APAC CUSTOMER SERVICE INC
Form 10-Q
August 04, 2008

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

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended June 29, 2008

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: 0-26786

APAC Customer Services, Inc.

(Exact name of registrant as specified in its charter)

Illinois	**36-2777140**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Six Parkway North, Deerfield, Illinois 60015

(Address of Principal Executive Offices, Zip Code)

Registrant s telephone number, including area code: **(847) 374-4980**

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 þ No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer* o	Smaller reporting company o

(*Do not check if a smaller reporting company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

There were 50,473,312 common shares, $0.01 par value per share, outstanding as of June 29, 2008.

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Forward-Looking Statements and Factors That May Affect Future Results

In passing the Private Securities Litigation Reform Act of 1995 (the Reform Act), Congress encouraged public companies to make forward-looking statements by creating a safe harbor to protect companies from securities law liability in connection with forward-looking statements. We intend to qualify our written and oral forward-looking statements for protection under the Reform Act and any other similar safe harbor provisions. Unless the context indicates otherwise, the words Company, we, our, and us when used in this Quarterly Report on Form 10-Q r collectively to APAC Customer Services, Inc. and its wholly-owned subsidiaries.

Generally, forward-looking statements include expressed expectations, estimates and projections of future events and financial performance and the assumptions on which these expressed expectations, estimates and projections are based. Statements that are not historical facts, including statements about our beliefs and expectations and our management, are forward-looking statements. Sometimes these statements will contain words such as believes, expects, anticipates, intends, estimates, goals, would, could, should, plans, and other si forward-looking statements are inherently uncertain as they are based on various expectations and assumptions about future events, and they are subject to known and unknown risks and uncertainties that can cause actual events and results to differ materially from historic results and those projected.

Due to such uncertainties, the investment community is cautioned not to place undue reliance on our written or oral forward-looking statements, which speak only as of the date on which they were made. If no date is provided, such statements speak only as of the date of this Quarterly Report on Form 10-Q. We expressly undertake no obligation to publicly update or revise any forward-looking statements as a result of changed assumptions, new information, future events or otherwise.

Forward-looking statements are contained in this Quarterly Report on Form 10-Q, primarily in Items 2 and 3. Moreover, through our senior management, we may from time to time make forward-looking statements about matters described herein or about other matters concerning us.

There are numerous factors that could prevent us from achieving our goals and cause future results to differ materially from historic results or those expressed or implied by our forward-looking statements including, but not limited to, the following:

- Our revenue is generated from a limited number of clients and the loss of one or more of them, or a reduction in their demand for our services, could materially affect our financial results.
- Our financial results depend on our ability to effectively manage our production capacity and our workforce.
- Our success is subject to the terms of our client contracts.
- Our success depends on our return to profitability.
- Our success depends on our ability to continue to reduce costs and achieve efficiencies.
- Our business may be affected by our cash flows from operations and our ability to comply with, or obtain waivers of or changes to, our debt covenants.
- Our principal shareholder can exercise significant control over us.

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- Our financial results may be affected by risks associated with international operations and expansion, including foreign currency fluctuations.
- Our success depends on key personnel.
- Our business operates in a highly competitive market.
- Circumstances outside our control such as typhoons, earthquakes, floods and other acts of God, political instability, equipment malfunction, telephone or data service interruptions, changes in the telecommunications market, war and terrorism could seriously harm our domestic or off-shore business.
- Our inability to attract and retain a sufficient number of qualified employees could negatively impact our business.
- Our business and our clients businesses are subject to federal and state regulation and industry standards, including laws and industry standards regarding consumer privacy and information security.

See our filings with the Securities and Exchange Commission for further discussion of the risks and uncertainties associated with our business, in particular, the discussion in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended December 30, 2007, and in Item 1A of Part II of our Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2008.

In various places throughout this Quarterly Report on Form 10-Q we use certain non-GAAP financial measures when describing our performance. A non-GAAP financial measure is defined as a numerical measure of a company s financial performance that excludes or includes amounts so as to be different than the most directly comparable measure calculated and presented in accordance with GAAP in the statements of operations, balance sheets or statements of cash flows of a company. We believe that non-GAAP financial measures provide meaningful supplemental information and are useful in understanding our results of operations and analyzing of trends because they exclude certain charges such as interest, taxes and depreciation and amortization expenses that are not part of our ordinary business operations. We also believe that non-GAAP financial measures are useful to investors and analysts in allowing for greater transparency with respect to the supplemental information used by us in our financial and operational decision-making. In addition, we believe investors, analysts and lenders benefit from referring to non-GAAP measures when assessing our performance and expectations of our future performance. However, this information should not be used as a substitute for our GAAP financial information; rather it should be used in conjunction with financial statement information contained in our condensed consolidated financial statements prepared in accordance with GAAP. We discuss non-GAAP financial measures in Item 2 of this Quarterly Report on Form 10-Q under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations Non-GAAP Financial Measures. Pursuant to the requirements of Regulation G, we have provided a reconciliation of all non-GAAP financial measures to the most directly comparable GAAP financial measure in Item 2 of this Quarterly Report on Form 10-Q.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	June 29, 2008 (Unaudited)	December 30, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,633	$ 1,426
Accounts receivable, net	31,715	34,468
Other current assets	3,615	5,971
Total current assets	36,963	41,865
Property and equipment, net	24,221	26,772
Goodwill	13,338	13,338
Other intangible assets, net	4,712	5,891
Other assets	1,624	2,060
Total assets	$ 80,858	$ 89,926
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Short-term debt	$ 17,743	$ 12,307
Current portion of long-term debt		2,400
Accounts payable	1,904	2,287
Income taxes payable	220	220
Accrued payroll and related items	17,888	15,954
Accrued liabilities	13,352	11,123
Total current liabilities	51,107	44,291
Long-term debt		11,600
Other liabilities	2,335	654
Commitments and contingencies		
Shareholders equity:		
Common shares, $0.01 per share; authorized 200,000,000 shares; 50,499,296 shares issued and 50,473,312 shares outstanding at June 29, 2008, and 50,379,296 shares issued and outstanding at December 30, 2007	506	504
Additional paid-in capital	103,812	102,647
Accumulated deficit	(76,850)	(72,760)
Accumulated other comprehensive (loss) income	(25)	2,990
Treasury shares: 25,984 and 0 shares at cost at June 29, 2008, and December 30, 2007, respectively	(27)	

Total shareholders equity		27,416		33,381
Total liabilities and shareholders equity	$	80,858	$	89,926

See Notes to Condensed Consolidated Financial Statements.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share data)
(Unaudited)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Net revenue	$ 60,710	$ 53,819	$ 124,227	$ 106,203
Cost of services	49,978	49,729	105,724	95,796
Gross profit	10,732	4,090	18,503	10,407
Operating expenses:				
Selling, general and administrative expenses	7,827	7,187	16,395	15,080
Restructuring and other charges:				
Restructuring charges	(23)	1,559	(20)	1,557
Other severance charges	460		2,798	
Total operating expenses	8,264	8,746	19,173	16,637
Operating income (loss)	2,468	(4,656)	(670)	(6,230)
Other income	(142)	(44)	(174)	(91)
Interest expense	2,673	812	3,595	1,650
Loss before income taxes	(63)	(5,424)	(4,091)	(7,789)
Income tax provision (benefit)		12		(17,568)
Net income (loss)	$ (63)	$ (5,436)	$ (4,091)	$ 9,779
Net income (loss) per share:				
Basic	$ (0.00)	$ (0.11)	$ (0.08)	$ 0.20
Diluted	$ (0.00)	$ (0.11)	$ (0.08)	$ 0.19
Weighted average number of shares outstanding:				
Basic	50,393	49,731	50,307	49,632
Diluted	50,393	49,731	50,307	51,241

See Notes to Condensed Consolidated Financial Statements.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Twenty-Six Weeks Ended June 29, 2008	Twenty-Six Weeks Ended July 1, 2007
Operating activities:		
Net income (loss)	$ (4,091)	$ 9,779
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	6,422	6,757
Non-cash restructuring charges		13
Stock compensation expense	844	940
Amortized gain on sale leaseback	(63)	(94)
(Gain) loss on sale of property and equipment	(1)	53
Income taxes payable		(17,580)
Change in operating assets and liabilities	10,190	6,829
Net cash provided by operating activities	13,301	6,697
Investing activities:		
Purchases of property and equipment, net	(2,786)	(7,033)
Net proceeds from sale of property and equipment	8	15
Net cash used in investing activities	(2,778)	(7,018)
Financing activities:		
Net (payments) borrowings on long-term debt	(14,000)	10,000
Net borrowings (payments) under revolving credit facility	5,436	(11,090)
Cash received from exercise of stock options	297	582
Net cash used in financing activities	(8,267)	(508)
Effect of exchange rate change on cash	(2,049)	(38)
Net increase (decrease) in cash and cash equivalents	207	(867)
Cash and cash equivalents:		
Beginning balance	1,426	1,305
Ending balance	$ 1,633	$ 438

See Notes to Condensed Consolidated Financial Statements.

APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except as otherwise indicated)

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements of APAC Customer Services, Inc. and its subsidiaries (collectively, the Company) have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for a fair presentation have been included. Interim consolidated financial statements are not necessarily indicative of the financial position or operating results for an entire year.

The Company s off-shore customer care centers use their local currency, the Philippine peso, as their functional currency. Assets and liabilities of off-shore customer care centers have been translated at period-end rates, and income and expenses have been translated using average exchange rates for the respective periods. All inter-company transactions and balances have been eliminated. The balance sheet at June 29, 2008 has been derived from the unaudited financial statements at that date and includes all of the information and notes required by GAAP for interim financial statements. These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in Item 8 of Part II of the Company s Annual Report on Form 10-K for the fiscal year ended December 30, 2007. Copies of the Company s filings are available on a web site maintained by the SEC at http://www.sec.gov.

The Company operates on a thirteen week fiscal quarter that ends on the Sunday closest to June 30. The Company operates on a 52/53 week fiscal year that ends on the Sunday closest to December 31.

2. New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157 (SFAS No. 157) Fair Value Measurements , which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008, the FASB issued Staff Position 157-2, Effective Date of FASB Statement No. 157 , which delays the effective date of SFAS No. 157 for non-financial assets and liabilities, except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis, until fiscal years beginning after November 15, 2008. The Company adopted SFAS 157 as of December 31, 2007, with the exception of the application of the statement to non-recurring, non-financial assets and liabilities. The adoption of SFAS 157 did not have a material impact on the Company s consolidated financial statements. See Note 12, Fair Value Measurements, for additional information.

In March 2008, the FASB issued Statement No. 161 (SFAS No. 161) Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 to amend and expand the disclosures about derivatives and hedging activities. The statement requires enhanced qualitative disclosures about an entity s objectives and strategies for using derivatives, and tabular quantitative disclosures about the fair value of derivative instruments and gains and losses on derivatives during the reporting period. SFAS No. 161 is effective for both fiscal years and interim periods that begin after November 15, 2008. The Company is evaluating the effect that this standard will have on its disclosures.

In April 2008, the FASB issued FASB Staff Position No. 142-3 (FSP FAS No. 142-3), Determining the Useful Life of Intangible Assets . FSP FAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142 (SFAS No. 142), Goodwill and Other Intangible Assets. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) Business Combinations . FSP FAS No. 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is evaluating the impact that FSP FAS No. 142-3 will have on its financial statements.

APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except as otherwise indicated)

In May 2008, the FASB issued Statement No. 162 (SFAS No. 162), The Hierarchy of Generally Accepted Accounting Principles . The standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. Prior to the issuance of SFAS No. 162, GAAP hierarchy was defined in the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles . SFAS No. 162 is effective 60 days following the Security and Exchange Commission s (SEC) approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company is currently evaluating the provisions and guidance of SFAS No. 162 and does not expect that it will have a material impact on the Company s financial condition or results of operations.

3. Accrued Liabilities

The components of other current accrued liabilities included in the condensed consolidated balance sheets are as follows:

	June 29, 2008	December 30, 2007
Deferred rent	$ 3,223	$ 4,094
Accrued workers compensation	1,774	2,089
Accrued severance	1,467	
Unrecognized loss on forward contracts	1,450	
Accrued professional fees	830	644
Accrued capital expenditures	745	
Accrued restructuring charges	574	1,756
Accrued property tax	216	332
Other	3,073	2,208
Total	$ 13,352	$ 11,123

4. Goodwill and Other Intangible Assets

Under SFAS No. 142, Goodwill and Other Intangible Assets, the Company is required and it is its policy to test all existing goodwill for impairment at least annually and more frequently if circumstances require. The Company tested the goodwill for impairment in the third quarter of fiscal year 2007, resulting in no impairment being recorded. As of June 29, 2008 and December 30, 2007, the Company had $13.3 million of goodwill.

The identifiable intangible assets of the Company represent acquired customer relationships and internally developed software. The acquired customer relationships have a gross carrying value of $28.5 million and accumulated amortization of $24.0 million and $22.8 million as of June 29, 2008 and December 30 2007, respectively. The internally developed software has a gross carrying value of $0.4 million as of June 29, 2008 and December 30, 2007 and accumulated amortization of $0.2 million and $0.1 million as of June 29, 2008 and December 30, 2007, respectively. Under the provisions of SFAS No. 142, the Company amortizes intangible assets with definite lives over their estimated useful lives. The Company evaluates the remaining useful life of its acquired customer relationships balance at least annually to determine whether events or circumstances warrant a revision to the remaining amortization period. The customer relationship intangible assets are amortized on a straight-line basis over the expected period of benefit of 12 years. The internally developed software intangible assets are amortized on a straight-line basis over an expected period of benefit of 3 to 5 years. Total amortization expense related to intangible assets was $0.6 million for each of the thirteen weeks ended June 29, 2008 and July 1, 2007, and $1.2 million for each of the twenty-six weeks ended June 29, 2008 and July 1, 2007. Annual amortization expense is expected to be $2.4 million for fiscal years 2008 and 2009, $1.0 million in fiscal year 2010 and less than $1.0 million in each of fiscal years 2011 and 2012.

APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except as otherwise indicated)

5. Accounting for Stock-Based Compensation

At June 29, 2008, the Company had a share-based incentive compensation plan for employees and non-employee directors, which authorized the granting of various equity-based incentive awards, including stock options and non-vested common shares. The total number of common shares authorized for issuance under the plan is 11.8 million, of which 1.8 million shares are available for future grants at June 29, 2008.

Total stock-based compensation expense was $0.1 million and $0.5 million for the thirteen weeks ended June 29, 2008 and July 1, 2007, respectively. For the twenty-six weeks ended June 29, 2008 and July 1, 2007, total stock-based compensation expense was $0.8 million and $0.9 million, respectively. As of June 29, 2008, there was $1.7 million of unrecognized compensation cost related to unvested awards that is expected to be recognized over a weighted-average period of approximately 4 years.

A summary of the Company s non-vested common share grant activity during the twenty-six weeks ended June 29, 2008 is presented below:

	Number of Shares
Outstanding on December 30, 2007	366,758
Granted	50,000
Exercised	(298,199)
Forfeited	(50,000)
Expired	
Outstanding on June 29, 2008	68,559

During the thirteen weeks ended June 29, 2008, the Company did not award any non-vested common shares to employees. During the thirteen weeks ended July 1, 2007, the Company awarded 6,000 non-vested common shares to employees at a weighted average value per share of $3.42. During the twenty-six weeks ended June 29, 2008 and July 1 2007, respectively, the Company awarded 50,000 and 106,000 non-vested common shares to employees at a weighted average value per share of $1.10 and $4.48, respectively. The majority of the non-vested common shares vest two years from the grant date.

A summary of the Company s stock option grant activity during the twenty-six weeks ended June 29, 2008 is presented below:

	Number of Options	Grant Price Range Per Share			Weighted Average Exercise Price Per Share		Aggregate Intrinsic Value	
Outstanding on December 30, 2007	6,495,396	$	0.85	$11.63	$	2.22		
Granted	2,545,063		0.79	1.21		1.03		
Exercised	(140,250)		0.88	1.21		0.93		
Forfeited	(734,501)		0.85	4.60		1.53		
Expired	(572,131)		1.35	11.56		3.32		
Outstanding on June 29, 2008	7,593,577	$	0.79	$11.63	$	1.82	$	1,220

Exercisable on June 29, 2008	4,199,683	$	0.85	$11.63	$	2.15	$ 441

APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except as otherwise indicated)

Prior to April 4, 2007, options to purchase common shares were granted with an exercise price equal to the average of the high and low market price of the Company s common shares on The NASDAQ OMX Group, Inc. on the date of the grant. Effective April 4, 2007, the 2005 Incentive Stock Plan was amended to provide that the fair value for future option grants would be the closing price of the common shares on The NASDAQ OMX Group, Inc. on the date of grant. Substantially all of the options become exercisable between one to five years after the grant date and generally expire ten years from the grant date.

6. Comprehensive Income (Loss)

Comprehensive income (loss) for the thirteen and twenty-six weeks ended June 29, 2008 and July 1, 2007, respectively, is as follows:

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Net income (loss)	$ (63)	$ (5,436)	$ (4,091)	$ 9,779
Foreign currency translation adjustment	(701)	352	(753)	519
Unrealized loss on forward contracts	(1,526)		(2,262)	
Total comprehensive income (loss)	$ (2,290)	$ (5,084)	$ (7,106)	$ 10,298

The foreign currency translation adjustment relates to the impact of a change in exchange rates on net assets located outside of the United States.

As of June 29, 2008, forward contracts to purchase 929 million Philippine pesos at a US dollar notional of $21.7 million were outstanding. The net loss recognized in earnings on settled forward contracts was $0.1 million for the thirteen weeks ended June 29, 2008 and the net gain recognized in earnings on settled forward contracts was $0.3 million for the twenty-six weeks ended June 29, 2008. The gain and loss on settled forward contracts is recorded as a component of cost of services. Unrealized loss in value of the outstanding forward contracts was $1.5 million and was recorded in other liabilities as of June 29, 2008. The unrealized loss will be recognized in earnings over the next 12 months as cash flows related to the intercompany payable are effectively settled.

7. Legal Proceedings

The Company is subject to lawsuits, governmental investigations and claims arising out of the routine conduct of its business. Management does not believe that the outcome of any pending proceedings will have a material adverse effect on the Company s business, results of operations, liquidity, or financial condition. Although management does not believe that any such proceeding will result in a material adverse effect, no assurance to that effect can be given.

8. Debt

As of December 30, 2007, the Company was party to two separate loan agreements: (i) a Second Restated Credit Agreement with LaSalle Bank National Association (LaSalle), as agent, as amended, and (ii) a Second Lien Loan Agreement with Atalaya Funding II, L.P. as lender and Atalaya Administrative, LLC, as agent (Atalaya), as amended. The loan agreements provided the Company with a $27.5 million revolving loan facility which expired in October 2010 (Revolving Loan Facility) and a $15.0 million term loan which matured in January 2011 (Term Loan). For additional information regarding the loan agreements, as amended, see Note 9 of the Notes to Consolidated Financial Statements in Item 8 of the Company s Annual Report on Form 10-K for the fiscal year ended December 30, 2007 and the Company s subsequent filing on Form 10-Q for the fiscal quarter ended March 30, 2008.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except as otherwise indicated)

Interest rates on the Company s borrowings under the Revolving Loan Facility with LaSalle during the period ended May 5, 2008 ranged from 5.25% to 7.5%. Interest rates on the Company s borrowings under the Term Loan with Atalaya during the period ended May 5, 2008 ranged from 13.5% to 14.0%.

On May 5, 2008, the Company entered into a Revolving Credit and Security Agreement (Revolving Loan Agreement) with PNC Bank National Association (PNC), as agent, and the financial institutions from time to time parties thereto as lenders. The Revolving Loan Agreement provides the Company with a $40.0 million revolving loan facility which expires in May 2011. Borrowings under the Revolving Loan Agreement were used to repay in full the Company s Revolving Loan Facility and Term Loan.

The Company s ability to borrow under the Revolving Loan Agreement depends on the amount of eligible accounts receivable from its clients. The Revolving Loan Agreement contains certain financial covenants including limits on the amount of capital expenditures and maintenance of a minimum fixed charge coverage ratio. Other covenants in the Revolving Loan Agreement prohibit (with limited exceptions) the Company from incurring additional indebtedness, repurchasing outstanding common shares, permitting liens, acquiring, selling or disposing of certain assets, engaging in certain mergers and acquisitions, paying dividends or making certain restricted payments.

Borrowings under the Revolving Loan Agreement incur a floating interest rate based on the London Interbank Offered Rate or LIBOR index rate or an alternate base rate which approximates the prime rate defined in the Revolving Loan Agreement. The Revolving Loan Agreement is secured principally by a grant of a first priority security interest in all of the Company s personal property, including its accounts receivable. In addition, the Company pays a commitment fee on the unused portion of the Revolving Loan Agreement as well as fees on outstanding letters of credit.

In addition to borrowing against its eligible receivables, the Company may borrow an additional $9.0 million which is supported by a letter of credit (Credit Enhancement Letter of Credit) which was provided by TCS Global Holdings, L.P. (TCS), an affiliate of Theodore G. Schwartz, the Company s chairman and principal shareholder. The face amount of the Credit Enhancement Letter of Credit may be reduced or entirely released by PNC under certain circumstances after PNC receives the Company s audited financial statements for the fiscal year ended December 28, 2008, and if the Company achieves certain financial ratios and EBITDA and meets certain minimum availability thresholds under the Revolving Loan Agreement.

In connection with the issuance of the Credit Enhancement Letter of Credit, the Company and TCS entered into a Reimbursement and Security Agreement, dated May 5, 2008 (Reimbursement Agreement). Under the terms of the Reimbursement Agreement, the Company paid $0.2 million in fees to TCS which are being amortized over the term of the Credit Enhancement Letter of Credit. Additionally, the Company pays TCS for providing the Credit Enhancement Letter of Credit an amount which varies depending on the amount of borrowings under the Revolving Loan Agreement. PNC is entitled to draw on the Credit Enhancement Letter of Credit under certain circumstances. In such event, the Company is obligated to reimburse TCS for the total amount so drawn. Any unpaid reimbursement amounts due under the Reimbursement Agreement incur interest at floating interest rate based on the LIBOR index rate. The Company s obligations under the Reimbursement Agreement are secured principally by a grant of a second priority security interest in all of the Company s personal property, including accounts receivable. The Reimbursement Agreement also contains covenants substantially identical to the covenants contained in the Revolving Loan Agreement.

On June 26, 2008, the Company entered into an amendment (the Amendment) to the Revolving Loan Agreement in connection with the syndication of that facility. Pursuant to the terms of the Amendment, the Company and PNC agreed to amend the definitions of applicable margin, obligations, and unbilled eligible receivables.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except as otherwise indicated)

Borrowings under the Revolving Loan Agreement totaled $17.7 million as of June 29, 2008. Interest rates on the Company s borrowings from May 6, 2008 through June 29, 2008 ranged from 4.98% to 5.5% under the Revolving Loan Agreement and the Credit Enhancement Letter of Credit. The Company had $11.0 million of unused borrowing capacity under the Revolving Loan Agreement as of June 29, 2008. The Company was in compliance with its financial covenants as of June 29, 2008.

The Company expects that its cash balances, cash flow from operations and available borrowings under its Revolving Loan Agreement will be sufficient to meet projected operating needs, fund any plann