
Operating Activities		
Net income	$1,793	$31
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,962	3,230
Share-based compensation expense	229	489
Deferred income taxes	65	51
Income tax benefit related to other comprehensive income	—	(166)
Changes in operating assets and liabilities:		
Trade accounts receivable	5,545	4,078
Prepaid expenses and other assets	(214)	362
Accounts payable	18	(268)
Accrued and other liabilities	(3,215)	(2,943)
Net cash provided by operating activities	7,183	4,864
Investing Activities		
Proceeds from sale of assets	342	—
Purchases of property, plant and equipment	(1,113)	(411)
Cash paid for acquisition of businesses	—	(217)
Net cash used in investing activities	(771)	(628)
Financing Activities		
Proceeds from the issuance of common stock	98	39
Proceeds from line of credit	79,675	76,400
Principal payments on line of credit	(84,980)	(81,759)
Principal payments on other debt	(868)	(700)
Net cash used in financing activities	(6,075)	(6,020)
Effect of exchange rate changes on cash	(12)	(12)
Net increase (decrease) in cash and cash equivalents	325	(1,796)
Cash and cash equivalents at beginning of period	$1,039	$2,626
Cash and cash equivalents at end of period	$1,364	$830

See Notes to Consolidated Financial Statements.

STARTEK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2017
(In thousands, except share and per share data)
(Unaudited)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by GAAP for complete financial statements. These financial statements reflect all adjustments (consisting only of normal recurring entries, except as noted) which, in the opinion of management, are necessary for fair presentation. Operating results for the three months ended March 31, 2017 are not necessarily indicative of operating results that may be expected during any other interim period of 2017 or the year ending December 31, 2017. The consolidated balance sheet as of December 31, 2016, included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP. As such, the information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.
Unless otherwise noted in this report, any description of "us," "we," or "our," refers to StarTek, Inc. and its subsidiaries. Financial information in this report is presented in U.S. dollars.

Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts included in the financial statements and accompanying notes. Estimates and assumptions are reviewed periodically, and the effects of revisions are reflected in the period they are determined to be necessary.

Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-04, Intangibles - Goodwill and Other (Topic 350) ("ASU 2017-04"), Simplifying the Test for Goodwill Impairment. To simplify the subsequent measurement of goodwill, the amendments eliminate Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The guidance is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019 and early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We do not expect the adoption of ASU 2017-04 will have a material impact on our consolidated financial statements.

In October 2016, FASB issued ASU 2016-16, Income Taxes (Topic 740) ("ASU 2016-16"), Intra-Entity Transfers of Assets Other Than Inventory. The purpose of ASU 2016-16 is to simplify the income tax accounting of an intra-entity transfer of an asset other than inventory and to record its effect when the transfer occurs. The guidance is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods and early adoption is permitted. We do not expect the adoption of ASU 2016-16 will have a material impact on our consolidated financial statements.

In June 2016, FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326) ("ASU 2016-13"), Measurement of Credit Losses on Financial Instruments. The standard significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. The standard will replace today's "incurred loss" approach with an "expected loss" model for instruments measured at amortized cost. For available-for-sale debt securities, entities will be required to record allowances rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. It also simplifies the accounting model for purchased credit-impaired debt securities and loans. This ASU is effective for annual periods beginning after December 15, 2019, and interim periods therein. Early adoption is permitted for annual periods beginning after December 15, 2018, and interim periods therein. We do not expect the adoption of ASU 2016-13 will have a material impact on our consolidated financial statements.

In March 2016, FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718) ("ASU 2016-09"), Improvements to Employee Share-Based Payment Accounting. The amendments in ASU 2016-09 address multiple aspects of the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liability, and classification on the statements of cash flows. This ASU is effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted in any interim or annual period. An entity that elects early adoption must adopt all the amendments in the same period, and any adjustments should be reflected as of the beginning of the fiscal year that includes the interim period. We adopted this ASU for the first quarter of 2017 and it did not have a material impact on our consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). These amendments require the recognition of lease assets and lease liabilities on the balance sheet by lessees for those leases currently classified as operating leases under ASC 840 “Leases”. These amendments also require qualitative disclosures along with specific quantitative disclosures. These amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. Entities are required to apply the amendments at the beginning of the earliest period presented using a modified retrospective approach. We are currently evaluating the impact that the adoption of ASU 2016-02 will have on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). ASU 2014-09 amends the guidance for revenue recognition to replace numerous, industry-specific requirements and converges areas under this topic with those of the International Financial Reporting Standards. The ASU implements a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. The amendment also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The amendments in this ASU are effective for reporting periods beginning after December 15, 2016; however, in July 2015, the FASB agreed to delay the effective date by one year. The proposed deferral may permit early adoption, but would not allow adoption any earlier than the original effective date of the standard. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. We have assessed the impact of ASU 2014-09 and have determined that our current revenue recognition process is substantially in compliance with the ASU. Therefore, we do not anticipate a material impact to our consolidated financial statements. We are currently evaluating the additional disclosures that will be required upon adoption.

2. GOODWILL AND INTANGIBLE ASSETS

Goodwill

Total goodwill of $9,077 is assigned to our Domestic segment. We perform a goodwill impairment analysis at least annually (in the fourth quarter of each year) unless indicators of impairment exist in interim periods. We performed a quantitative assessment to determine whether it was more likely than not that the fair value of the Domestic reporting unit exceeded its carrying value. In making this assessment, we evaluated overall business and economic conditions as well as expectations of projected revenues and cash flows, assumptions impacting the weighted average cost of capital and overall global industry and market conditions.

In 2016, we concluded that goodwill was not impaired. No indicators of impairment exist as of March 31, 2017.

Intangible Assets

The following table presents our intangible assets as of March 31, 2017:

	Gross Intangibles	Accumulated Amortization	Net Intangibles	Weighted Average Amortization Period (years)
Developed technology	$ 390	$ 195	$ 195	3.75
Customer relationships	7,550	2,030	5,520	4.68
Trade names	1,050	353	697	2.86
	$ 8,990	$ 2,578	$ 6,412	4.45

Expected future amortization of intangible assets as of March 31, 2017 is as follows:

Year Ending December 31,	Amount
Remainder of 2017	$ 855
2018	1,140
2019	1,131
2020	1,128
2021	1,004
Thereafter	1,154

3. NET INCOME PER SHARE

Basic net income per common share is computed based on our weighted average number of common shares outstanding. Diluted earnings per share is computed based on our weighted average number of common shares outstanding plus the effect of dilutive stock options and non-vested restricted stock using the treasury stock method. Dilutive stock options for the three months ended March 31, 2017 and 2016 totaled 1,179,634 and 256,661, respectively.

4. PRINCIPAL CLIENTS

The following table represents revenue concentration of our principal clients:

	Three Months Ended March 31,					
	2017			2016		
	Revenue	Percentage		Revenue	Percentage	
T-Mobile	$22,054	28.4	%	$16,017	20.5	%
Sprint	$10,256	13.2	%	$10,871	13.9	%
AT&T	$8,647	11.1	%	$10,487	13.4	%

We enter into master service agreements (MSAs) that cover all of our work for each client. These MSAs are typically multi-year contracts that include auto-renewal provisions. They typically do not include contractual minimum volumes and are generally terminable by the customer or us with prior written notice.

To limit credit risk, management performs periodic credit analyses and maintains allowances for uncollectible accounts as deemed necessary. Under certain circumstances, management may require clients to pre-pay for services. As of March 31, 2017, management believes reserves are appropriate and does not believe that any significant credit risk exists.

We have entered into factoring agreements with financial institutions to sell certain of our accounts receivable under non-recourse agreements. These transactions are accounted for as a reduction in accounts receivable because the agreements transfer effective control over and risk related to the receivables to the buyers. We do not service any factored accounts after the factoring has

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occurred. We utilize factoring arrangements as part of our financing for working capital. The aggregate gross amount factored under these agreements was $28,742 and $7,824 for the three months ended March 31, 2017 and March 31, 2016, respectively.

5. DERIVATIVE INSTRUMENTS

We use derivatives to partially offset our business exposure to foreign currency exchange risk. We enter into foreign currency forward and option contracts to hedge our anticipated operating commitments that are denominated in foreign currencies, including forward contracts and range forward contracts (a transaction where both a call option is purchased and a put option is sold). The contracts cover periods commensurate with expected exposure, generally three to twelve months, and are principally unsecured foreign exchange contracts. The market risk exposure is essentially limited to risk related to currency rate movements. We operate in Canada, Jamaica, and the Philippines, where the functional currencies are the Canadian dollar, the Jamaican dollar, and the Philippine peso, respectively, which are used to pay labor and other operating costs in those countries. We provide funds for these operating costs as our client contracts generate revenues, which are paid in U.S. dollars. In Honduras, our functional currency is the U.S. dollar and the majority of our costs are denominated in U.S. dollars. We have elected to designate our derivatives as cash flow hedges in order to associate the results of the hedges with forecasted expenses.

Unrealized gains and losses are recorded in accumulated other comprehensive income ("AOCI") and will be re-classified to operations as the forecasted expenses are incurred, typically within one year. During the three months ended March 31, 2017 and 2016, our cash flow hedges were highly effective and hedge ineffectiveness was not material.

The following table shows the notional amount of our foreign exchange cash flow hedging instruments as of March 31, 2017:

	Local Currency Notional Amount	U.S. Dollar Notional Amount
Canadian Dollar	13,880	$ 10,571
Philippine Peso	1,646,700	32,471
		$ 43,042