CONVERGYS CORP
Form 10-Q
May 08, 2018

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 March 31, 2018
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
(Exact name of registrant as specified in its charter)

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 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the 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	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

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

At March 31, 2018, there were 91,499,038 common shares outstanding, excluding amounts held in treasury of 1,351,300.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Amounts in millions except per share amounts)	Three Months Ended March 31, 2018	2017
Revenues	$674.2	$727.6
Costs and Expenses:		
Cost of providing services and products sold [(1)]	417.7	450.2
Selling, general and administrative	172.4	177.5
Depreciation	23.8	27.4
Amortization	6.9	7.2
Restructuring charges	18.9	15.0
Transaction and integration costs	—	1.5
Total costs and expenses	639.7	678.8
Operating Income	34.5	48.8
Other (expense) income, net	(0.5)	1.3
Interest expense	(4.5)	(5.3)
Income before Income Taxes	29.5	44.8
Income tax (benefit) expense	(0.3)	6.9
Net Income	$29.8	$37.9
Basic Earnings per Common Share	$0.33	$0.40
Diluted Earnings per Common Share	$0.30	$0.38
Weighted Average Common Shares Outstanding:		
Basic	91.6	94.4
Diluted	98.2	100.5
Cash dividends declared per share	$0.11	$0.09

(1) Exclusive of depreciation and amortization, with the exception of amortization of deferred charges.

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended March 31,	
(In millions)	2018	2017
Net Income	$29.8	$37.9
Other Comprehensive (Loss) Income, net of tax:		
Foreign currency translation adjustments	6.4	3.0
Change related to pension liability	(4.5)	0.9
Unrealized (loss) gain on hedging activities	(20.1)	10.7
Total other comprehensive (loss) income	(18.2)	14.6
Total Comprehensive Income	$11.6	$52.5

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

(Amounts in millions)	(Unaudited) At March 31, 2018	At December 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	$186.3	$193.7
Short-term investments	13.1	13.5
Receivables, net of allowances of $4.4 and $4.8	567.7	567.2
Prepaid expenses	39.5	35.9
Other current assets	49.9	47.4
Total current assets	856.5	857.7
Property and equipment, net	240.0	260.0
Goodwill	942.8	937.9
Other intangibles, net	282.8	287.3
Deferred income tax assets	19.6	21.3
Other assets	44.6	50.5
Total Assets	$2,386.3	$2,414.7
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Debt and capital lease obligations maturing within one year	$50.3	$0.9
Payables and other current liabilities	309.6	322.1
Total current liabilities	359.9	323.0
Long-term debt and capital lease obligations	230.0	267.7
Deferred income tax liabilities	213.4	222.6
Accrued pension liabilities	92.5	94.7
Other long-term liabilities	57.1	69.5
Total liabilities	952.9	977.5
Convertible debentures conversion feature	59.0	59.5
Shareholders' Equity:		
Preferred shares—without par value, 5.0 authorized; none issued or outstanding	—	—
Common shares—without par value, 500.0 authorized; 92.9 and 92.5 issued, 91.5 and 91.8 outstanding, as of March 31, 2018 and December 31, 2017, respectively	3.3	2.5
Treasury stock—1.4 and 0.6 shares as of March 31, 2018 and December 31, 2017, respectively	(32.2)	(16.0)
Retained earnings	1,488.1	1,457.8
Accumulated other comprehensive loss	(84.8)	(66.6)
Total shareholders' equity	1,374.4	1,377.7
Total Liabilities and Shareholders' Equity	$2,386.3	$2,414.7

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(Amounts in millions)	Three Months Ended March 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$29.8	$37.9
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	30.7	34.6
Deferred income tax expense (benefit)	4.1	(0.6)
Stock compensation expense	5.2	4.4
Changes in assets and liabilities, net of acquisitions:		
Change in receivables	(0.8)	1.3
Change in other current assets	(8.2)	1.4
Change in deferred charges, net	0.1	0.1
Change in other assets and liabilities	(30.0)	(11.2)
Change in payables and other current liabilities	(18.2)	(35.0)
Net cash provided by operating activities	12.7	32.9
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(5.9)	(8.9)
Net cash used in investing activities	(5.9)	(8.9)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of other long-term debt (term loan)	—	100.0
Repayments of other long-term debt (term loan and capital lease obligations)	(51.1)	(215.7)
Proceeds from Asset Securitization Facility	215.3	333.6
Repayment of Asset Securitization Facility	(153.3)	(173.6)
Repurchase of common shares	(15.9)	(21.5)
Payments of dividends	(9.2)	(8.5)
Net cash (used in) provided by financing activities	(14.2)	14.3
Net (decrease) increase in cash and cash equivalents	(7.4)	38.3
Cash and cash equivalents at beginning of period	193.7	138.8
Cash and cash equivalents at end of period	$186.3	$177.1

The accompanying notes are an integral part of the Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in millions except per share amounts)

1. BACKGROUND AND BASIS OF PRESENTATION

Convergys Corporation is a global leader in customer experience outsourcing, focused on bringing value to its clients through every customer interaction. As of March 31, 2018, Convergys had approximately 110,000 employees in 33 countries, interacting with our clients' customers in 58 languages. In order to help clients serve their customers, Convergys operates 136 contact centers. Convergys leverages its geographic footprint and comprehensive capabilities to help leading companies create quality customer experiences across multiple interaction channels, such as voice, chat, email and interactive voice response.

The accompanying Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting (U.S. GAAP) and U.S. Securities and Exchange Commission (SEC) regulations 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 Consolidated 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 year ended December 31, 2017, filed with the SEC on February 21, 2018.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This ASU permits companies to reclassify disproportionate tax effects in accumulated other comprehensive income (AOCI) caused by the Tax Cuts and Jobs Act of 2017 (the 2017 Tax Act) to retained earnings. The Company elected to early adopt this standard as of January 1, 2018, on a prospective basis, resulting in a $6.0 reclassification adjustment, using a specific identification method, that increased retained earnings and decreased AOCI.

In May 2017, the FASB issued ASU 2017-09, Stock Compensation - Scope of Modification Accounting. This ASU clarifies which changes to the terms or conditions of a share-based payment award require the application of modification accounting under ASC 718. The Company adopted this standard as of January 1, 2018. The adoption of this standard did not have an impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment. This ASU eliminates the two-step process that required identification of potential impairment and a separate measure of the actual impairment. Goodwill impairment charges, if any, would be determined by the difference between a reporting unit's carrying value and its fair value (impairment loss is limited to the carrying value). This standard is effective for annual or any interim goodwill impairment tests beginning after December 15, 2019. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230). The objective of this update is to provide additional guidance and reduce diversity in practice when classifying certain transactions within the statement of cash flows. In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. This new standard requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. These standards are effective for financial statements issued for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted these standards as of January 1, 2018 utilizing the retrospective transition method. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. This ASU will require lessees to recognize almost all leases on the balance sheet as a right-of-use asset and a lease liability. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as finance leases or operating leases. The Company will adopt this standard on January 1, 2019 and is currently assessing the effect that adoption of the new standard will have on its consolidated financial statements and related disclosures, as well as its processes, systems and internal controls. The Company currently expects adoption of this standard will result in a material increase to the assets and liabilities reported on the Company's Consolidated Balance Sheets.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. The standard applies one comprehensive revenue recognition model across all contracts, entities and sectors. The core principal of the new standard is that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard includes cost guidance, whereby all direct and incremental costs to obtain or fulfill a contract with a customer are capitalized and amortized over the corresponding period of benefit. The Company adopted this standard for all contracts with customers outstanding on January 1, 2018 using the modified retrospective adoption method, which resulted in a $3.2 adjustment to the opening balance of retained earnings. Results for reporting periods after January 1, 2018 are presented under ASU 2014-09, while prior period amounts are not adjusted and continue to be reported in accordance with the accounting standards in effect for those periods. The largest adoption impacts to the Company's consolidated financial statements resulted from the new qualitative and quantitative disclosures provided in Note 3, and the capitalization of certain direct and incremental contract costs that are now being capitalized and amortized over the estimated period of benefit of the corresponding contracts. The new standard does not have an impact on the timing or revenue recognition pattern of any of our identified revenue streams. The cumulative effect of the changes made to our January 1, 2018 Consolidated Balance Sheet for the adoption of ASU 2014-09 were as follows:

Consolidated Balance Sheet Caption	Balance at December 31, 2017	Adjustments Due to ASU 2014-09	Balance at January 1, 2018
Assets			
Other current assets	$47.4	$2.0	$49.4
Total current assets	$857.7	$2.0	$859.7
Other assets	$50.5	$2.3	$52.8
Total Assets	$2,414.7	$4.3	$2,419.0
Liabilities and Shareholders' Equity			
Deferred income tax liabilities	$222.6	$1.1	$223.7
Total liabilities	$977.5	$1.1	$978.6
Retained Earnings	$1,457.8	$3.2	$1,461.0
Total shareholders' equity	$1,377.7	$3.2	$1,380.9
Total Liabilities and Shareholders' Equity	$2,414.7	$4.3	$2,419.0

The impacts to the Company's Consolidated Statement of Income for the three months ended March 31, 2018 and Consolidated Balance Sheet as of March 31, 2018, as a result of the adoption of ASU 2014-09 were as follows:

Consolidated Statement of Income Caption	Three Months Ended March 31, 2018 As Reported	Amounts Without Adoption of ASU 2014-09	Effect of Change
Selling, general and administrative	$172.4	$172.8	($0.4)
Total costs and expenses	$639.7	$640.1	($0.4)
Operating Income	$34.5	$34.1	$0.4
Income before Income Taxes	$29.5	$29.1	$0.4
Income tax benefit	($0.3)	($0.2)	($0.1)
Net Income	$29.8	$29.5	$0.3

Consolidated Balance Sheet Caption	Three Months Ended March 31, 2018 As Reported	Balances Without Adoption of ASU 2014-09	Effect of Change
Assets			
Other current assets	$49.9	$47.6	$2.3
Total current assets	$856.5	$854.2	$2.3
Other assets	$44.6	$42.1	$2.5
Total Assets	$2,386.3	$2,381.5	$4.8
Liabilities and Shareholders' Equity			
Deferred income tax liabilities	$213.4	$212.2	$1.2
Total liabilities	$952.9	$951.7	$1.2
Retained earnings	$1,488.1	$1,484.5	$3.6
Total shareholders' equity	$1,374.4	$1,370.8	$3.6
Total Liabilities and Shareholders' Equity	$2,386.3	$2,381.5	$4.8

3. REVENUE FROM CONTRACTS WITH CUSTOMERS

Revenue Recognition Policy

More than 95% of the Company’s revenues are derived from fees for customer experience outsourcing services provided to the Company’s clients. Revenues from our contracts to provide these services relate to a single performance obligation to stand ready to provide services to the customer. The Company recognizes these revenues over time as services are performed based on the volumes of services provided and contractual rates. The Company’s remaining revenues, which represent less than 5% of the Company’s total revenues, are derived from the sale of premise-based and hosted self-care and technology solutions and provision of professional services. Revenues from the sale of these solutions and provision of these services are recognized over time as solutions or services are provided over the duration of the contract, using contractual rates. These contracts are typically one year or less in duration.

Certain of our contracts, primarily for agent-related services, include pricing terms and conditions that include components of variable consideration. The variable consideration is typically in the form of performance-related bonus and penalty provisions that are determined based upon our meeting, or not meeting, agreed-upon service levels and performance metrics specified within the contract. Some contracts also contain discounts that the client can earn through the achievement of specified volume levels or through early payment for services provided by Convergys. Each component of variable consideration is earned based on the Company's actual performance during the measurement period specified within the contract (typically monthly for bonus and penalty provisions and either quarterly or annually for volume discounts). In order to determine the transaction price, the Company estimates the variable consideration using the most likely amount method, based on the specific contract provisions and known performance results during the relevant measurement period. When determining if variable consideration should be constrained, the Company considers whether factors outside its control could result in a significant reversal of revenue. In making these assessments, the Company considers the likelihood and magnitude of a potential reversal. The Company's performance period generally corresponds with the monthly invoice period. Given our historical experiences and relatively short duration of periods subject to variable consideration adjustments, no constraints on our revenue recognition were applied during the first quarter of 2018. The Company reassesses these estimates during each reporting period.

Disaggregation of Revenue

We provide services to companies across a variety of industries including communications, technology, retail, financial services, healthcare and other. The following table presents our disaggregated revenue from customers by key industry vertical for the three months ended March 31, 2018 and 2017.

	Three Months Ended March 31,	
	2018	2017
Revenues:		
Communications	$287.2	$336.8
Technology	148.9	156.5
Retail	76.4	66.4
Financial Services	74.7	77.9
Healthcare	51.4	51.4
Other	35.6	38.6
Total Revenues	$674.2	$727.6

While most of our contracts are priced in U.S. dollars, we also recognize revenue under contracts that are denominated in euros, British pounds, Australian dollars or Canadian dollars. The following table presents the Company's U.S. dollar equivalent revenue by currency for the three months ended March 31, 2018 and 2017.

	Three Months Ended March 31,	
	2018	2017
U.S. Dollar Revenue by Currency:		
U.S. dollar	$494.2	$570.1
Euro	92.3	77.7
British pound	52.7	39.8
Australian dollar	11.5	15.3
Canadian dollar	9.6	