

CONVERGYS CORP  
Form 10-Q  
August 07, 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 June 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

Edgar Filing: CONVERGYS CORP - Form 10-Q

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 July 31, 2007, there were 135,583,159 common shares outstanding, excluding amounts held in Treasury of 45,439,413.

---

## PART I - FINANCIAL INFORMATION

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

## AND COMPREHENSIVE INCOME

(Unaudited)

(Amounts in millions, except per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Revenues	\$ 707.0	\$ 691.8	\$ 1,426.9	\$ 1,367.1
Operating Costs and Expenses				
Cost of providing services and products sold	461.6	438.6	920.4	862.0
Selling, general and administrative	137.1	132.0	281.8	264.8
Research and development costs	19.6	21.4	38.7	41.8
Depreciation	28.4	32.3	58.3	65.1
Amortization	2.2	4.7	4.4	8.6
Total costs and expenses	648.9	629.0	1,303.6	1,242.3
Operating Income	58.1	62.8	123.3	124.8
Equity in Earnings of Cellular Partnerships	3.6	1.5	5.6	2.9
Other Income, net	0.5	0.8	2.7	1.1
Interest Expense	(4.6)	(5.8)	(9.4)	(11.5)
Income Before Income Taxes	57.6	59.3	122.2	117.3
Income Tax Expense	18.8	19.5	39.8	40.8
Net Income	\$ 38.8	\$ 39.8	\$ 82.4	\$ 76.5
Other Comprehensive Income (Loss), net of tax:				
Foreign currency translation adjustments	\$ 7.7	\$ 2.8	\$ 8.5	\$ 3.2
Change related to pension liability	2.8		2.8	
Unrealized gains (losses) on hedging activities	25.4	(5.8)	30.1	(7.5)
Total other comprehensive income (loss)	35.9	(3.0)	41.4	(4.3)
Comprehensive Income	\$ 74.7	\$ 36.8	\$ 123.8	\$ 72.2
Earnings Per Common Share				
Basic	\$ 0.28	\$ 0.29	\$ 0.60	\$ 0.55
Diluted	\$ 0.28	\$ 0.28	\$ 0.59	\$ 0.54
Average Common Shares Outstanding				
Basic	136.3	139.1	136.5	139.2
Diluted	140.2	142.4	140.5	142.3

See Notes to Consolidated Financial Statements.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts In Millions)	(Unaudited) June 30, 2007	December 31, 2006
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 221.8	\$ 235.9
Receivables, net of allowances of \$9.4 and \$12.0	551.5	545.6
Deferred income tax benefits	29.2	53.5
Prepaid expenses	41.9	37.3
Other current assets	107.7	57.9
Total current assets	952.1	930.2
Property and equipment, net	354.2	368.6
Goodwill, net	886.4	880.2
Other intangibles, net	45.6	49.9
Investment in Cellular Partnerships	55.1	49.5
Deferred charges	246.2	228.0
Other assets	36.0	33.9
Total Assets	\$ 2,575.6	\$ 2,540.3
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Debt maturing within one year	\$ 20.6	\$ 83.9
Payables, deferred revenue and other current liabilities	373.5	512.0
Total current liabilities	394.1	595.9
Long-term debt	291.9	259.6
Deferred income tax liability	58.6	43.9
Accrued pension liability	113.1	105.0
Deferred revenue and other long-term liabilities	168.4	80.8
Total liabilities	1,026.1	1,085.2
Shareholders' Equity		
Preferred shares without par value, 5.0 authorized; none outstanding		
Common shares without par value, 500.0 authorized; 181.0 outstanding in 2007 and 179.6 outstanding in 2006	985.1	965.1
Treasury stock 44.7 shares in 2007 and 43.1 in 2006	(791.0)	(749.4)
Retained earnings	1,310.3	1,235.7
Accumulated other comprehensive income	45.1	3.7
Total shareholders' equity	1,549.5	1,455.1
Total Liabilities and Shareholders' Equity	\$ 2,575.6	\$ 2,540.3

See Notes to Consolidated Financial Statements.



## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Amounts in millions)	Six Months Ended June 30,	
	2007	2006
<b><u>CASH FLOWS FROM OPERATING ACTIVITIES</u></b>		
Net income	\$ 82.4	\$ 76.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	62.7	73.7
Deferred income tax expense	29.5	(0.5)
Cellular Partnerships results in excess of distributions	(5.6)	(2.9)
Stock compensation expense	12.3	13.7
Changes in assets and liabilities, net of effects from acquisitions:		
Increase in receivables	(5.9)	(37.7)
(Increase)/decrease in other current assets	(0.9)	2.2
Increase in deferred charges, net	(10.6)	(32.0)
Change in other assets and liabilities	20.6	16.9
(Decrease)/increase in payables and other current liabilities	(77.5)	15.5
Other, net	(1.9)	(5.2)
<b>Net cash provided by operating activities</b>	<b>105.1</b>	<b>120.2</b>
<b><u>CASH FLOWS FROM INVESTING ACTIVITIES</u></b>		
Capital expenditures	(45.9)	(52.2)
Proceeds from disposal of property and equipment	0.3	2.1
Purchase of auction rate securities, net	(8.7)	
Return of capital from Cellular Partnerships		5.8
<b>Net cash used in investing activities</b>	<b>(54.3)</b>	<b>(44.3)</b>
<b><u>CASH FLOWS FROM FINANCING ACTIVITIES</u></b>		
Repayments of commercial paper and other debt, net	(31.0)	(43.3)
Excess tax benefits from share-based payment arrangements	1.7	1.8
Purchase of treasury shares	(41.6)	(39.4)
Issuance of common shares	6.0	10.1
<b>Net cash used in financing activities</b>	<b>(64.9)</b>	<b>(70.8)</b>
Net (decrease) /increase in cash and cash equivalents	(14.1)	5.1
Cash and cash equivalents at beginning of period	235.9	196.0
<b>Cash and cash equivalents at end of period</b>	<b>\$ 221.8</b>	<b>\$ 201.1</b>

See Notes to Consolidated Financial Statements.

Form 10-Q Part I

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 six months ended June 30, 2007 included long-term incentive plan expense of \$8.2 and \$16.7, respectively, compared to \$8.0 and \$14.3, respectively, for the same periods in 2006. Long-term incentive plan expense for the three months and six months ended June 30, 2007 included stock compensation expense of \$7.0 and \$12.3, respectively, compared to \$8.0 and \$14.3, respectively, for the same periods in 2006. Included in the stock compensation expense of \$14.3 for the six months ended June 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 six months ended June 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	(880)	15.32		
Forfeited/cancelled	(242)	35.69		
Outstanding at Jun. 30, 2007	11,706	\$ 29.55	3.4	\$ 12.46
Options exercisable at June 30, 2007	11,706	\$ 29.55	3.4	\$ 12.46

Restricted Stock and Restricted Stock Units

During the first six months of 2007, the Company granted 1.5 shares of restricted stock units with a weighted average fair value of \$24.15. Included in the above were approximately 440,000 of performance-related restricted stock units granted at the fair value of \$21.14 per share that vest upon the Company's satisfaction of certain financial performance conditions (relative shareholder return versus the S&P 500 return) as of December 31, 2009. During the six months ended June 30, 2006, the Company granted 1.8 shares of restricted stock units at a weighted-average fair value of \$18.04. Included in the above were 554,000 of performance-related restricted stock units granted at the fair value of \$16.08 per share that vest upon the Company's satisfaction of certain financial conditions as of December 31, 2008.

Form 10-Q Part I

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

The Company used a Monte Carlo simulation model to estimate the fair value for performance-based restricted stock units issued during 2007 and 2006. The assumptions used in this model for the 2007 awards are noted in the table below. Expected volatilities are based on historical volatility and daily returns for the three-year period ended January 1, 2007 of the Company's stock and S&P 500 companies. The total stock return for the Company over the performance period is based on comparing Convergys' average closing price from the fourth quarter of 2006 with the average closing price for the fourth quarter of 2009. The total stock return of the S&P 500 companies is computed by comparing the closing price of the S&P 500 companies on December 29, 2006 with the closing price at the end of December 2009. The risk-free interest rate for the expected term of the award granted is based on the U.S. Treasury yield curve in effect at the time of grant.

	June 30, 2007
Expected volatility	27.5%
Expected term (in years)	3.0
Risk-free interest rate	4.6%

The total compensation cost related to non-vested restricted stock and restricted stock units not yet recognized as of June 30, 2007 was approximately \$40, which is expected to be recognized over a weighted average of 1.8 years. Changes to non-vested restricted stock and restricted stock units for the six months ended June 30, 2007 were as follows:

Shares in Millions Except	Number of	Weighted
Per Share Amounts	Shares	Average Fair
		Value at Date
		Of Grant
Non-vested at December 31, 2006	4.4	\$ 15.76
Granted	1.5	24.15
Vested	(1.5)	(15.10)
Forfeited	(0.2)	(18.29)
Non-vested at June 30, 2007	4.2	\$ 19.12

Form 10-Q Part I

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

**(4) BUSINESS RESTRUCTURING AND ASSET IMPAIRMENT****2006 Restructuring**

As discussed more fully in the Business Restructuring and Asset Impairment section of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Company initiated a restructuring plan in the fourth quarter of 2006. The plan resulted in a net restructuring charge of \$12.5 and included \$24.1 of severance costs, \$0.5 of facility closure costs and the reversal of \$12.1 in abandonment costs for a facility being brought back into service to support consolidation of operations at an international location. Restructuring actions were taken in each business segment, of which \$6.5 related to Customer Care, \$0.8 related to Information Management, \$2.1 related to Employee Care and \$3.1 related to Corporate. The severance charge of \$24.1 is being paid pursuant to our existing severance policy and employment agreements and includes cash-related payments of \$21.3 and a non-cash charge of \$2.8 related to acceleration of equity-based awards. These actions, which will affect approximately 630 professional employees, are expected to be completed by the end of 2007. Through June 2007, the Company completed approximately 400 of the planned headcount reductions.

Restructuring liability activity for the 2006 plan consisted of the following:

Balance at January 1, 2007	\$ 20.5
Severance costs	(7.6)
Lease termination payments	( 0.5)
Balance at June 30, 2007	\$ 12.4

**2002 Restructuring**

In connection with a restructuring plan initiated during the fourth quarter of 2002, the Company made headcount reductions that affected professional and administrative employees worldwide and closed certain Customer Care and Information Management facilities.

Restructuring liability activity for the 2002 plan consisted of the following:

	2007	2006
Balance at January 1	\$ 3.0	\$ 16.0
Lease termination payments	(0.4)	(1.7)
Other	(1.1)	0.6
Balance at June 30	\$ 1.5	\$ 14.9

In the fourth quarter of 2006, the Company made a decision to consolidate operations in certain U.K. locations and move into one of the facilities that was originally abandoned in 2002. This resulted in the reversal of facility abandonment costs of \$12.1 at December 31, 2006.

The remaining accrual of \$1.5 reflects facility abandonment costs, which will be paid over several years until the leases expire. The accrual is equal to the future costs associated with those abandoned facilities, net of the proceeds from any probable future sublease agreements. The Company used estimates, based on consultation with its real estate advisors, to arrive at the proceeds from any future sublease agreements. The Company will continue to evaluate such estimates in recording the facilities abandonment charge. Consequently, there may be additional reversals or charges in the future.



Form 10-Q Part I

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

**(5) GOODWILL AND OTHER INTANGIBLE ASSETS**

As discussed more fully in the Goodwill and Other Intangible Assets section of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Company is required to test goodwill for impairment annually and at other times if events have occurred or circumstances exist that indicate the carrying value of goodwill may no longer be recoverable. The Company performed its annual impairment tests during the fourth quarter of 2006 and concluded that no goodwill impairment existed.

Goodwill increased to \$886.4 at June 30, 2007 from \$880.2 at December 31, 2006, as a result of currency translation adjustments.

As of June 30, 2007, the Company's other intangible assets acquired primarily through business combinations consisted of the following:

	Gross Carrying Amount	Accumulated Amortization	Net
Software (classified with Property, Plant & Equipment)	\$ 44.3	\$ (39.8)	\$ 4.5
Customer relationships and other intangibles	140.5	(94.9)	45.6
<b>Total</b>	<b>\$ 184.8</b>	<b>\$ (134.7)</b>	<b>\$ 50.1</b>

Intangible amortization expense for the six-month period ended June 30, 2007 and 2006 was \$4.4 and \$8.6, and is estimated to be approximately \$9 for the year ending December 31, 2007. Estimated intangible amortization expense for the five subsequent fiscal years is:

For the year ended 12/31/08	\$ 8
For the year ended 12/31/09	\$ 8
For the year ended 12/31/10	\$ 7
For the year ended 12/31/11	\$ 6
For the year ended 12/31/12	\$ 6
Thereafter	\$ 10

The intangible assets are being amortized over the following periods: five to seven years for software and three to twelve years for customer relationships and other. The weighted average amortization period for intangible assets subject to amortization is nine years (six years for software, and ten years for customer relationships and other).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

**(6) ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES**

On January 1, 2007, the Company adopted the provisions of Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 creates a single model to address uncertainty in income tax positions. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition and, excludes income taxes from Statement of Financial Accounting Standard (SFAS) No. 5, Accounting for Contingencies. FIN 48 applies to all tax positions related to income taxes subject to SFAS No. 109, Accounting for Income Taxes. This includes tax positions considered to be routine as well as those with a high degree of uncertainty. As a result of the adoption of FIN 48, the Company recognized a \$7.9 increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the retained earnings balance as of January 1, 2007. Additionally, adoption of FIN 48 caused balance sheet reclassifications from deferred tax and accrued tax accounts to a FIN 48 liability for unrecognized tax benefits. The FIN 48 tax liability for unrecognized tax benefits of \$88.8 as of January 1, 2007 included an accrual for interest and penalties of \$17.6. The impact of timing differences and tax attributes are considered when calculating interest and penalty accruals associated with the tax reserve. The Company's policy is to recognize interest and penalties accrued on unrecognized tax benefits as part of income tax expense. The total amount of net unrecognized tax benefits that would affect income tax expense, if ever recognized in the financial statements, is \$62.4. This amount includes net interest and penalties of \$12.9.

As of June 30, 2007, the liability for unrecognized tax benefits was \$83.2 of which \$7.9 is recorded within other current liabilities and \$75.3 is recorded within other long-term liabilities in the accompanying Consolidated Financial Statements. The Company does not presently anticipate that the unrecognized tax benefits will materially increase or decrease prior to December 31, 2007; however, actual developments in this area could differ from those currently expected.

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With a few exceptions, the Company is no longer subject to examinations by tax authorities for years before 2002.

**(7) DEFERRED CHARGES**

The Company often performs, in connection with its outsourcing arrangements, certain set-up activities or implementations, including the installation and customization of the Company's proprietary software. Additionally, with respect to arrangements where all of the services are accounted for as a single unit of accounting, the Company defers all revenue until it begins to deliver the final service. In connection with these arrangements, the Company capitalizes all direct and incremental multiple-element costs (by analogy to SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases) to the extent recovery of these costs is probable. All implementation and set-up activity costs are amortized ratably over the life of the arrangements as costs of providing service. Deferred amounts are protected in the event of early termination of the contract and are monitored regularly for impairment.

Form 10-Q Part I

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

In the event these costs are not deemed recoverable, the costs are expensed as incurred. The Company evaluates the probability of recovery by considering profits to be earned during the term of the related contract, the creditworthiness of the client and, if applicable, contract termination penalties payable by the client in the event that the client terminates the contract early. During the second quarter of 2007, the Company expensed \$6.1 of implementation costs related to a large, Employee Care, HR BPO contract as they were deemed not recoverable in accordance with the Company's accounting policy. Refer to the "Deferred Charges" section of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 for more detailed discussions on deferred charges and the Company's policy on assessing recoverability of deferred charges.

In connection with certain of the Company's outsourcing arrangements, the Company from time to time will incur costs that are non-refundable cash payments to clients to acquire or extend a contractual relationship. To the extent recovery of these costs is probable, the Company capitalizes these client acquisition costs (by analogy to SFAS No. 91) and amortizes them ratably over the life of the contract as a reduction of revenue.

During the six months ended June 30, 2007 and 2006, the Company capitalized \$41.7 and \$57.2, respectively, of client acquisition and implementation costs. The related amortization for these periods was \$23.5 and \$25.2, respectively.

**(8) PAYABLES AND OTHER CURRENT LIABILITIES**

	At Jun. 30, 2007	At Dec. 31, 2006
Accounts payable	\$ 21.4	\$ 27.2
Accrued taxes	0.9	94.7
Accrued payroll-related expenses	119.0	152.1
Executive deferred compensation plan	6.0	8.6
Accrued expenses, other	122.4	105.2
Restructuring and exit costs	13.9	23.5
Deferred revenue and government grants	89.9	100.7
	\$ 373.5	\$ 512.0

**(9) EMPLOYEE BENEFIT PLANS**

The Company sponsors a defined benefit pension plan, which includes both a qualified and non-qualified portion, for all eligible employees (the cash balance plan). The Company also sponsors a non-qualified, unfunded executive deferred compensation plan and a supplemental, non-qualified, unfunded plan for certain senior executives (the executive pension plans). The pension benefit formula for the cash balance plan is determined by a combination of compensation and age-based credits and annual guaranteed interest credits. Benefits for the executive deferred compensation plan are based on employee deferrals, matching contributions and investment earnings on participant accounts. Benefits for the supplemental plan are based on age, years of service and eligible pay. Funding of the qualified portion of the cash balance plan has been achieved through contributions made to a trust fund. The contributions have been determined using the aggregate cost method. The Company's measurement date for all plans is December 31. The projected unit credit cost method is used for determining the unfunded executive pension cost for financial reporting purposes. Pension costs for the cash balance plan are determined based on the traditional unit credit cost method. The plan assumptions are evaluated annually and are updated as necessary.



Form 10-Q Part I

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

Components of pension cost for the cash balance plan are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Service cost (benefits earned during the period)	\$ 4.4	\$ 6.0	\$ 9.0	\$ 11.9
Interest cost on projected benefit obligation	2.7	2.7	5.8	5.5
Expected return on plan assets	(3.7)	(3.7)	(7.3)	(7.4)
Amortization and deferrals net	0.5	0.5	1.3	1.0
<b>Pension cost</b>	<b>\$ 3.9</b>	<b>\$ 5.5</b>	<b>\$ 8.8</b>	<b>\$ 11.0</b>

Pension cost for the unfunded executive pension plans included the following components:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Service cost (benefits earned during the period)	\$ 0.9	\$ 0.9	\$ 1.9	\$ 2.2
Interest cost on projected benefit obligation	1.0	1.1	2.2	2.4
Settlement loss			0.6	
Amortization and deferrals net	0.2	0.2	0.5	0.6
<b>Pension cost</b>	<b>\$ 2.1</b>	<b>\$ 2.2</b>	<b>\$ 5.2</b>	<b>\$ 5.2</b>

The Company expects to contribute approximately \$19 to its cash balance plan during the third quarter of 2007 to satisfy pension funding requirements under the Employee Retirement Income Security Act of 1974.

**(10) SHAREHOLDERS EQUITY**

The Company's Board of Directors has authorized the repurchase of up to 30 million of the Company's common shares. Through December 31, 2006, the Company repurchased 25.4 million shares of Convergys stock for \$398.3 million pursuant to these authorizations. During the six months ended June 30, 2007, the Company repurchased 1.6 million shares of Convergys stock for a total cost of \$41.6. At June 30, 2007, the Company may repurchase 3.0 million of additional common shares pursuant to this authorization.

From July 1 to August 3, 2007, the Company repurchased 1.2 million shares of Convergys stock for \$22.5 pursuant to these authorizations.

**(11) SIGNIFICANT CUSTOMERS**

The Customer Care and Information Management segments derive significant revenues from AT&T Inc. (AT&T). Revenues from AT&T were 15.0% and 16.5% of the Company's consolidated revenues for the three months ended June 30, 2007 and 2006, respectively and 14.9% and 17.2% of the Company's consolidated revenues for the six-month periods ended June 30, 2007 and 2006, respectively. Related accounts receivable from AT&T totaled \$69.8 and \$76.4 at June 30, 2007 and December 31, 2006, respectively.



Form 10-Q Part I

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

**(12) COMMITMENTS AND CONTINGENCIES**

The Company is from time to time subject to claims and administrative proceedings that are filed in the ordinary course of business. The Company believes that the results of any such claims or administrative proceedings, either individually or in the aggregate, will not have a materially adverse effect on the Company's financial condition.

As discussed more fully in the Accounting Policies section of Notes to Consolidated Financial Statements in the Company's 2006 Annual Report on Form 10-K for the year ended December 31, 2006, Convergys is a limited partner of Cincinnati SMSA Limited Partnership. From December 2003 through February 2004, six separate lawsuits were filed in the Court of Common Pleas, Cuyahoga County, Ohio, against Cincinnati SMSA Limited Partnership and other defendants. Five of the suits were filed by companies purporting to be resellers (the Resellers Cases), while the sixth was filed by an individual consumer purporting to represent a class of damaged consumers (the Consumer Case). Each of the Reseller Cases seeks damages ranging from \$1 to \$3 plus treble damages under Ohio law. The Consumer Case seeks damages in excess of \$60 plus treble damages under Ohio law. At June 30, 2007, all five of the Reseller Cases were dismissed.

A motion by Cincinnati SMSA Limited Partnership to dismiss the Consumer Case was granted, in part, and overruled, in part, by the trial court. Cincinnati SMSA Limited Partnership sought review by the Ohio Supreme Court of the part of the trial court's decision that overruled the motion to dismiss. The Ohio Supreme Court denied review of the consumer class action. The Consumer Case has now been stayed pending the resolution of the start of the statute of limitations.

Pursuant to the partnership agreement, Convergys, as a limited partner, has no right to direct or participate in the defense of these actions and, therefore, has no current ability to assess the merit of any claims made in these actions or to identify any possible loss, which could result from these claims against the partnership.

Global Docugraphix, Inc., also known as Document Imaging, Inc. and GDxdata (GDx), is an electronic document management company previously engaged by the Company to perform work under the Company's human resources outsourcing contract with the Florida Department of Management Services (DMS). GDx has been the subject of two lawsuits filed in the Florida courts. The first lawsuit names GDx, together with its parent company, Global Docugraphix, Inc., as defendants in a false claims action filed on behalf of the State of Florida by two former employees of GDx on or around March 1, 2005 under seal in the Circuit Court of the Second Judicial Circuit in Leon County, Florida. The complaint alleges that GDx submitted invoices for work performed by GDx, which work was in violation of its subcontract with Convergys, and Convergys' contract with DMS, involving the security of the human resources data provided to GDx. The Complaint further alleges that by submitting such invoices, which allegedly were paid from funds paid to Convergys by the State, GDx submitted false invoices to the State. The Complaint seeks treble damages, penalties, attorney fees and costs from GDx based on the amount of the allegedly improper invoices. The State of Florida's Attorney General's Office has not intervened in this case, but continues to monitor it.

Form 10-Q Part I

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

On April 12, 2006, GDX and Global Docugraphix, Inc. filed a Motion to Dismiss the lawsuit ( Motion ). The Motion remains pending before the Court. In addition, Global Docugraphix, Inc. has filed a suggestion of bankruptcy.

Convergys is not a party to this litigation and both Convergys and the State have investigated the allegations against GDX. The Company is providing certain credit protection and credit monitoring services to State of Florida employees who have chosen to enroll in these services. The Company continues to provide services to the State of Florida pursuant to the existing human resources outsourcing contract identified above. At June 30, 2007, the Company does not believe this matter will have a materially adverse impact on the financial condition of the Company.

The Company has the right to seek indemnity against GDX for any claims brought against the Company or losses suffered by the Company as a result of the actions and conduct of GDX.

On January 3, 2006, in the Circuit Court of Leon County, Florida, Samuel McDowell, a former employee of the Company, as Relator, filed a false claims action alleging that the Company failed to provide proper data security under the Company's contract with DMS, and as a result, falsely invoiced the State of Florida. The State of Florida's Attorney General's office exercised its right to intervene in this action. The Company has been served with the Complaint, but has not yet been required to respond.

Because the claim relates to the Company's contract with DMS, the Attorney General has invoked the pre-suit dispute resolution procedures set forth in such contract, which require various discussions and then mediation between the parties to determine whether the claims can be resolved without resorting to further litigation. Discussions are continuing (and have included DMS and the GDX plaintiffs). While the Company has made progress in the discussions, this matter was not resolved at June 30, 2007. The Company does not believe this matter will have a materially adverse impact on the Company's financial condition.

The Company is currently attempting to resolve tax audits relating to prior years in various jurisdictions. The Company believes that it is appropriately reserved with regard to these audits as of June 30, 2007. However, to the extent that the ultimate resolutions vary from the amounts reserved, such impact would be recorded to the tax provision in the period in which such resolution is reached.

The Company leases certain facilities and equipment used in its operations under operating leases. This includes the Company's office complex in Orlando, Florida, which is leased from Wachovia Development Corporation (Lessor), a wholly owned subsidiary of Wachovia Corporation, under an agreement that expires in June 2010. Upon termination or expiration of the lease, the Company must either purchase the property from the Lessor for \$65.0 or arrange to have the office complex sold to a third party. If the office complex is sold to a third party for an amount less than the \$65.0, the amount paid by the Lessor for the purchase of the complex from an unrelated third party, the Company has agreed under a residual value guarantee to pay the Lessor up to \$55.0. If the office complex is sold to a third party for an amount in excess of \$65.0, the Company is entitled to collect the excess. At the inception of the lease, the Company recognized a liability of approximately \$5 for the related residual value guarantee. The value of the guarantee was determined by computing the estimated present value of probability-weighted cash flows that might be expended under the guarantee. The Company recorded a liability for the fair value of the obligation with a corresponding asset recorded as prepaid rent, which is being amortized to rental expense over the lease term. The liability will remain on the balance sheet until the end of the lease term. Under the terms of the lease, the Company also provides certain indemnities to the Lessor, including environmental indemnities. Due to the nature of such potential obligations, it is not possible to estimate the maximum amount of such exposure or the fair value.

Form 10-Q Part I

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

The Company does not expect such amounts, if any, to be material. The Company has concluded that it is not required to consolidate the Lessor pursuant to FASB Interpretation No. 46R, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51.

At June 30, 2007, the Company had outstanding letters of credit of \$42.6 related to performance and payment guarantees. The Company believes that any guarantee obligation that may arise will not be material.

The Company also has purchase commitments with three telecommunications providers of \$18.1 for the remainder of 2007 and \$26.1 for 2008.

**(13) BUSINESS SEGMENT INFORMATION**

As discussed in Note 1, the Company has three segments, which are identified by service offerings. Customer Care provides outsourced customer care service as well as professional and consulting services to in-house customer care operations. Information Management provides billing and information solutions. Employee Care provides human resource business processing outsourcing solutions. These segments are consistent with the Company's management of the business and reflect its internal financial reporting structure and operating focus.

The Company does not allocate activities below the operating income level to its reported segments. The Company's business segment information is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
<b>Revenues:</b>				
Customer Care	\$ 460.6	\$ 446.2	\$ 929.6	\$ 880.2
Information Management	183.4	195.4	369.3	384.2
Employee Care	63.0	50.2	128.0	102.7
	\$ 707.0	\$ 691.8	\$ 1,426.9	\$ 1,367.1
<b>Depreciation:</b>				
Customer Care	\$ 13.6	\$ 15.7	\$ 27.6	\$ 32.5
Information Management	8.1	8.4	17.1	17.0
Employee Care	2.1	3.5	4.4	6.3
Corporate	4.6	4.7	9.2	9.3
	\$ 28.4	\$ 32.3	\$ 58.3	\$ 65.1
<b>Amortization:</b>				
Customer Care	\$ 0.6	\$ 0.7	\$ 1.2	\$ 2.7
Information Management	0.9	3.6	1.9	4.9
Employee Care	0.7	0.4	1.3	1.0
	\$ 2.2	\$ 4.7	\$ 4.4	\$ 8.6

Edgar Filing: CONVERGYS CORP - Form 10-Q

Operating Income (Loss):				
Customer Care	\$ 44.7	\$ 48.2	\$ 101.0	\$ 94.4
Information Management	38.4	30.5	63.7	62.0
Employee Care	(17.1)	(8.2)	(24.5)	(17.8)
Corporate	(7.9)	(7.7)	(16.9)	(13.8)
	\$ 58.1	\$ 62.8	\$ 123.3	\$ 124.8

Form 10-Q Part I

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Capital Expenditures: <sup>(1)</sup>				
Customer Care	\$ 8.1	\$ 8.3	\$ 15.8	\$ 16.5
Information Management	2.7	12.9	7.1	21.3
Employee Care	2.4	2.4	3.8	5.2
Corporate <sup>(2)</sup>	8.7	4.1	19.2	9.2
	\$ 21.9	\$ 27.7	\$ 45.9	\$ 52.2

<sup>(1)</sup> Excluding proceeds from the disposal of property and equipment.<sup>(2)</sup> Includes shared services-related capital expenditures.

	At June 30, 2007	At Dec. 31, 2006
Goodwill:		
Customer Care	\$ 571.9	\$ 566.3
Information Management	184.9	184.3
Employee Care	129.6	129.6
	\$ 886.4	\$ 880.2

**(14) EARNINGS PER SHARE**

The following is a reconciliation of the numerator and denominator of the basic and diluted earnings per share (EPS) computations:

	Net Income	Shares	Per Share Amount
<b>Three Months Ended June 30, 2007</b>			
Basic EPS	\$ 38.8	136.3	\$ 0.28
Effect of dilutive securities:			
Stock-based compensation arrangements		3.9	
Diluted EPS	\$ 38.8	140.2	\$ 0.28
<b>Six Months Ended June 30, 2007</b>			
Basic EPS	\$ 82.4	136.5	\$ 0.60
Effect of dilutive securities:			
Stock-based compensation arrangements		4.0	(0.01)
Diluted EPS	\$ 82.4	140.5	\$ 0.59



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Millions Except Per Share Amounts)

(Unaudited)

	Net Income	Shares	Per Share Amount
<b>Three Months Ended June 30, 2006</b>			
Basic EPS	\$ 39.8	139.1	\$ 0.29
Effect of dilutive securities:			
Stock-based compensation arrangements		3.3	(0.01)
Diluted EPS	\$ 39.8	142.4	\$ 0.28
<b>Six Months Ended June 30, 2006</b>			
Basic EPS	\$ 76.5	139.2	\$ 0.55
Effect of dilutive securities:			
Stock-based compensation arrangements		3.1	(0.01)
Diluted EPS	\$ 76.5	142.3	\$ 0.54

The diluted EPS calculation for the six months ended June 30, 2007 and 2006 excludes the effect of 7.5 million and 9.5 million outstanding stock options, respectively, because they are anti-dilutive.

**(15) DERIVATIVE INSTRUMENTS**

The Company had derivative liabilities related to outstanding forward exchange contracts and options maturing within 42 months, consisting primarily of Canadian dollar, Indian rupee and Philippine pesos with a notional value of \$600.5 at June 30, 2007 and \$562.7 at December 31, 2006. These derivatives were classified as other current assets of \$58.8 and \$16.9 and other current liabilities of \$0.1 and \$3.2 at June 30, 2007 and December 31, 2006, respectively. The Company recorded deferred tax liabilities of \$20.1 and \$4.4 related to these derivatives at June 30, 2007 and December 31, 2006, respectively. A total of \$38.4 and \$8.3 of deferred gains, net of tax, on derivative instruments at June 30, 2007 and December 31, 2006, respectively, were accumulated in other comprehensive income. The amount expected to be reclassified into earnings from other comprehensive income during the next 12 months is \$27.4, net of tax.

During the six months ended June 30, 2007 and 2006, the Company recorded net gains of \$9.7 and \$15.9, respectively, related to the settlement of forward contracts and options which were designated as cash flow hedges. These amounts have been classified together with the hedged transactions in the consolidated statement of income as costs of providing service.

During the six months ended June 30, 2007 and 2006, the Company recognized net gains of \$2.5 and \$0.6, respectively, of other expense related to changes in the fair value of derivative instruments not designated as hedges.

Form 10-Q Part I

ITEM 2.

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

**BACKGROUND**

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 and its predecessors for support. By providing value-added billing, customer care and employee care solutions for our clients, we have developed a base of recurring revenues, generally under multiple year contracts.

We report 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. Certain prior year data have been reclassified to conform to current period presentation.

Customer Care

Our Customer Care segment manages customer relationships on behalf of our clients through our multi-channel customer care contact centers and through consulting engagements. Phone and Web-based agent-assisted service channels provide customers with assistance across the entire customer lifecycle. We deliver these services using a variety of tools including computer telephony integration, interactive voice response, advanced speech recognition, knowledge-based management and the Internet through agent-assisted and self-service channels.

Customer Care typically recognizes revenues as services are performed based on staffing hours or the number of contacts handled by service agents using contractual rates. In a limited number of engagements where the client pays a fixed fee, we recognize revenues based on the specific facts and circumstances of the engagement, using the proportional performance method or upon final completion of the engagement. We sometimes earn supplemental revenues depending on our satisfaction of certain service levels or achievement of certain performance measurement targets. The supplemental revenues are recognized only after the required measurement targets are met. Customer Care's remaining revenues are derived from collection services and professional and consulting services. Revenues for collection-related services are recognized in the month collection payments are received based on a percentage of cash collected or other contractual parameters. Revenues for professional and consulting services are recognized as the services are performed.

Customer Care principally focuses on developing long-term strategic outsourcing relationships with large companies and governmental agencies with the need for more cost-effective customer care services. We have deployed a full suite of product and service offerings, which includes customer and technical support, account management, and professional services to strengthen our position in the customer care outsourcing market and the in-house contact center market. Our operational strategy to deliver high quality products and services through process excellence, and the geographical diversity of our operations, creates a distinct competitive advantage for us in the opportunity-rich customer care market place.

During the first six months of 2007, Customer Care's revenue increased 6% to \$929.6 compared to the prior year. Customer Care's operating income and operating margin were \$101.0 and 10.9%, respectively, compared with \$94.4 and 10.7% in the prior year. This improvement largely reflects increases from revenue growth.

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

Information Management

Our Information Management segment serves clients principally by providing and managing complex billing and information software that addresses all segments of the communications industry. We provide our software products in one of three delivery modes: outsourced, licensed or build-operate-transfer (BOT). In the outsourced delivery mode, Information Management provides the billing services by running its software in one of its data centers. In the licensed delivery mode, the software is licensed to clients who perform billing internally. Under the BOT delivery mode, Information Management implements and initially runs its software in the client's data center while the client has the option to transfer the operation of the center to itself at a future date.

During the first six months of 2007, Information Management's revenue was \$369.3, a 4% decline compared to the prior year mainly due to the negative impact of two, large, North American client migrations. Data processing, which accounted for 35% of Information Management's revenues for the first six months of 2007, consists of monthly fees for processing client transactions in Information Management's data centers and, in some cases, the clients' data centers, using Information Management's proprietary software. Data processing revenues are recognized based on the number of invoices, subscribers or events that are processed by Information Management using contractual rates. In connection with any new data processing outsourcing arrangements, Information Management often must perform significant set-up activities or implementations, including the installation and customization of its proprietary software in its centers. Professional and consulting services for installation, implementation, customization, migration, training and managed services accounted for 36% of Information Management's revenues for the six months ended June 30, 2007. The professional and consulting fees are either invoiced monthly to the Company's clients based on time and material costs incurred at contractually agreed upon rates or, in some instances, for a fixed fee. Information Management's remaining revenues consisted of license and related support and maintenance fees earned under perpetual and term license arrangements. The Company invoices its clients for licenses either up-front or monthly based on the number of subscribers, events or units processed using the software. Fees for support and maintenance normally are charged in advance either on an annual, quarterly or monthly basis. Information Management's operating income and operating margin were \$63.7 and 17.2%, respectively, compared with \$62.0 and 16.1% in the prior year. The increase in operating income was driven by operational efficiencies and cost controls.

Information Management continues to face competition as well as consolidation within the communications industry. In October 2004, Cingular Wireless (Cingular) completed its acquisition of AT&T Wireless. Prior to the acquisition, AT&T Wireless was Information Management's largest client. We have assisted Cingular with its strategy to migrate subscribers off of the AT&T Wireless billing systems (that we support) onto Cingular's two systems (one of which we support through a managed services agreement). The Cingular migration is now complete. In December 2006, AT&T Inc. and Bell South Corporation merged. We have a long-standing relationship with both AT&T and Bell South. Prior to the merger, Cingular (a joint venture between AT&T Inc. and Bell South Corporation) was our largest client in terms of revenue. As a result of the merger, AT&T is now our largest client in terms of revenue. In September 2005, Sprint PCS, a large data processing outsourcing client, completed its acquisition of Nextel Communications. Sprint Nextel has informed us that it intends to consolidate its billing systems onto a competitor's system, and they announced plans to migrate subscribers from our billing system by the end of 2007. The migration began in 2006.

Information Management continues to make steady progress around the world, while dealing with the near-term challenges due to client migrations in North America. During the past year, we entered into Infinys<sup>TM</sup> license arrangements with multiple clients. We believe this is evidence of the market's acceptance of Infinys, and we see an opportunity to build on these successes.

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

Employee Care

Our Employee Care segment provides a full range of human resource business processing outsourcing services including benefits administration, human resource administration, learning, payroll administration and recruiting and staffing services to large companies and governmental entities. We take advantage of our economies of scale in order to standardize human resource processes across departments, business lines, language differences and national borders. With a global network of data and operations centers, we provide our clients' employees with a single point of contact in 70 countries speaking nearly 35 different languages through multi-channel communication vehicles. These multi-channel lines include advanced speech recognition technology, Web chats, telecommunications and fax.

During the past few years, we have transformed Employee Care into a leading player in the growing human resource outsourcing market. In connection with our efforts to grow the business and build a global infrastructure of human resource expertise and know-how, we have incurred significant start-up costs. Furthermore, despite our success in winning long-term outsourcing arrangements with several clients, the sales cycles for these arrangements have ranged from 12 to 24 months. For these reasons, coupled with the fact that we are in the early stages with many of our outsourcing arrangements, where margins tend to be lower, we have generated significant operating losses over the past few years.

Demand for human resource outsourcing is strong and we are one of the leaders in the large and growing human resource outsourcing market. We now have future revenue of over \$3 billion under contract in this business. During the first six months of 2007, Employee Care revenue increased 25% to \$128.0 compared to the prior year. Employee Care's operating loss was \$24.5 compared to a loss of \$17.8 in the prior year. The increased operating loss was mainly due to expensing \$6.1 of implementation costs related to a large HR BPO contract.

**FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995, which are based on current expectations, estimates and projections. Statements that are not historical facts, including statements about the beliefs and expectations of the Company, are forward-looking statements. Sometimes these statements will contain words such as believes, expects, intends, could, should, plans, anticipates and other similar words. These statements discuss potential risks and uncertainties; and, therefore, actual results may differ materially. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they were made. The Company expressly states that it has no current intention to update any forward-looking statements, whether as a result of new information, future events or otherwise. See the discussion under the Risks Relating to Convergys and Its Business section of Management Discussion and Analysis.

**RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with the condensed consolidated financial statements and segment data. Detailed comparisons of revenue and expenses are presented in the discussions of the operating segments, which follow the consolidated results discussion. Results for interim periods may not be indicative of the results for the full years.

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

**CONSOLIDATED RESULTS**

	Three Months Ended June 30,				Six Months Ended June 30,			
	2007	2006	Change	%	2007	2006	Change	%
Revenues	\$ 707.0	\$ 691.8	\$ 15.2	2	\$ 1,426.9	\$ 1,367.1	\$ 59.8	4
Costs of products and services	461.6	438.6	23.0	5	920.4	862.0	58.4	7
Selling, general and administrative expenses	137.1	132.0	5.1	4	281.8	264.8	17.0	6
Research and development costs	19.6	21.4	(1.8)	(8)	38.7	41.8	(3.1)	(7)
Depreciation	28.4	32.3	(3.9)	(12)	58.3	65.1	(6.8)	(10)
Amortization	2.2	4.7	(2.5)	(53)	4.4	8.6	(4.2)	(49)
Total costs	648.9	629.0	19.9	3	1,303.6	1,242.3	61.3	5
Operating income	58.1	62.8	(4.7)	(7)	123.3	124.8	(1.5)	(1)
Equity in earnings of Cellular Partnerships	3.6	1.5	2.1	140	5.6	2.9	2.7	93
Other expense, net	0.5	0.8	(0.3)	(37)	2.7	1.1	1.6	145
Interest expense	(4.6)	(5.8)	1.2	(21)	(9.4)	(11.5)	2.1	(18)
Income before income taxes	57.6	59.3	(1.7)	(3)	122.2	117.3	4.9	4
Income taxes	18.8	19.5	(0.7)	(4)	39.8	40.8	(1.0)	(2)
Net income	\$ 38.8	\$ 39.8	\$ (1.0)	(3)	\$ 82.4	\$ 76.5	\$ 5.9	8
Diluted earnings per common share	\$ 0.28	\$ 0.28	\$ 0.00		\$ 0.59	\$ 0.54	\$ 0.05	9
Operating margin	8.2%	9.1%			8.6%	9.1%		

**Three Months Ended June 30, 2007 versus Three Months Ended June 30, 2006**

Consolidated revenues for the second quarter of 2007 increased 2% from the second quarter of 2006 to \$707.0. This increase reflects 3% growth in Customer Care revenues and 25% growth in Employee Care revenues, partially offset by a 6% decline in revenues from Information Management. Operating income for the second quarter of 2007 decreased 7% or \$4.7 to \$58.1 compared with \$62.8 in the prior year. Significant improvement in operating results in Information Management was offset by declines in Employee Care and Customer Care. Operating income for the second quarter of 2007 include expensing implementation costs of \$6.1 related to a large Employee Care HR BPO contract, approximately \$7 of negative impact due to a weakened U.S. dollar, and capacity expansion costs of several million dollars in Customer Care.

As a percentage of revenues, costs of products and services were 65.3% compared to 63.4% during the corresponding period last year. This reflects an increase in costs of products and services as a percentage of revenues both at Employee Care and Customer Care, partially offset by lower costs of products and services as a percentage of revenues at Information Management. Selling, general, and administrative expenses of \$137.1 increased 4% from the second quarter of 2006. As a percentage of revenues, selling, general and administrative expenses were 19.4% in the second quarter of 2007, up 30 basis points compared to the same period last year, primarily reflecting additional capacity expansion costs at Customer Care. The 8% decrease in research and development costs reflects lower spending at Customer Care. The 53% decrease in amortization expense reflects accelerated amortization of acquired software at Information Management in the second quarter of 2006.



Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

During the second quarter of 2007, we recorded equity income in the Cellular Partnerships of \$3.6 compared to equity income of \$1.5 in the prior year. Interest expense of \$4.6 decreased from \$5.8 in the prior year primarily reflecting a lower level of debt. Our effective tax rate was 32.6% for the three months ended June 30, 2007 and was in-line with the same period last year.

As a result of the forgoing, second quarter 2007 net income and earnings per diluted share were \$38.8 and \$0.28, respectively, compared with \$39.8 and \$0.28, respectively, in the second quarter of 2006.

**Six Months Ended June 30, 2007 versus Six Months Ended June 30, 2006**

Consolidated revenues for the first six months of 2007 increased 4% from the first six months of 2006 to \$1,426.9. This increase reflects 6% growth in Customer Care revenues and 25% growth in Employee Care revenues, partially offset by a 4% decline in revenues from Information Management. Operating income for the first half of 2007 decreased 1% or \$1.5 to \$123.3 compared with \$124.8 in the prior year. Improvement in operating results at Customer Care and Information Management partially offset declines in Employee Care and an increase of \$2.4 in long-term incentive plan expense recorded at Corporate due to strong stock price performance through June 30, 2007.

As a percentage of revenues, costs of products and services were 64.5% in the first half of 2007 compared to 63.1% during the corresponding period last year. This increase was largely due to increases in costs of products and services as a percentage of revenues at Employee Care. Selling, general, and administrative expenses of \$281.8 increased 6% compared to the first half of 2006. As a percentage of revenues, selling, general and administrative expenses were 19.7% for the six months ended June 30, 2007, up 30 basis points compared to the same period last year. This increase primarily reflects additional capacity expansion costs as well as the impact of a weakened U.S. dollar at Customer Care. The 7% decrease in research and development costs mainly reflects lower spending at Customer Care. The 10% decrease in depreciation expense primarily reflects assets obtained through acquisitions that were fully depreciated. Compared to the prior year, the 49% decrease in amortization expense primarily reflects accelerated amortization of acquired software at Information Management in the second quarter of 2006.

During the first half of 2007, we recorded equity income in the Cellular Partnerships of \$5.6 compared to equity income of \$2.9 in the prior year. Interest expense of \$9.4 decreased from \$11.5 in the prior year primarily reflecting a lower level of debt. Other income for the first six months of 2007 was \$2.7 compared to \$1.1 in the prior year, primarily as a result of higher interest income. Our effective tax rate was 32.6% for the six months ended June 30, 2007 versus 34.8% during the six months ended June 30, 2006. The decline in the effective tax rate was largely due to an increase in taxable income outside the U.S.

As a result of the forgoing, net income and earnings per diluted share for the first half of 2007 were \$82.4 and \$0.59 compared with \$76.5 and \$0.54 in the first half of 2006. Beginning January 1, 2007, we adopted FIN 48, Accounting for Uncertainty in Income Taxes. Refer to Note 6 to the Notes to Consolidated Financial Statements for details related to the adoption of this Standard. The adoption of this Standard resulted in a reduction of \$7.9 to our retained earnings at January 1, 2007 and did not have any impact on our Consolidated Statements of Income.

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

**CUSTOMER CARE**

	Three Months				Six Months			
	Ended June 30,				Ended June 30,			
	2007	2006	Change	%	2007	2006	Change	%
<b>Revenues:</b>								
Communications	\$ 267.1	\$ 234.9	\$ 32.2	14	\$ 527.4	\$ 454.7	\$ 72.7	16
Technology	37.5	38.8	(1.3)	(3)	80.2	77.9	2.3	3
Financial services	64.7	63.2	1.5	2	133.8	126.0	7.8	6
Other	91.3	109.3	(18.0)	(16)	188.2	221.6	(33.4)	(15)
<b>Total revenues</b>	<b>460.6</b>	<b>446.2</b>	<b>14.4</b>	<b>3</b>	<b>929.6</b>	<b>880.2</b>	<b>49.4</b>	<b>6</b>
Costs of products and services	308.2	296.0	12.2	4	611.9	578.2	33.7	6
Selling, general and administrative expenses	92.4	83.3	9.1	11	185.4	168.0	17.4	10
Research and development costs	1.1	2.3	(1.2)	(52)	2.5	4.4	(1.9)	(43)
Depreciation	13.6	15.7	(2.1)	(13)	27.6	32.5	(4.9)	(15)
Amortization	0.6	0.7	(0.1)	(14)	1.2	2.7	(1.5)	(56)
<b>Total costs</b>	<b>415.9</b>	<b>398.0</b>	<b>17.9</b>	<b>4</b>	<b>828.6</b>	<b>785.8</b>	<b>42.8</b>	<b>5</b>
<b>Operating income</b>	<b>\$ 44.7</b>	<b>\$ 48.2</b>	<b>\$ (3.5)</b>	<b>(7)</b>	<b>\$ 101.0</b>	<b>\$ 94.4</b>	<b>\$ 6.6</b>	<b>7</b>
Operating margin	9.7%	10.8%			10.9%	10.7%		

**Three Months Ended June 30, 2007 versus Three Months Ended June 30, 2006****Revenues**

Customer Care's revenues were \$460.6, a 3% increase from the second quarter of 2006. Revenues increased from several clients in the communication vertical which more than offset revenue declines with several clients in the other markets.

Revenues from the communication services vertical increased 14% from the second quarter of 2006, reflecting increased revenue from more than a dozen clients. Revenues from the technology vertical decreased 3% compared to the three months ended June 30, 2006. Increases with a large software client were offset by declines with two hardware manufacturers. Revenues from the financial services vertical increased 2%, reflecting higher volume with several credit card issuers that was partially offset by a decline with a collections program. Other revenues, which are comprised of clients outside of Customer Care's three largest industries, decreased 16% from the second quarter of 2006. This was primarily due to declines in transportation, and government programs and the timing of growth in new programs.

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

***Costs and Expenses***

Customer Care's total costs and expenses were \$415.9, a 4% increase from the second quarter of 2006. Customer Care's costs of products and services during the second quarter of 2007 increased 4% to \$308.2 from the second quarter of 2006. As a percentage of revenues, costs of products and services were 66.9%, up 60 basis points from 66.3% in the prior year. The benefits from improved agent utilization were more than offset by higher expenses of approximately 140 basis points resulting from the impact of a weakened U.S. dollar. Selling, general and administrative expenses of \$92.4 in the second quarter of 2007 increased 11% compared to the prior year. As a percentage of revenues, selling, general and administrative expenses were 20.1% in the second quarter of 2007 compared to 18.7% in the same period last year, reflecting higher costs from capacity expansions during the current year and higher expenses of approximately 20 basis points from a weakened U.S. dollar. The \$1.2 decrease in research and development costs reflects reduced spending on a Customer Care application. Compared to prior year, the 13% decrease in depreciation expense primarily reflects assets acquired through acquisitions that were fully depreciated.

***Operating Income***

Customer Care's second quarter 2007 operating income and margin were \$44.7 and 9.7%, respectively, compared to \$48.2 and 10.8%, respectively, in the second quarter of 2006.

**Six Months Ended June 30, 2007 versus Six Months Ended June 30, 2006**

***Revenues***

Customer Care's revenues were \$929.6, a 6% increase from the first half of 2006. Revenue growth from several existing clients in the communication, technology and financial services verticals more than offset revenue declines with several clients in the other markets.

Revenues from the communication services vertical increased 16% from the first half of 2006, reflecting increased revenue from several existing and new clients. Revenues from the technology vertical increased 3%, reflecting increased spending from a large software company. Revenues from the financial services vertical increased 6% from the first half of 2006, reflecting higher volume with several large credit card issuers that were partially offset by a decline with a collections program. Other revenues, which are comprised of clients outside of Customer Care's three largest industries, decreased 15% from the first half of 2006. This was primarily due to declines in transportation and government programs and the timing of growth in new programs.

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

**Costs and Expenses**

Customer Care's total costs and expenses were \$828.6, a 5% increase from the first six months of 2006. Customer Care's costs of products and services during the first half of 2007 increased 6% to \$611.9 from the first half of 2006. As a percentage of revenues, costs of products and services were 65.8%, up 10 basis points from 65.7% in the prior year. Costs of products and services for the first half of 2007 include a 60 basis point positive impact from a one-time resolution of a prior cost as well as benefits from operational efficiencies. These benefits were offset by higher expenses of approximately \$14 resulting from the impact of a weakened U.S. dollar. Selling, general and administrative expenses of \$185.4 in the first six months of 2007 increased 10% compared to the prior year. As a percentage of revenues, selling, general and administrative expenses were 19.9% in the first six months of 2007 compared to 19.1% in the same period last year, primarily due to higher costs from capacity expansions during the current year and higher expenses of approximately 30 basis points from a weakened U.S. dollar. Compared to prior year, the \$1.9 decrease in research and development costs reflects reduced spending on a Customer Care application. The 15% decrease in depreciation expense reflects assets acquired through acquisitions that were fully depreciated. The 56% decrease in amortization expense reflects acquired client contracts that became fully amortized in early 2006.

**Operating Income**

Customer Care's first six months of 2007 operating income and margin was \$101.0 and 10.9%, respectively, compared to \$94.4 and 10.7%, respectively, in the first six months of 2006.

**INFORMATION MANAGEMENT**

	Three Months				Six Months			
	Ended June 30,				Ended June 30,			
	2007	2006	Change	%	2007	2006	Change	%
<b>Revenues:</b>								
Data processing	\$ 62.4	\$ 74.2	\$ (11.8)	(16)	\$ 130.6	\$ 153.4	\$ (22.8)	(15)
Professional and consulting	71.2	73.0	(1.8)	(2)	134.3	146.1	(11.8)	(8)
License and other	49.8	48.2	1.6	3	104.4	84.7	19.7	23
<b>Total revenues</b>	<b>183.4</b>	<b>195.4</b>	<b>(12.0)</b>	<b>(6)</b>	<b>369.3</b>	<b>384.2</b>	<b>(14.9)</b>	<b>(4)</b>
Costs of products and services	95.6	107.1	(11.5)	(11)	199.5	209.5	(10.0)	(5)
Selling, general and administrative expenses	22.4	27.0	(4.6)	(17)	52.0	54.2	(2.2)	(4)
Research and development costs	18.0	18.8	(0.8)	(4)	35.1	36.6	(1.5)	(4)
Depreciation	8.1	8.4	(0.3)	(4)	17.1	17.0	0.1	1
Amortization	0.9	3.6	(2.7)	(75)	1.9	4.9	(3.0)	(61)
<b>Total costs</b>	<b>145.0</b>	<b>164.9</b>	<b>(19.9)</b>	<b>(12)</b>	<b>305.6</b>	<b>322.2</b>	<b>(16.6)</b>	<b>(5)</b>
Operating income	\$ 38.4	\$ 30.5	\$ 7.9	26	\$ 63.7	\$ 62.0	\$ (1.7)	3
Operating margin	20.9%	15.6%			17.2%	16.1%		

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

**Three Months Ended June 30, 2007 versus Three Months Ended June 30, 2006**

***Revenues***

Information Management revenues of \$183.4 during the second quarter of 2007 were down 6% compared to the corresponding period last year primarily due to the negative impact of two large client migrations.

Data processing revenues of \$62.4 decreased 16% from the corresponding period last year. This largely reflects the changing dynamics of Information Management's billing relationship with AT&T, as AT&T migrated Cingular subscribers to an in-house managed service environment. The Cingular migration is now complete. Professional and consulting revenues of \$71.2 decreased 2% from the prior year. This decrease was also largely related to AT&T, due to a reduction in migration services. License and other revenues increased 3% to \$49.8. This reflects strong license revenue increases with several international service providers. Revenues from Sprint Nextel were down 10% in the second quarter of 2007 compared to the corresponding period last year. We expect the revenues from Sprint Nextel to continue to decline as they migrate subscribers from our billing system during 2007.

***Costs and Expenses***

Information Management's total costs and expenses were \$145.0, a 12% decline from the second quarter of 2006. Compared to prior year, Information Management's costs of products and services during the second quarter of 2007 decreased 11% to \$95.6. The decrease in costs of products and services was primarily due to operational efficiencies and benefits from cost reduction actions taken during 2006. As a percentage of revenues, costs of products and services were 52.1% in the second quarter of 2007, down from 54.8% in the second quarter of 2006. Selling, general and administrative expenses of \$22.4 in the second quarter of 2007 decreased 17% compared to the prior year, reflecting benefits from cost controls. As a percentage of revenues, selling, general and administrative expenses were 12.2% in the second quarter of 2007, compared with 13.8% in the prior year. The 75% decrease in amortization expense reflects accelerated amortization of acquired software in the second quarter of 2006.

***Operating Income***

Information Management's operating income and operating margin during the second quarter of 2007 were \$38.4 and 20.9%, respectively, compared with \$30.5 and 15.6%, respectively, during the second quarter of 2006.

**Six Months Ended June 30, 2007 versus Six Months Ended June 30, 2006**

***Revenues***

Information Management revenues of \$369.3 during the first six months of 2007 were down 4% compared to the corresponding period last year. Growth from license and other revenues were offset by declines in professional and consulting and data processing revenues resulting from client migrations.

Data processing revenues of \$130.6 decreased 15% from the corresponding period last year. This reflects the changing dynamics of Information Management's billing relationship with AT&T, as AT&T migrated Cingular subscribers to an in-house managed service environment. The Cingular migration was completed earlier this year. Professional and consulting revenues of \$134.3 decreased 8% from the prior year. This decrease was also largely related to AT&T, due to a reduction in migration services. License and other revenues increased 23% to \$104.4. This reflects strong license revenue increases with several international service providers.



Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

Revenues from Sprint Nextel were down 5% in the first half of 2007 compared to the corresponding period last year. We expect the revenues from Sprint Nextel to continue to decline as they migrate subscribers from our billing system during 2007.

**Costs and Expenses**

Information Management's total costs and expenses were \$305.6, a 5% decrease from the first six months of 2006. Compared to the prior year, Information Management's costs of products and services during the first half of 2007 decreased 5% to \$199.5. The decrease in costs of products and services was primarily due to operational efficiencies and cost reductions. As a percentage of revenues, costs of products and services were 54.0% in the first six months of 2007, down from 54.5% in the first six months of 2006. Selling, general and administrative expenses of \$52.0 in the first half of 2007 decreased 4% compared to the prior year. As a percentage of revenues, selling, general and administrative expenses were relatively flat at 14.1% for the six months ended June 30, 2007 and June 30, 2006. The 61% decrease in amortization expense reflects accelerated amortization of acquired software in the second quarter of 2006.

**Operating Income**

Information Management's operating income and operating margin during the first six months of 2007 were \$63.7 and 17.2%, respectively, compared with \$62.0 and 16.1%, respectively, during the first six months of 2006.

**EMPLOYEE CARE**

	Three Months				Six Months			
	Ended June 30,				Ended June 30,			
	2007	2006	Change	%	2007	2006	Change	%
Revenues	\$ 63.0	\$ 50.2	\$ 12.8	25	\$ 128.0	\$ 102.7	\$ 25.3	25
Costs of products and services	57.8	35.5	22.3	63	109.0	74.3	34.7	47
Selling, general and administrative expenses	19.0	18.7	0.3	2	36.7	38.1	(1.4)	(4)
Research and development costs	0.5	0.3	0.2	67	1.1	0.8	0.3	38
Depreciation	2.1	3.5	(1.4)	(40)	4.4	6.3	(1.9)	(30)
Amortization	0.7	0.4	0.3	75	1.3	1.0	0.3	30
<b>Total costs</b>	<b>80.1</b>	<b>58.4</b>	<b>21.7</b>	<b>37</b>	<b>152.5</b>	<b>120.5</b>	<b>32.0</b>	<b>27</b>
Operating loss	\$ (17.1)	\$ (8.2)	\$ (8.9)		\$ (24.5)	\$ (17.8)	\$ (6.7)	38

**Three Months Ended June 30, 2007 versus Three Months Ended June 30, 2006**

**Revenues**

Employee Care's revenues in the second quarter of 2007 were \$63.0, a 25% increase from the second quarter of 2006. Revenue growth was largely due to two large global implementations.

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

***Costs and Expenses***

Employee Care's costs of products and services during the second quarter of 2007 increased 63% to \$57.8 from the second quarter of 2006. As a percentage of revenues, costs of products and services were 91.7%, up from 70.7% in the prior year. This increase was partly due to the expensing of \$6.1 of implementation costs related to a large HR BPO contract. As discussed more fully in the "Deferred Charges" section of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, we typically defer implementation costs and amortize them ratably over the life of the contract. When implementation costs are deemed not recoverable in accordance with our accounting policy, we expense such excess costs even if the contract is profitable over its term. Also, the costs of products and services include higher early-stage operational costs related to recent client program implementations. In the early stages of client programs, margins tend to be lower. However, as we become more efficient with the delivery of services, margins tend to improve on these programs. Additionally, some revenue recognized in this quarter was pass-through in nature. Selling, general and administrative expenses of \$19.0 in the second quarter of 2007 increased 2% compared to the prior year. As a percentage of revenues, selling, general and administrative expenses were 30.2% in the second quarter of 2007, compared with 37.3% in the prior year, primarily reflecting revenue growth. Depreciation expense of \$2.1 in the second quarter of 2007 decreased 40% or \$1.4 compared to the prior year as data center assets are now being managed in a shared service environment.

***Operating Income***

Employee Care's six months ended June 30, 2007 operating loss increased to \$17.1 from \$8.2 in the six months ended June 30, 2006.

**Six Months Ended June 30, 2007 versus Six Months Ended June 30, 2006**

***Revenues***

Employee Care's revenues in the first half of 2007 were \$128.0, a 25% increase from the first half of 2006. Revenue growth was largely due to two large global implementations.

***Costs and Expenses***

Employee Care's costs of products and services during the six months ended June 30, 2007 increased 47% to \$109.0 from the six months ended June 30, 2006. As a percentage of revenues, costs of products and services were 85.2%, up from 72.3% in the prior year. This increase was partly due to the expensing of \$6.1 of implementation costs discussed above. As also discussed above, the costs of products and services for the first half of 2007 include higher early-stage operational costs related to recent client program implementations. In the early stages of client programs, margins tend to be lower. However, as we become more efficient with the delivery of services, margins tend to improve on these programs. Additionally, some revenue recognized in this period was pass-through in nature. Selling, general and administrative expenses of \$36.7 in the first half of 2007 decreased 4% compared to the prior year. As a percentage of revenues, selling, general and administrative expenses were 28.7% in the first six months of 2007, compared with 37.1% in the prior year, primarily reflecting revenue growth. Depreciation expenses of \$4.4 in the first half of 2007 decreased 30% or \$1.9 compared to the prior year as data center assets are now being managed in a shared service environment.

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

**Operating Income**

Employee Care's six months ended June 30, 2007 operating loss increased to \$24.5 from \$17.8 in the six months ended June 30, 2006.

**Restructuring and Impairment Charges**2006 Restructuring

As discussed more fully in the Business Restructuring and Asset Impairment section of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Company initiated a restructuring plan in the fourth quarter of 2006. The plan resulted in a net restructuring charge of \$12.5 and included \$24.1 of severance costs, \$0.5 of facility closure costs and the reversal of \$12.1 in abandonment costs for a facility being brought back into service to support consolidation of operations at an international location. Completion of the facility consolidation could result in the recording of additional reserves in the third quarter of 2007. Restructuring actions were taken in each business segment, of which \$6.5 related to Customer Care, \$0.8 related to Information Management, \$2.1 related to Employee Care and \$3.1 related to Corporate. The severance charge of \$24.1 is being paid pursuant to our existing severance policy and employment agreements and includes cash-related payments of \$21.3 and a non-cash charge of \$2.8 related to acceleration of equity-based awards. These actions, which will affect approximately 630 professional employees, are expected to be completed by the end of 2007. Through June 2007, the Company completed approximately 400 of the planned headcount reductions.

Restructuring liability activity for the 2006 plan consisted of the following:

Balance at January 1, 2007	\$ 20.5
Severance costs	(7.6)
Lease termination payments	(0.5)
Balance at June 30, 2007	\$ 12.4

2002 Restructuring

In connection with a restructuring plan initiated during the fourth quarter of 2002, the Company made headcount reductions that affected professional and administrative employees worldwide and closed certain Customer Care and Information Management facilities.

Restructuring liability activity for the 2002 plan consisted of the following:

	2007	2006
Balance at January 1	\$ 3.0	\$ 16.0
Lease termination payments	(0.4)	(1.7)
Other	(1.1)	0.6
Balance at June 30	\$ 1.5	\$ 14.9

In the fourth quarter of 2006, the Company made a decision to consolidate its operations in certain U.K. locations and move into one of the facilities that was originally abandoned in 2002. This resulted in the reversal of \$12.1 of facility abandonment costs at December 31, 2006.



Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

The remaining accrual of \$1.5 reflects facility abandonment costs, which will be paid over several years until the leases expire. The accrual is equal to the future costs associated with those abandoned facilities, net of the proceeds from any probable future sublease agreements. The Company used estimates, based on consultation with its real estate advisors, to arrive at the proceeds from any future sublease agreements. The Company will continue to evaluate such estimates in recording the facilities abandonment charge. Consequently, there may be additional reversals or charges in the future.

**CLIENT CONCENTRATION**

In December 2006, AT&T and Bell South Corporation merged. Prior to the merger, Cingular (a joint venture between AT&T and Bell South Corporation) was our largest client in terms of revenue. As a result of the merger, AT&T is now our largest client in terms of revenue. We serve AT&T under Information Management, Customer Care and Employee Care contracts. See further discussion of risks associated with client consolidation under the Risks Relating to Convergys and Its Business section of Management Discussion and Analysis.

Our three largest clients accounted for 31.4% of our revenues during the first six months of 2007, down from 34.4% in the same period of 2006. We serve AT&T, our largest client with 14.9% of revenues in the first half of 2007, and Sprint Nextel, our second largest client, under information management and customer care contracts. We provide customer care services to Sprint Nextel, for the Sprint PCS division, under a contract between Sprint Nextel and IBM, as a subcontractor to IBM. We serve DirecTV, our third largest client in 2007, under a customer care contract. Volumes under certain of our long-term contracts are subject to variation based on, among other things, the spending by clients on outsourced customer support and subscriber levels.

**BUSINESS OUTLOOK**

We expect record revenue in 2007 with increases in Customer Care and Employee Care more than offsetting anticipated declines in Information Management. We continue to expect full year earnings of more than \$1.20 per diluted share. Not embedded in this guidance are the potential for expensing significantly higher implementation costs than originally planned for a large HR BPO contract. Due to the size of this contract, these additional costs could have a significant impact on the operating income of Employee Care in 2007 and/or over the life of the contract. We are working to resolve the issue so that there would be no additional implementation costs expensed in this year, and are having productive discussions with the client. However, the outcome could be additional expense of as much as approximately \$35 in the second half of the year. The guidance for 2007 also does not include the potential for additional cost actions in the second half of the year to further streamline the business.

The long-term expectation for annual revenue growth in Customer Care business remains 10 percent. However, we now expect Customer Care revenue to grow 5 percent in 2007 as compared to our previous expectation of 10% growth in 2007. About half of this change is due to a change in expected volume with a large communications client. After the program volume adjustment, this client will still remain one of Customer Care's largest clients. The rest of the change in growth estimate is due to slower than anticipated new client signings and ramps. We expect full year Customer Care margin to be similar to last year.

For Information Management, we expect data processing revenue to decline through the rest of the year and into next year. We also expect operating income and operating margin to decline for the rest of the year. This will be partially offset by further progress in our license and professional services businesses, with growth in international operations and tight cost controls.

Form 10-Q Part I

MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Amounts in Millions Except Per Share Amounts)

We expect Employee Care revenues will grow 20 to 30 percent in 2007 due to growth with clients now in live operations. We do not expect Employee Care to reach profitability in 2008 because of the current implementation plans and the timing of revenue recognition for two, large contracts signed in 2007.

There are execution risks and significant growth opportunities taken into account in our 2007 guidance. Challenges to be overcome include: the impact of AT&T and Sprint Nextel migrations, foreign currency exchange rate impacts, labor costs and expensing of additional HR implementation costs related to a large HR BPO contract. Significant opportunities for revenue and earnings growth include: driving more Customer Care revenue and operating efficiencies, growing Information Management's share of the billing and care market around the globe, revenue growth and reduction in operating loss with Employee Care, and improving margin from further productivity and cost actions across the business.

We have not yet provided guidance for 2008. However, the above challenges (client migrations, foreign currency exchange impacts, labor costs and additional HR implementation costs) and opportunities (revenue growth and improving operating efficiencies) are expected to continue in varying degrees into 2008. More detailed guidance will be provided at a future date.

**FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES**

**Liquidity and Cash Flows**

Cash flow from operating activities provides us with a significant source of funding for our investing and financing activities. Also, we have borrowing facilities available, including a \$400 Five-Year Revolving Credit Facility to fund these activities. See further discussion of these borrowing facilities under the next section titled, Capital Resources, Off-Balance Sheet Arrangements and Contractual Commitments.

Cash flow from operating activities totaled \$105.1 in the first six months of 2007, compared to \$120.2 in the same period last year. Compared to the prior year, the \$15.1 decline in cash flow from operations was driven by a significant increase in working capital which was partially offset by less cash used on deferred charges related to client implementations and increase in deferred tax expenses. Days sales outstanding (DSO) in receivables increased to 71 days at June 30, 2007 compared to 70 days at December 31, 2006. During the first six months of 2006, DSO increased to 74 days at June 30, 2006 versus 72 days at December 31, 2005. DSO is computed as follows: receivables, net of allowances divided by average days sales. Average days sales are defined as consolidated revenues during the quarter just ended divided by the number of calendar days in the quarter just ended.

We used \$54.3 for investing activities during the first six months of 2007 compared to \$44.3 during the first six months of 2006. The increase in amounts used in investing activities during the first half of 2007 was mainly due to \$8.7 invested in auction rate securities. These se