

TECHTEAM GLOBAL INC

Form 10-Q

November 09, 2009

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

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2009**

**Commission File Number: 0-16284**

**TECHTEAM GLOBAL, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation)

**38-2774613**

(I.R.S. Employer Identification No.)

**27335 West 11 Mile Road, Southfield, MI 48033**

(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code: **(248) 357-2866**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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. (Check one):

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

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

Yes  No

The number of shares of the registrant's common stock outstanding at November 1, 2009 was 11,130,057.

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**PART 1 FINANCIAL INFORMATION**  
**ITEM 1 FINANCIAL STATEMENTS**  
**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**  
(In thousands, except per share data)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Revenue</b>				
Commercial				
IT Outsourcing Services	\$ 26,184	\$ 30,452	\$ 80,462	\$ 91,154
IT Consulting and Systems Integration	2,711	6,338	9,780	21,283
Other Services	3,740	5,406	11,981	19,358
Total Commercial	32,635	42,196	102,223	131,795
Government Technology Services	19,713	21,988	60,557	66,230
<b>Total revenue</b>	<b>52,348</b>	<b>64,184</b>	<b>162,780</b>	<b>198,025</b>
<b>Cost of revenue</b>				
Commercial				
IT Outsourcing Services	20,838	24,137	62,903	72,847
IT Consulting and Systems Integration	2,083	4,988	7,712	16,702
Other Services	2,860	4,189	9,008	14,911
Total Commercial	25,781	33,314	79,623	104,460
Government Technology Services	14,525	16,063	43,841	48,391
<b>Total cost of revenue</b>	<b>40,306</b>	<b>49,377</b>	<b>123,464</b>	<b>152,851</b>
<b>Gross profit</b>				
Commercial	6,854	8,882	22,600	27,335
Government Technology Services	5,188	5,925	16,716	17,839
<b>Total gross profit</b>	<b>12,042</b>	<b>14,807</b>	<b>39,316</b>	<b>45,174</b>
Selling, general and administrative expense	10,351	11,021	32,393	35,325
Restructuring charge (credit)	(57)		(756)	3,884
<b>Operating income</b>	<b>1,748</b>	<b>3,786</b>	<b>7,679</b>	<b>5,965</b>
Net interest expense	(314)	(425)	(918)	(1,291)
Foreign currency transaction loss	(68)	(277)	(717)	(46)
<b>Income before income taxes</b>	<b>1,366</b>	<b>3,084</b>	<b>6,044</b>	<b>4,628</b>
Income tax provision	504	1,175	2,242	2,866
<b>Net income</b>	<b>\$ 862</b>	<b>\$ 1,909</b>	<b>\$ 3,802</b>	<b>\$ 1,762</b>

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<b>Basic earnings per common share</b>	\$ 0.08	\$ 0.18	\$ 0.36	\$ 0.17
<b>Diluted earnings per common share</b>	\$ 0.08	\$ 0.18	\$ 0.36	\$ 0.17

**Weighted average number of common shares and common share equivalents outstanding**

Basic	10,628	10,566	10,609	10,514
Diluted	10,754	10,592	10,664	10,540

See accompanying notes.

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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

	September 30, 2009 (Unaudited)	December 31, 2008
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 16,659	\$ 16,881
Accounts receivable (less allowance of \$1,594 at September 30, 2009 and \$986 at December 31, 2008)	49,599	59,705
Prepaid expenses and other current assets	4,148	4,315
<b>Total current assets</b>	<b>70,406</b>	<b>80,901</b>
<b>Property, equipment and software, net</b>	<b>7,017</b>	<b>8,327</b>
<b>Goodwill and other intangible assets, net</b>	<b>75,224</b>	<b>77,361</b>
<b>Other assets</b>	<b>662</b>	<b>774</b>
<b>Total assets</b>	<b>\$ 153,309</b>	<b>\$ 167,363</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Current liabilities</b>		
Current portion of long-term debt	\$ 7,944	\$ 7,987
Accounts payable	5,670	6,340
Accrued payroll and related taxes	11,809	12,477
Accrued expenses	4,255	9,054
Other current liabilities	4,284	2,616
<b>Total current liabilities</b>	<b>33,962</b>	<b>38,474</b>
<b>Long-term liabilities</b>		
Long-term debt, less current portion	11,203	27,202
Deferred income taxes	1,603	1,966
Other long-term liabilities	702	988
<b>Total long-term liabilities</b>	<b>13,508</b>	<b>30,156</b>
<b>Shareholders equity</b>		
Preferred stock, 5,000,000 shares authorized, no shares issued	111	109

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Common stock, \$0.01 par value, 45,000,000 shares authorized, 11,132,634 and 10,884,998 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively

Additional paid-in capital	79,385	77,939
Retained earnings	25,161	21,359
Accumulated other comprehensive income (loss)	1,182	(674)
<b>Total shareholders equity</b>	<b>105,839</b>	<b>98,733</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 153,309</b>	<b>\$ 167,363</b>

See accompanying notes.

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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
(In thousands)

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Operating activities</b>		
Net income	\$ 3,802	\$ 1,762
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,059	5,813
Non-cash expense related to stock options and issuance of common stock and restricted common stock	1,477	1,663
Other	786	55
Changes in current assets and liabilities	5,490	(4,774)
Changes in long-term assets and liabilities	(260)	(699)
Net cash provided by operating activities	16,354	3,820
<b>Investing activities</b>		
Purchase of property, equipment and software	(1,211)	(2,101)
Cash paid for acquisitions, net of cash acquired	(375)	(5,958)
Net cash used in investing activities	(1,586)	(8,059)
<b>Financing activities</b>		
Proceeds from issuance of long-term debt	600	5,000
Proceeds (expenditures) from issuance of common stock	(28)	351
Tax expense from stock options		(5)
Payments on long-term debt	(16,640)	(4,227)
Net cash (used in) provided by financing activities	(16,068)	1,119
<b>Effect of exchange rate changes on cash and cash equivalents</b>	1,078	(440)
<b>Decrease in cash and cash equivalents</b>	(222)	(3,560)
<b>Cash and cash equivalents at beginning of period</b>	16,881	19,431
<b>Cash and cash equivalents at end of period</b>	\$ 16,659	\$ 15,871

See accompanying notes.



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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared by TechTeam Global, Inc. ( TechTeam or the Company ) in accordance with United States generally accepted accounting principles 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 footnotes required by United States generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included, and such adjustments are of a normal recurring nature. Operating results for the three and nine months ended September 30, 2009, are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

In the first quarter of fiscal 2009, management changed its methodology for evaluation of the performance of the Company s outsourcing services. As a result of this change, certain costs that were previously included in Selling, general and administrative expense are now being included in Cost of revenue in the Company s Condensed Consolidated Statements of Income because they are directly related to revenue. The Company s financial statements for fiscal year 2008 have been revised, for all periods presented, to conform to the current year presentation. The Company s fiscal year 2008 financial statements were impacted as follows, for all periods presented, as a result of this change in classification:

	<b>Three Months Ended September 30, 2008</b>	<b>Nine Months Ended September 30, 2008</b>
	(In thousands)	
Cost of revenue increase	\$ 1,352	\$ 4,515
Gross profit decrease	(1,352)	(4,515)
Selling, general, and administrative expense decrease	(1,352)	(4,515)
Net income		
Earnings per share		

This re-categorization of costs did not change net income or earnings per share, for all periods presented, in fiscal year 2008. There was no cumulative effect to retained earnings as a result of this re-categorization, and there was no change to the carrying amount of assets and liabilities in fiscal 2008.

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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

**Note 2 Comprehensive Income (Loss)**

Comprehensive income (loss) is defined as net income and all non-ownership changes in shareholders' equity. For the Company, comprehensive income (loss) for the periods presented consists of net income, the foreign currency translation adjustment and net unrealized gain on derivative instruments. A summary of comprehensive income (loss) for the periods presented is as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	(In thousands)			
<b>Comprehensive income (loss)</b>				
Net income	\$ 862	\$ 1,909	\$ 3,802	\$ 1,762
Other comprehensive income (loss)				
Foreign currency translation adjustment	397	(2,235)	1,381	(1,031)
Unrealized gain on derivative instruments	140	119	475	105
Comprehensive income (loss)	\$ 1,399	\$ (207)	\$ 5,658	\$ 836

**Note 3 Earnings Per Share**

Earnings per share for common stock is computed using the weighted average number of common shares and common share equivalents outstanding. Common share equivalents consist of stock options, unvested restricted stock issued to employees and shares held in escrow in connection with the Company's acquisition of RL Phillips, Inc. During the three months ended September 30, 2009 and 2008, 1,853,400 and 1,740,700 stock options, respectively, were excluded from the computation of diluted earnings per common share because the exercise prices of the options were higher than the average market price of the Company's common stock for the respective period. Stock options excluded totaled 2,077,400 and 1,494,400 for the nine months ended September 30, 2009 and 2008, respectively.

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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
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**Note 4 Restructuring**

During 2008, the Company announced corporate-wide organizational realignment and restructuring actions to improve operating efficiency, achieve greater global consistency and drive improved financial performance.

The following table summarizes the accrued charges related to the restructuring:

	<b>Accrued Restructuring Charges at December 31, 2008</b>	<b>Adjustments to Accrued Restructuring Charges (In thousands)</b>	<b>Cash Payments</b>	<b>Accrued Restructuring Charges at September 30, 2009</b>
Workforce reductions	\$ 359	\$ (43)	\$ (316)	\$
Other	1,387	(713)	(435)	239
<b>Total</b>	<b>\$ 1,746</b>	<b>\$ (756)</b>	<b>\$ (751)</b>	<b>\$ 239</b>

The following table summarizes the restructuring charges by operating segment:

	<b>Accrued Restructuring Charges at December 31, 2008</b>	<b>Adjustments to Accrued Restructuring Charges (In thousands)</b>	<b>Cash Payments</b>	<b>Accrued Restructuring Charges at September 30, 2009</b>
Restructuring charges				
Commercial				
IT Outsourcing Services	\$ 40	\$ (26)	\$ (14)	\$
IT Consulting and Systems Integration.	50		(50)	
Other Services	80		(80)	
<b>Total Commercial</b>	<b>170</b>	<b>(26)</b>	<b>(144)</b>	
Government Technology Services	367		(146)	221
Selling, general and administrative expense	1,209	(730)	(461)	18
<b>Total restructuring charges</b>	<b>\$ 1,746</b>	<b>\$ (756)</b>	<b>\$ (751)</b>	<b>\$ 239</b>

Due to the inherent uncertainty involved in estimating restructuring expenses, actual amounts paid for such activities may differ from amounts initially estimated. Accordingly, previously recorded reserves of \$756,000 were reversed during the nine months ended September 30, 2009. Such reversals are recorded consistent with FASB Accounting

Standards Codification ( ASC ) 420, Exit or Disposal Cost Obligations , and primarily result from the Company favorably amending a lease for facilities in Europe to eliminate its obligation to pay for leased space that was vacated and expensed in 2008.

**Note 5 Property, Equipment and Software**

Long-lived assets are evaluated for impairment when events occur or circumstances indicate that the remaining estimated useful lives may warrant revision or that the remaining balances may not be recoverable. When this occurs, an estimate of undiscounted cash flows is used to determine if the remaining balances are recoverable.

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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

**Note 6 Acquisitions and Dispositions**

***Onvaio LLC***

On May 30, 2008, TechTeam Global, Inc. completed the acquisition of Onvaio LLC ( Onvaio ), a California limited liability company. Onvaio is a provider of technical support outsourcing services for clients globally through its wholly-owned subsidiary, Onvaio Asia Services, Inc., based in Manila, Philippines. The initial purchase price totaled \$4,787,000 and included acquisition costs of \$400,000. In addition to the initial purchase price paid at closing, an additional \$1,500,000 was placed into an escrow account and is payable in increments of \$125,000 on the last day of each fiscal quarter provided that Onvaio is still providing services to its largest customer in substantially the same form and content as it provided at closing. As of September 30, 2009, \$625,000 had been released from escrow and paid to the selling shareholders. This additional amount is being recorded as goodwill as it is earned.

***RL Phillips, Inc.***

On August 31, 2007, TechTeam Global, Inc., through its wholly-owned subsidiary TechTeam Government Solutions, Inc., completed the acquisition of all the outstanding common stock of RL Phillips, Inc. ( RL Phillips ) for approximately \$2,150,000. Of the total purchase price, \$300,000 was paid in shares of TechTeam common stock, which was placed into escrow for a period of three years after closing to reimburse the Company for any claims for indemnity or breach of representation and warranties. Furthermore, \$100,000 was held back and is scheduled to be paid in equal installments on the first and second anniversary of the date of acquisition. On August 31, 2008, \$50,000 was paid to the selling shareholders. The installment due on August 31, 2009 was held back due to a claim for indemnity. The Company is uncertain if this amount will be released in the future.

***NewVectors LLC***

In connection with the Company's acquisition of NewVectors LLC ( NewVectors ) on May 31, 2007, \$4,000,000 of the total purchase price was placed into escrow for a period of one year after closing to reimburse the Company for any claims for indemnity or breach of representation and warranties. On May 31, 2008, the amount held in escrow was released in its entirety.

***SQM Sverige AB***

In connection with the Company's acquisition of SQM Sverige AB ( SQM ) on February 9, 2007, the selling shareholders had the potential to receive SEK 4,200,000 (equal to \$600,000 at the acquisition date), subject to SQM's achievement of a defined revenue target for the 2007 calendar year. The selling shareholders received SEK 4,200,000 (equal to \$660,000 on the date of payment) in February 2008 as a result of achieving the revenue target. The additional consideration was recorded as goodwill when it was earned.

***Disposition of TechTeam A.N.E. NV/SA***

On October 31, 2008, the Company completed the sale of TechTeam A.N.E. NV/SA ( ANE ), the results of which were included in continuing operations through the date of the sale. This disposition was completed as the Company determined that this business unit was not core to the Company's long-term growth strategy. This business, included in the IT Consulting and Systems Integration segment, had net sales of \$7.2 million and a net operating loss of \$76,000 for 2008 through the date of the sale. Total gross proceeds from the sale were 1.1 million euro (\$1.4 million at the disposition date); the Company recognized a net gain of \$155,000, which was included in other income in the Consolidated Statements of Income, related to the sale of the business for the year ended December 31, 2008.

***Pro Forma Results of Operations***

The pro forma results of operations for the acquisition of Onvaio and the disposition of ANE are not materially different than reported results, therefore are not presented.

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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

**Note 7 Stock-Based Compensation**

The Company measures and recognizes compensation expense for all stock-based payment awards based on the estimated fair value of the award. Compensation expense is recognized over the period during which the recipient is required to provide service in exchange for the award. Stock-based compensation expense recognized in each period is based on the value of the portion of the share-based award that is ultimately expected to vest during the period. The Company's outstanding stock-based awards consist of stock options and restricted stock.

**Stock Options**

The Company recorded compensation expense totaling \$286,000 and \$296,000 during the three months ended September 30, 2009 and 2008, respectively, related to outstanding options and compensation expense totaling \$879,000 and \$843,000 during the nine months ended September 30, 2009 and 2008, respectively. At September 30, 2009 and 2008, there was approximately \$2,248,000 and \$3,243,000, respectively, of unrecognized compensation expense related to stock options. Unrecognized compensation expense at September 30, 2009, is expected to be recognized over a weighted-average period of approximately two years.

The Company records compensation expense for stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes valuation model. The Company uses historical data among other factors to estimate the expected price volatility, the expected option term and the expected forfeiture rate. The risk-free rate is based on the U.S. Treasury yield curve in effect at the date of grant for the expected term of the option.

The following assumptions were used to estimate the fair value of options granted for the nine months ended September 30, 2009 and 2008:

	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Expected dividend yield	0.0%	0.0%
Weighted average volatility	61%	37%
Risk free interest rate	1.4%	1.8% 3.4%
Expected term (in years)	3.0	3.1

**Restricted Common Stock**

Compensation expense related to restricted stock under all plans is recorded on a straight-line basis over the vesting period. The Company recorded compensation expense of approximately \$241,000 and \$199,000 for the three months ended September 30, 2009 and 2008, respectively, related to outstanding shares of restricted stock under all plans and compensation expense of approximately \$483,000 and \$674,000 for the nine months ended September 30, 2009 and 2008, respectively. Compensation expense for the nine months ended September 30, 2008, includes \$254,000 of expense related to the accelerated vesting of all non-vested restricted stock awards granted to the Company's former President and Chief Executive Officer, William C. Brown, in accordance with Mr. Brown's amended Employment and Noncompetition Agreement.

The weighted average grant-date fair value of restricted stock granted under all plans during the three months ended September 30, 2009 and 2008 was \$8.61 and \$9.44, respectively. The weighted average grant-date fair value of restricted stock granted under all plans during the nine months ended September 30, 2009 and 2008 was \$5.07 and \$9.03, respectively. The fair value of restricted stock awards granted under all plans was determined based on the closing trading price of the Company's common stock on the date of grant.

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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(continued)

**Note 7 Stock-Based Compensation** (continued)

At September 30, 2009 and 2008, there was approximately \$2,500,000 and \$2,300,000, respectively, of total unrecognized compensation expense related to non-vested shares of restricted stock. Unrecognized compensation expense at September 30, 2009, is expected to be recognized over a weighted average period of approximately three years.

**Note 8 Income Taxes**

At September 30, 2009 and December 31, 2008, the Company had an unrecognized tax benefit of approximately \$108,000 and \$107,000, respectively. The Company recognizes accrued interest related to unrecognized tax benefits as a component of interest expense and recognizes penalties as a component of selling, general and administrative expense. During the three and nine months ended September 30, 2009 and 2008, interest and penalties recognized in the financial statements were not material. The Company had no material accruals for the payment of interest and penalties at September 30, 2009 and December 31, 2008.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2002. The Internal Revenue Service commenced an examination of the Company's 2004 U.S. federal income tax return in the first quarter of 2007, which was completed in the second quarter of 2008. The following table summarizes tax years that remain subject to examination by major tax jurisdictions:

**Major Jurisdiction****Open Years**

U.S. Federal income taxes

2005 through 2008

U.S. State income taxes

2004 through 2008

Foreign income taxes

2002 through 2008

For the three and nine months ended September 30, 2009, the consolidated effective tax rate was 36.9% and 37.1%, respectively. This rate differs from statutory levels in the three months ended September 30, 2009, primarily because the reversal of the restructuring charge was recorded in Belgium where there was no tax expense for the charge due to the availability of tax loss carry forwards which offset taxable income. Excluding the reversal of restructuring charges, the effective tax rate for the three and nine months ended September 30, 2009 was 38.5% and 42.4%, respectively. The effective tax rate excluding the reversal of restructuring charges differs from the statutory tax rate of 34.0% primarily due to state income taxes, non-deductible expenses and foreign operating losses for which a tax benefit is not recorded.

For the three months ended September 30, 2008, the consolidated effective tax rate of 38.1% differs from the statutory tax rate of 34.0% primarily due to state income taxes, foreign operating losses for which a tax benefit is not recorded and nondeductible expenses. For the nine months ended September 30, 2008, the consolidated effective tax rate of 61.9% differs from the statutory tax rate of 34.0% primarily due to foreign operating losses for which a tax benefit is not recorded and non-deductible expenses. The level of foreign operating losses was made worse during the second quarter of 2008 because a significant portion of the Company's restructuring charge was incurred in countries with historical operating losses.

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**TECHTEAM GLOBAL, INC. AND SUBSIDIARIES**  
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(continued)

**Note 9 Segment Reporting**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision-making group is the Executive Leadership Team. The operating segments are managed separately because each operating segment represents a strategic business unit which offers different services.

The accounting policies of the operating segments are the same as those described in Note 1 to the Company's consolidated financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The Company evaluates segment performance based on segment gross profit. Assets are not allocated to operating segments, but certain amounts of depreciation and amortization expense are