HOVNANIAN ENTERPRISES INC
Form 10-Q
September 09, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended JULY 31, 2015

OR

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 1-8551

Hovnanian Enterprises, Inc. (Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)

22-1851059 (I.R.S. Employer Identification No.)

110 West Front Street, P.O. Box 500, Red Bank, NJ 07701 (Address of Principal Executive Offices)

732-747-7800 (Registrant's Telephone Number, Including Area Code)

N/A (Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] 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.

Large Accelerated Filer [ ] Accelerated Filer [X]

Non-Accelerated Filer [ ] (Do not check if smaller reporting company) 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 [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 131,532,118 shares of Class A Common Stock and 14,985,099 shares of Class B Common Stock were outstanding as of September 3, 2015.

HOVNANIAN ENTERPRISES, INC.

FORM 10-Q

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands)

	July 31,	October 31,
	2015 (Unaudited)	2014 (1)
ASSETS		
Homebuilding:		
Cash and cash equivalents	$207,302	$255,117
Restricted cash and cash equivalents	9,772	13,086
Inventories:		
Sold and unsold homes and lots under development	1,294,033	961,994
Land and land options held for future development or sale	209,101	273,463
Consolidated inventory not owned:		
Specific performance options	-	3,479
Other options	109,355	105,374
Total consolidated inventory not owned	109,355	108,853
Total inventories	1,612,489	1,344,310
Investments in and advances to unconsolidated joint ventures	66,535	63,883
Receivables, deposits and notes, net	87,059	92,546
Property, plant and equipment, net	45,839	46,744
Prepaid expenses and other assets	80,468	69,358
Total homebuilding	2,109,464	1,885,044
Financial services:		
Cash and cash equivalents	6,635	6,781
Restricted cash and cash equivalents	16,647	16,236
Mortgage loans held for sale at fair value	110,670	95,338
Other assets	2,138	1,988
Total financial services	136,090	120,343
Income taxes receivable – including net deferred tax benefits	303,790	284,543
Total assets	$2,549,344	$2,289,930

(1) Derived from the audited balance sheet as of October 31, 2014.

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands Except Share and Per Share Amounts)

	July 31,	October 31,
	2015 (Unaudited)	2014 (1)
LIABILITIES AND EQUITY		
Homebuilding:		
Nonrecourse mortgages	$133,380	$103,908
Accounts payable and other liabilities	354,128	370,876
Customers’ deposits	47,299	34,969
Nonrecourse mortgages secured by operating properties	15,796	16,619
Liabilities from inventory not owned	98,406	92,381
Total homebuilding	649,009	618,753
Financial services:		
Accounts payable and other liabilities	24,996	22,278
Mortgage warehouse lines of credit	88,554	76,919
Total financial services	113,550	99,197
Notes payable:		
Senior secured notes, net of discount	980,988	979,935
Senior notes, net of discount	841,056	590,472
Senior amortizing notes	12,811	17,049
Senior exchangeable notes	72,838	70,101
Accrued interest	30,599	32,222
Total notes payable	1,938,292	1,689,779
Total liabilities	2,700,851	2,407,729
Stockholders’ equity deficit:		
Preferred stock, $0.01 par value - authorized 100,000 shares; issued and outstanding 5,600 shares with a liquidation preference of $140,000 at July 31, 2015 and at October 31, 2014	135,299	135,299
Common stock, Class A, $0.01 par value – authorized 400,000,000 shares; issued 143,292,881 shares at July 31, 2015 and 142,836,563 shares at October 31, 2014 (including 11,760,763 shares at July 31, 2015 and October 31, 2014 held in Treasury)	1,433	1,428
Common stock, Class B, $0.01 par value (convertible to Class A at time of sale) – authorized 60,000,000 shares; issued 15,676,847 shares at July 31, 2015 and 15,497,543 shares at October 31, 2014 (including 691,748 shares at July 31, 2015 and October 31,	157	155

2014 held in Treasury)		
Paid in capital – common stock	705,847	697,943
Accumulated deficit	(878,883)	(837,264)
Treasury stock – at cost	(115,360)	(115,360)
Total stockholders' equity deficit	(151,507)	(117,799)
Total liabilities and equity	$2,549,344	$2,289,930

(1) Derived from the audited balance sheet as of October 31, 2014.

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands Except Per Share Data)

(Unaudited)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2015	2014	2015	2014
Revenues:				
Homebuilding:				
Sale of homes	$526,156	$538,007	$1,414,799	$1,331,490
Land sales and other revenues	97	1,896	2,538	4,884
Total homebuilding	526,253	539,903	1,417,337	1,336,374
Financial services	14,360	11,106	37,939	28,612
Total revenues	540,613	551,009	1,455,276	1,364,986
Expenses:				
Homebuilding:				
Cost of sales, excluding interest	432,625	424,145	1,169,576	1,063,465
Cost of sales interest	16,323	15,827	39,654	37,724
Inventory impairment loss and land option write-offs	1,077	741	7,618	1,927
Total cost of sales	450,025	440,713	1,216,848	1,103,116
Selling, general and administrative	51,998	51,150	152,258	142,918
Total homebuilding expenses	502,023	491,863	1,369,106	1,246,034
Financial services	8,244	7,212	23,069	20,591
Corporate general and administrative	15,874	15,804	49,275	46,837
Other interest	22,493	19,880	70,594	66,685
Other operations	1,532	1,089	4,864	3,349
Total expenses	550,166	535,848	1,516,908	1,383,496
Loss on extinguishment of debt	-	-	-	(1,155)
(Loss) income from unconsolidated joint ventures	(448)	211	2,470	3,849
(Loss) income before income taxes	(10,001)	15,372	(59,162)	(15,816)
State and federal income tax (benefit) provision:				
State	999	247	3,717	1,484
Federal	(3,316)	(1,980)	(21,260)	(1,980)
Total income taxes	(2,317)	(1,733)	(17,543)	(496)
Net (loss) income	$(7,684)	$17,105	$(41,619)	$(15,320)
Per share data:				
Basic:				
(Loss) income per common share	$(0.05)	$0.11	$(0.28)	$(0.10)

Weighted-average number of common shares outstanding	147,010	146,365	146,846	146,223
Assuming dilution:				
(Loss) income per common share	$(0.05)	$0.11	$(0.28)	$(0.10)
Weighted-average number of common shares outstanding	147,010	162,278	146,846	146,223

See notes to condensed consolidated financial statements (unaudited).

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF EQUITY

(In Thousands Except Share Amounts)

(Unaudited)

	A Common Stock		B Common Stock		Preferred Stock					
	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount	Paid-In Capital	Accumulated Deficit	Treasury Stock	Total
Balance, October 31, 2014	131,075,800	$1,428	14,805,795	$155	5,600	$135,299	$697,943	$(837,264)	$(115,360)	$(117
Stock options, amortization and issuances	18,125						1,986			1,986
Restricted stock amortization, issuances and forfeitures	438,093	5	179,404	2			5,918			5,925
Conversion of Class B to Class A Common Stock	100		(100)							-
Net loss								(41,619)		(41,6
Balance, July 31, 2015	131,532,118	$1,433	14,985,099	$157	5,600	$135,299	$705,847	$(878,883)	$(115,360)	$(151

See notes to condensed consolidated financial statements (unaudited).

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

	Nine Months Ended July 31, 2015	 2014
Cash flows from operating activities:		
Net loss	$(41,619)	$(15,320)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation		

Total costs and expenses	855.7	918.2	(62.5)	(7)	2,265.4	2,237.8	27.6	1
Operating Loss	(90.3)	(242.0)	151.7	(63)	(122.6)	(155.7)	33.1	(21)
Equity in Earnings of Cellular Partnerships	10.2	7.7	2.5	32	31.7	25.8	5.9	23
Other Income (Expense), net	(0.6)	9.6	(10.2)		(10.4)	7.7	(18.1)	
Interest Expense	(7.4)	(5.5)	(1.9)	35	(21.1)	(13.3)	(7.8)	59
Loss Before Income Taxes	(88.1)	(230.2)	142.1	(62)	(122.4)	(135.5)	13.1	(10)
Income Tax Benefit	(2.1)	(90.2)	88.1	(98)	(3.5)	(71.9)	68.4	(95)
Net Loss	$ (86.0)	$ (140.0)	$ 54.0	(39)	$ (118.9)	$ (63.6)	$ (55.3)	87
Diluted loss per common share	$ (0.70)	$ (1.15)	$ 0.45	(39)	$ (0.97)	$ (0.51)	$ (0.46)	90

Three Months Ended September 30, 2009 versus Three Months Ended September 30, 2008

Consolidated revenues for the third quarter of 2009 were $765.4 compared to $676.2 in the prior year. Growth in revenues from HR Management and Customer Management was offset by revenue declines at Information Management. As described more fully under the HR Management section on page 29, revenue for the three months ended September 30, 2009 includes $106.3 of previously deferred implementation revenue recognized in the third quarter of 2009 related to one of the large HR Management contracts. Operating loss for the third quarter of 2009 was $90.3 compared to operating loss of $242.0 in the prior year. As described more fully under the HR Management section, operating loss for the three months ended September 30, 2009 and 2008 include implementation-related and asset impairment charges of $224.6 and $272.9, respectively. The implementation-related and impairment charges noted above that were recorded both during 2009 and 2008 primarily relate to two large HR Management related contracts. Operating results for the three months ended September 30, 2009 also included restructuring charges of $12.8 mostly to align costs to future growth.

As a percentage of revenues, the cost of providing services and products sold was 73.0% compared to 75.4% during the corresponding period last year, largely due to the HR Management implementation revenue and charges. These charges are described more fully under the HR Management section. Selling, general, and administrative expenses of $156.6 increased 4% from the third quarter of 2008. The increase was due to higher selling, general, and administrative expenses at Customer Management, primarily reflecting higher sales and marketing costs to service the expanded client base and extensive global channel partnerships obtained through the Intervoice acquisition. The 24% increase in research and development costs primarily reflects our investments in the automated self-care and technology solutions particularly related to the acquired Intervoice platforms. Compared to the prior year, the $3.0 decrease in amortization expense reflects costs incurred within the Information Management segment in the third quarter of 2008 to write-off certain customer relationship assets. As noted under the heading, Restructuring Charges, we recorded a restructuring charge of $12.8 during the third quarter of 2009 mostly related to the realignment of resources to expected revenue growth.

During the third quarter of 2009, we recorded equity income in the Cellular Partnerships of $10.2 compared to equity income of $7.7 in the prior year. Interest expense of $7.4 increased from $5.5 in the prior year reflecting a higher level of debt outstanding throughout the third quarter of 2009 compared to the third quarter of 2008. The $10.2 decrease in other income (expense), net, was due to a foreign exchange loss in the current year and a $6.0 gain on the termination of treasury lock derivative instruments recorded in the third quarter 2008. Our effective tax benefit rate was 2.4% for the three months ended September 30, 2009 compared to an effective tax benefit rate 39.2% in the same period last year.

The low tax benefit rate for the three months ended September 30, 2009 is due to the geographic mix of the HR Management-related charges and income.

As a result of the foregoing, third quarter 2009 net loss and loss per diluted share were $86.0 and $0.70, respectively, compared with net loss and loss per diluted share of $140.0 and $1.15, respectively, in the third quarter of 2008.

Nine Months Ended September 30, 2009 versus Nine Months Ended September 30, 2008

Consolidated revenues for the first nine months of 2009 were $2,142.8 compared to $2,082.1 in the prior year period. Growth in revenues from HR Management and Customer Management was offset by revenue declines at Information Management. As described more fully under the HR Management section, revenue for the first nine months of 2009 includes $106.3 of previously deferred implementation revenue recognized in the third quarter of 2009 related to one of the large HR Management contracts. Operating loss for the first nine months of 2009 was $122.6 compared to an operating loss of $155.7 in the prior year period. As described more fully under the HR Management section, operating loss for the nine months ended September 30, 2009 and 2008 include implementation-related and asset impairment charges of $354.2 and $272.9, respectively. The implementation-related and impairment charges noted above primarily related to two large HR Management contracts.

As a percentage of revenues, the cost of providing services and products sold was 70.3% compared to 69.2% during the corresponding period last year, largely due to the HR Management accelerated implementation revenue and charges. These charges are described more fully under the HR Management section above. Selling, general, and administrative expenses of $478.4 increased 9% compared to the first nine months of 2008. The increase was due to higher selling, general, and administrative expenses at Customer Management, primarily reflecting higher sales and marketing costs to service the expanded client base and extensive global channel partnerships obtained through the Intervoice acquisition. The 56% increase in research and development costs reflects our investments in the automated self-care and technology solutions particularly related to Intervoice platforms and our focused increased spending at Information Management on strategic initiatives to enhance the functionality of our business support system and operational support system offerings. Compared to the prior year, the $3.8 increase in depreciation expense reflects assets that were added due to the Intervoice acquisition during the third quarter of 2008 that were partially offset by decreases at Information Management due to assets that were fully depreciated. As noted under the heading Restructuring Charges, we recorded a restructuring charge of $12.8 during the third quarter of 2009 mostly related to the realignment of resources to expected revenue growth. Restructuring charges of $14.1 were recorded during the first quarter of 2008 to align resources to future business needs and to shift the geographic mix of certain resources.

During the first nine months of 2009, we recorded equity income in the Cellular Partnerships of $31.7 compared to equity income of $25.8 in the prior year period. The $18.1 decrease in other income (expense), net, was due to a foreign exchange loss in the current year and a $6.0 gain on the termination of treasury lock derivative instruments recorded in the third quarter 2008. Interest expense of $21.1 increased from $13.3 in the prior year period primarily reflecting a higher level of debt due to the Intervoice acquisition. Our effective tax benefit rate was 2.9% for the nine months ended September 30, 2009 compared to an effective tax benefit rate of 53.1% in the same period last year. The low tax benefit rate for the first nine months of 2009 is due to the geographic mix of the HR Management-related charges and income.

As a result of the foregoing, net loss and loss per diluted share for the first nine months of 2009 were $118.9 and $0.97, respectively, compared with a net loss and loss per diluted share of $63.6 and $0.51, respectively, in the first nine months of 2008.

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CUSTOMER MANAGEMENT

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009	**2008**	**Change**	**%**	**2009**	**2008**	**Change**	**%**
Revenues:								
Communications	$ 296.4	$ 285.4	$ 11.0	4	$ 891.2	$ 837.4	$ 53.8	6
Technology	36.8	41.8	(5.0)	(12)	117.0	118.6	(1.6)	(1)
Financial services	71.9	61.8	10.1	16	223.6	180.3	43.3	24
Other	86.5	94.2	(7.7)	(8)	271.3	291.9	(20.6)	(7)
Total revenues	491.6	483.2	8.4	2	1,503.1	1,428.2	74.9	5
Cost of providing services and products sold	305.2	325.6	(20.4)	(6)	935.1	974.6	(39.5)	(4)
Selling, general and administrative	125.1	115.5	9.6	8	380.8	333.2	47.6	14
Research and development costs	5.5	2.4	3.1		16.9	4.3	12.6	
Depreciation	16.8	15.0	1.8	12	50.5	43.7	6.8	16
Amortization	2.0	1.4	0.6	43	5.6	2.4	3.2	
Restructuring charges	3.5		3.5		3.5	5.4	(1.9)	(35)
Total costs and expenses	458.1	459.9	(1.8)		1,392.4	1,363.6	28.8	2
Operating Income	$ 33.5	$ 23.3	$ 10.2	44	$ 110.7	$ 64.6	$ 46.1	71
Operating Margin	6.8%	4.8%			7.4%	4.5%		

Three Months Ended September 30, 2009 versus Three Months Ended September 30, 2008

Revenues

Customer Management revenues for the third quarter of 2009 were $491.6, a 2% increase from the third quarter of 2008. This included $41.9 in revenue from Intervoice compared to $14.2 in Intervoice revenue for the third quarter of 2008 from the acquisition that closed on September 3, 2008. The increase in revenues from the Intervoice acquisition was partially offset by a decline in agent-related call volumes.

Revenues from the communications vertical increased 4% from the third quarter of 2008, primarily reflecting growth from the Intervoice acquisition. Revenues from the technology vertical decreased 12% compared to the three months ended September 30, 2008, largely reflecting volume declines from two customers. Revenues from the financial services vertical increased 16% from the third quarter of 2008, primarily reflecting growth from the Intervoice acquisition. Other revenues, which are comprised of clients outside of Customer Management s three largest verticals, decreased 8% from the third quarter of 2008, reflecting declines in revenues from several retail and manufacturing clients that were partially offset by growth from the Intervoice acquisition.

Costs and Expenses

Customer Management total costs and expenses of $458.1 were relatively flat compared to the prior year period. Customer Management cost of providing services and products sold during the third quarter of 2009 decreased 6% to $305.2 from the third quarter of 2008. As a percentage of revenues, cost of providing services and products sold was 62.1%, down 530 basis points from 67.4% in the prior year period, due to effective live-agent workforce management, as well as positive contribution from the Intervoice acquisition. Selling, general and administrative expenses of $125.1 in the third quarter of 2009 increased 8% compared to the prior year period. This largely reflects higher sales and marketing costs to service the expanded client base and extensive global channel partnerships obtained through the Intervoice acquisition. As a percentage of revenues, selling, general and administrative expenses were 25.4% in the third quarter of 2009 compared to 23.9% in the same period last year. The $3.1 increase in research and development costs reflects our investments in the automated self-care and technology solutions related to the acquired Intervoice platforms. Compared to the prior year period, the $1.8 increase in depreciation expense reflects assets that were added due to the Intervoice acquisition during the third quarter of 2008. As noted under the heading, Restructuring Charges, we recorded a restructuring charge of $3.5 during the third quarter of 2009 to align costs to expected future revenue growth.

Operating Income

As a result of the foregoing, Customer Management third quarter 2009 operating income and margin were $33.5 and 6.8%, respectively, compared to $23.3 and 4.8%, respectively, in the third quarter of 2008.

Nine Months Ended September 30, 2009 versus Nine Months Ended September 30, 2008

Revenues

Customer Management revenues were $1,503.1, a 5% increase from the first nine months of 2008. Revenues from the communications vertical increased 6% from the first nine months of 2008, largely reflecting growth from the Intervoice acquisition. Revenues from the financial services vertical increased 24%, reflecting growth both from the Intervoice acquisition as well as from new collection programs in the current year. Other revenues, which are comprised of clients outside of Customer Management s three largest industries, decreased 7% from the first nine months of 2008. A decline in revenues from several retail clients as a result of the softness in the current economic environment were partially offset by growth from the Intervoice acquisition.

Costs and Expenses

Customer Management total costs and expenses were $1,392.4, a 2% increase from the first nine months of 2008. Customer Management cost of providing services and products sold during the first nine months of 2009 decreased 4% to $935.1 from the first nine months of 2008. As a percentage of revenues, cost of providing services and products sold was 62.2%, down 600 basis points from 68.2% in the prior year period, due to effective live-agent workforce management, as well as positive contribution from the Intervoice acquisition. Selling, general and administrative expenses of $380.8 in the first nine months of 2009 increased 14% compared to the prior year. This largely reflects higher sales and marketing costs to service the expanded client base and extensive global channel partnerships obtained through the Intervoice acquisition. As a percentage of revenues, selling, general and administrative expenses were 25.3% in the first nine months of 2009 compared to 23.3% in the same period last year. The $12.6 increase in research and development costs reflects our investments in the automated self-care and technology solutions related to the acquired Intervoice platforms. Compared to the prior year period, the $6.8 and $3.2 increase in depreciation and amortization expense, respectively, largely reflects assets that were added due to the Intervoice acquisition during the third quarter of 2008. As noted under the heading Restructuring Charges, we recorded restructuring charges of $3.5 in the third quarter of 2009 and $5.4 during the first quarter of 2008 to better align cost structure to future business needs.

Operating Income

As a result of the foregoing, Customer Management first nine months of 2009 operating income and margin were $110.7 and 7.4%, respectively, compared to $64.6 and 4.5%, respectively, in the first nine months of 2008.

INFORMATION MANAGEMENT

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009	2008	Change	%	2009	2008	Change	%
Revenues:								
Data processing	$ 24.2	$ 28.4	$ (4.2)	(15)	$ 93.4	$ 108.0	$ (14.6)	(14)
Professional and consulting	38.7	49.8	(11.1)	(22)	117.3	174.7	(57.4)	(33)
License and other	36.3	55.4	(19.1)	(34)	111.2	175.2	(64.0)	(37)
Total revenues	99.2	133.6	(34.4)	(26)	321.9	457.9	(136.0)	(30)
Cost of providing services and products sold	50.9	69.5	(18.6)	(27)	165.5	243.6	(78.1)	(32)
Selling, general and administrative	19.6	23.3	(3.7)	(16)	56.1	62.0	(5.9)	(10)
Research and development costs	13.2	12.8	0.4	3	41.3	33.2	8.1	24
Depreciation	5.7	6.6	(0.9)	(14)	17.7	21.7	(4.0)	(18)
Amortization	0.9	4.0	(3.1)	(78)	2.9	5.7	(2.8)	(49)
Restructuring charges	5.6		5.6		5.6	6.9	(1.3)	(19)
Total costs and expenses	95.9	116.2	(20.3)	(17)	289.1	373.1	(84.0)	(23)
Operating Income	$ 3.3	$ 17.4	$ (14.1)	(81)	$ 32.8	$ 84.8	$ (52.0)	(61)
Operating Margin	3.3%	13.0%			10.2%	18.5%		

Three Months Ended September 30, 2009 versus Three Months Ended September 30, 2008

Revenues

Information Management revenues of $99.2 during the third quarter of 2009 were down 26% compared to the corresponding period last year due to North American client migrations and international project completions.

Data processing revenues of $24.2 decreased 15% from the corresponding period last year reflecting North American client migrations partially offset by revenues from a new client. Compared to the prior year period, professional and consulting revenues of $38.7 decreased 22% from the corresponding period last year, largely reflecting international project completions and reduction in services resulting from client migrations. License and other revenues decreased 34% to $36.3, due to international project completions. In addition, prior year included one-time termination revenue of $10.0 from a North American client.

Revenues from Sprint Nextel were down 96%, or approximately $7, in the third quarter of 2009 compared to the corresponding period last year. We expect revenues from Sprint Nextel to be down by approximately $50 for 2009, compared to 2008.

Costs and Expenses

Information Management total costs and expenses were $95.9, a 17% decline from the third quarter of 2008. Compared to prior year, Information Management cost of providing services and products sold during the third quarter of 2009 decreased 27% to $50.9. As a percentage of revenues, cost of providing services and products sold was 51.3% in the third quarter of 2009, down from 52.0% in the third quarter of 2008. Selling, general and administrative expenses of $19.6 in the third quarter of 2009 decreased 16% or approximately $4 compared to the prior year period, primarily due to higher pension-related costs in the third quarter of 2008. As a percentage of revenues, selling, general and administrative expenses were 19.8% in the third quarter of 2009, compared to 17.4% in the prior year period, largely due to revenue declines. Compared to the third quarter of 2008, the $3.1 decrease in amortization expense reflects $3.0 of costs incurred in the third quarter of 2008 to write-off certain customer relationship assets. As noted under the heading, Restructuring Charges, we recorded restructuring charges of $5.6 in the third quarter of 2009 related to additional lease rental accruals for a property closed in 2007, shifting of the geographic mix of our resources and streamlining of operations.

Operating Income

As a result of the foregoing, Information Management operating income and operating margin during the third quarter of 2009 were $3.3 and 3.3%, respectively, compared with $17.4 and 13.0%, respectively, during the third quarter of 2008.

Nine Months Ended September 30, 2009 versus Nine Months Ended September 30, 2008

Revenues

Information Management revenues of $321.9 during the first nine months of 2009 were down 30% compared to the corresponding period last year due to North American client migrations and international project completions partially offset by revenues from a new client.

Data processing revenues of $93.4 decreased 14% from the corresponding period last year reflecting North American client migrations partially offset by revenues from a new client. Compared to the prior year period, professional and consulting revenues of $117.3 decreased 33% from the corresponding period last year, reflecting international project completions and reduction in services resulting from client migrations. License and other revenues decreased 37% to $111.2. This reduction is partially due to client migrations and international project completions. In addition, prior year license and other revenues included a large amount of termination revenue from client migrations.

Revenues from Sprint Nextel were down 85%, or approximately $48, in the first nine months of 2009 compared to the corresponding period last year. We expect revenues from Sprint Nextel to be down by approximately $50 for 2009, compared to 2008.

Costs and Expenses

Information Management total costs and expenses were $289.1, a 23% decline from the first nine months of 2008. Compared to prior year, Information Management cost of providing services and products sold during the first nine months of 2009 decreased 32% to $165.5. As a percentage of revenues, cost of providing services and products sold in the first nine months of 2009 was 51.4%, down from 53.2% in the corresponding period last year. Selling, general and administrative expenses of $56.1 in the first nine months of 2009 decreased 10% or approximately $6 compared to the prior year, primarily due to higher pension-related costs in the third quarter of 2008. As a percentage of revenues, selling, general and administrative expenses were 17.4% in the first nine months of 2009, compared to 13.5% in the prior year period, largely due to revenue declines. The 24% increase in research and development costs reflects our focused increased spending at Information Management on strategic initiatives to enhance the functionality of our business support system and operational support system offerings. The $4.0 decrease in depreciation expense for the first nine months of 2009 compared to the first nine months of 2008 is mostly the result of fully depreciated assets. As discussed above, the $2.8 decrease in amortization expense year over year primarily reflects $3.0 of costs incurred in the third quarter of 2008 to write-off certain customer relationship assets. As noted under the heading, Restructuring Charges, results for the nine months of 2009 included $5.6 of restructuring charges related to additional lease rental accruals for a property closed in 2007, shifting of the geographic mix of our resources and streamlining operations. Prior year results included $6.9 of restructuring charges to streamline operations and reduce headcount.

Operating Income

As a result of the foregoing, Information Management operating income and operating margin during the first nine months of 2009 were $32.8 and 10.2%, respectively, compared with $84.8 and 18.5%, respectively, during the first nine months of 2008.

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HR MANAGEMENT

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009	2008	Change	%	2009	2008	Change	%
Revenues:	$ 174.6	$ 59.4	$ 115.2		$ 317.8	$ 196.0	$ 121.8	62
Cost of providing services and products sold	202.4	115.0	87.4	76	406.7	223.5	183.2	82
Selling, general and administrative	15.1	13.7	1.4	10	44.9	43.8	1.1	3
Depreciation	2.1	2.4	(0.3)	(13)	7.0	6.5	0.5	8
Amortization	0.1	0.6	(0.5)	(83)	0.7	1.8	(1.1)	(61)
Restructuring charges	3.7		3.7		3.7	1.8	1.9	
Asset impairment	76.1	207.5	(131.4)	(63)	108.6	207.5	(98.9)	(48)
Total costs and expenses	299.5	339.2	(39.7)	(12)	571.6	484.9	86.7	18
Operating Loss	$ (124.9)	$ (279.8)	$ 154.9	(55)	$ (253.8)	$ (288.9)	$ 35.1	(12)

Three Months Ended September 30, 2009 versus Three Months Ended September 30, 2008

Revenues

HR Management revenues in the third quarter of 2009 were $174.6, a $115.2 increase from the third quarter of 2008. This increase mostly reflects $106.3 of accelerated implementation revenue recognized in the third quarter of 2009 related to one of the large HR Management contracts that was restructured as discussed in more detail below and revenue growth from services in operation with two large HR Management contracts.

Costs and Expenses

The Company has restructured one of the large HR Management contracts to terminate future implementation obligations related to services not already live and continue providing services already live in operation. As a result, during the third quarter of 2009, all of the remaining capitalized implementation costs related to this contract were written off and a portion of implementation revenue referenced above was recognized. During the three months ended September 30, 2009, the Company recorded implementation and impairment charges of $224.6 related to one large contract of which (a) $148.5 was recorded within the cost of providing services and products sold caption representing previously deferred implementation costs incurred for services not yet operational and (b) $76.1 was reported as asset impairment primarily related to previously deferred costs pertaining to services already operational that were projected to no longer be profitable at September 30, 2009. After the write-off, this contract is expected to be profitable over its remaining contract term. During the third quarter of 2008, the Company recorded $272.9 of impairment and implementation charges, of which $207.5 was reported as asset impairment and $65.4 was reported within the cost of providing services and products sold and was due to expensing of implementation costs that exceeded the termination for convenience fees for a contract at September 30, 2008. See HR Management section on page 21 for additional discussions related to the status of these two large HR Management clients.

HR Management cost of providing services and products sold during the third quarter of 2009 increased to $202.4 from $115.0 in the third quarter of 2008. As noted above, cost of providing services and products sold caption for both the three months ended September 2009 and 2008 included implementation-related charges of $148.5 and $65.4, respectively. Selling, general and administrative expenses of $15.1 in the third quarter of 2009 increased 10%, or $1.4 compared to the prior year period. As noted under the heading, Restructuring Charges, we recorded a restructuring charge of $3.7 during the third quarter of 2009 to better align staffing levels to expected revenues.

Operating Income

As a result of the foregoing, HR Management three months ended September 30, 2009 operating loss was $124.9 compared to $279.8 in the same period last year.

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Nine Months Ended September 30, 2009 versus Nine Months Ended September 30, 2008

Revenues

HR Management revenues in the first nine months of 2009 were $317.8, a 62% increase from the first nine months of 2008. This increase reflects $106.3 related to the accelerated recognition of previously received implementation revenue in the third quarter of 2009 related to one of the large HR Management contracts as discussed in more detail above and revenue growth from services already in operation with two large HR Management contracts.

Costs and Expenses

During the nine months ended September 30, 2009 and 2008, the Company recorded implementation-related and impairment charges of $354.2 and $272.9, respectively. These charges that were recorded both during 2009 and 2008, primarily related to two large HR Management contracts. We have restructured one of the large HR Management contracts to terminate future implementation obligations related to services not already live and to continue providing services already live in operation. We are actively negotiating on the other large contract with the client to change the scope and other terms of the contract. The implementation for this project is on hold at this time. The nine months ended September 30, 2009 charge of $354.2 includes (a) $245.6 recorded within the cost of providing services and products sold caption representing $148.5 of previously deferred implementation costs incurred for services not yet operational that were written off during the third quarter of 2009 as noted above and $97.1 that was recorded during the first half of 2009 and related to the two large HR Management contracts and (b) $108.6 reported as asset impairment representing impairment of previously deferred costs related to the two large HR Management contracts. During the nine months ended September 30, 2008, the Company recorded $272.9 of impairment and implementation charges, of which $207.5 was reported as asset impairment and $65.4 was reported within the cost of providing services and products sold and was due to expensing of implementation costs that exceeded the termination for convenience fees for a contract at September 30, 2008. See HR Management section on page 21 for additional discussions related to the status of these client contracts.

HR Management cost of providing services and products sold for the first nine months of 2009 increased to $406.7 from $223.5 for the first nine months of 2008. As noted above, the cost of providing services and products sold for both the nine months ended September 2009 and 2008 include implementation-related charges of $245.6 and $65.4, respectively. Selling, general and administrative expenses of $44.9 for the first nine months of 2009 increased 3%, or $1.1 compared to the prior year. The 61% or $1.1 decline in amortization expenses is due to full amortization of certain intangible assets during the nine months ended September 30, 2009, resulting in a lower amortization expense as compared to the prior year period. As noted under the heading, Restructuring Charges, we recorded restructuring charges of $3.7 in the third quarter of 2009 and $1.8 during the first quarter of 2008 to better align staffing levels to expected revenues.

Operating Income

As a result of the foregoing, HR Management nine months ended September 30, 2009 operating loss was $253.8 compared to $288.9 in the same period last year.

RESTRUCTURING CHARGES

As discussed in Note 4 to Notes to Consolidated Financial Statements, we recorded the following restructuring charges:

2009 Restructuring

During the third quarter of 2009, the Company initiated a restructuring plan. The total charge of $12.8 included $9.7 of severance-related charges and $3.1 of facility-related charges. The $9.7 of severance-related charges were comprised of $3.7 at HR Management, related to terminating employees across the globe in order to align resources to expected future revenue, $3.5 of severance at Customer Management, largely resulting from an unexpected reduction in the size of one international program, and $2.5 at Information Management related to shifting the geographic mix of certain resources and further streamlining of operations. The severance charge of $9.7 will largely be paid in cash pursuant to the Company s existing severance policy and employment agreements. These actions will affect approximately 300 professional and administrative employees worldwide and are expected to be mostly completed by the end of 2009.

	2009
Severance charge	$ 9.7
Severance payments	(0.6)
Balance at September 30	$ 9.1

The $3.1 facility-related charge at Information Management relates to additional lease rent accruals for a property that was closed during 2007. The charge is equal to the future costs associated with the facility, net of proceeds from any probable future sublease agreements. We used estimates, based on consultation with our real estate advisors, to arrive at the proceeds from any future sublease agreements. We will continue to evaluate this estimate in recording the facilities abandonment charge. Consequently there may be additional reversals or charges relating to this facility closure in the future. At September 30, 2009, this restructuring reserve had an outstanding balance of $3.4, which will be paid over several years until the lease expires.

2008 Restructuring

As discussed more fully in the Restructuring section of the Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, the Company initiated restructuring plans both in the first and fourth quarters of 2008. Restructuring liability activity for the 2008 plans consisted of the following:

	2009	2008
Balance at January 1	$ 22.1	$
Severance charge		14.1
Severance payments	(20.2)	(9.2)
Balance at September 30	$ 1.9	$ 4.9

These actions are expected to be completed during 2009.

CLIENT CONCENTRATION

For purposes of disclosing our client concentration, we are excluding the implementation revenue from an HR Management client. See the HR Management section on page 21 for more discussion related to the implementation revenue recognized in the third quarter of 2009. As the $106.3 of accelerated recognition of implementation revenue from this client is non-recurring, we will provide client concentration details excluding this revenue. During the first nine months of 2009, our three largest clients, accounted for 34.8% of our revenues, compared to 32.1% in the same period of 2008. We serve AT&T, our largest client with 20.7% of revenues in the first nine months of 2009, under Customer Management and Information Management contracts. We serve DirecTV and Comcast Corporation, our second and third largest clients, under Customer Management contracts. 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 are projecting fourth quarter 2009 revenue of approximately $650 to $670. As described in the HR Management section on page 21, we have restructured one large contract and implementation related to the other large client is on hold at this time. At this time, we are unable to estimate either the timing or the net impact these contract restructurings could have to our financial statements. In addition, there is the potential for restructuring expense to further streamline the business during the fourth quarter of 2009 and we are unable to estimate the amount of these charges as we are in the process of determining them. Therefore, we will provide fourth quarter 2009 guidance on a non-GAAP basis excluding the impact of potential HR Management charges, if any, and restructuring charges. Fourth quarter 2009 non-GAAP earnings are projected to be more than $0.30 per diluted share, due in part to an expected favorable tax benefit in the fourth quarter of 2009.

We expect 2009 free cash flow of $165 to $185. In addition, we expect approximately $40 cash flow from the Cellular Partnership that is not included in the 2009 free cash flow.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Cash Flows

We believe that Convergys has adequate liquidity from cash and expected future cash flows to fund ongoing operations, invest in the business and make required debt payments. The Company s free cash flow, defined as cash flow from operating activities less capital expenditures (net of proceeds related to disposals) was $131.9 for the first nine months of 2009, and we currently expect the full year 2009 free cash flow to be between $165 and $185, which is significantly higher than the 2008 free cash flow of $100. In addition, we expect approximately $40 cash flow from the Cellular Partnership that is not included in the estimated 2009 free cash flow above.

Cash flow from operating activities generally provides us with a significant source of funding for our investing and financing activities. Cash flow from operating activities totaled $191.7 in the first nine months of 2009, compared to $68.3 in the same period last year. The $123.4 increase in cash flow from operations was largely driven by improvement in our accounts receivable collections, a decrease of approximately $46 in net deferred charges (implementation costs less implementation revenue paid by the clients, and the related amortization of deferred cost and revenue is described as net deferred charges). Days sales outstanding decreased to 61 days at September 30, 2009, versus 77 days at September 30, 2008. This performance measure is computed as follows: receivables, net of allowances, divided by average daily revenue.

We used $33.3 for investing activities during the first nine months of 2009 compared to $339.0 during the first nine months of 2008. The $305.7 decrease in amounts used in investing activities during the first nine months of 2009 was mainly due to completion of the Intervoice acquisition during the third quarter of 2008. During the nine months ended September 30, 2008 we paid $307.8 for the acquisition of Intervoice in the Customer Management segment and two other small acquisitions in the Information Management segment.

Cash flow used for financing activities was $62.1 during the first nine months of 2009 compared to an inflow of $286.7 during the first nine months of 2008. Financing activities during the first nine months of 2009 included retirement of $58.2 of our 4.875% Senior Notes due in December 2009. We made no share repurchases during the first nine months of 2009 compared to repurchases of 7.7 million of the Company s shares for $116.6 during the first nine months of 2008. In addition, during the third quarter of 2008, we borrowed the entire amount available under our $400 Five-Year Competitive Advance and Revolving Credit Facility to fund our acquisition of Intervoice that closed on September 3, 2008.

During 2008, both Moody s and Standard and Poor s downgraded our credit ratings, and our debt is no longer considered investment grade by either agency. As of September 30, 2009, our credit ratings and outlook are as follows:

	Long-Term Debt	Outlook
Moody s	Ba1	Negative
Standard and Poor s	BB+	Negative

The changes in credit ratings had no material impact on the interest costs of our outstanding debt. However, our credit rating and outlook could impact our ability to raise capital in the future as well as increase borrowing costs.

The Company s free cash flows, defined as cash flow from operating activities less capital expenditures (net of proceeds related to disposals) were $131.9 and $4.4 for the first nine months of 2009 and 2008, respectively. Compared to the prior year, the increase in free cash flow of $127.5 was due to a higher amount of cash generated from operating activities during the first nine months of 2009 as discussed above. The Company uses free cash flow to assess the financial performance of the Company. The Company believes that free cash flow is useful to investors because it relates the operating cash flow of the Company to the capital that is spent to continue and improve business operations, such as investment in the Company s existing businesses. Further, free cash flow facilitates management s ability to strengthen the Company s Balance Sheet, to repurchase the Company s common shares and to repay the Company s debt obligations. Limitations associated with the use of free cash flow include that it does not represent the residual cash flow available for discretionary expenditures as it does not incorporate certain cash payments including payments made on capital lease obligations or cash payments for business acquisitions. Management compensates for these limitations by utilizing both the non-GAAP measure, free cash flow, and the GAAP measure, cash from operating activities, in its evaluation of performance. There are no material purposes for which we use this non-GAAP measure beyond the purposes described above.

Capital Resources, Off-Balance Sheet Arrangements and Contractual Commitments

We believe that our financial structure and condition are solid. At September 30, 2009, total capitalization was $1,704.8, consisting of $603.9 of short-term and long-term debt and $1,100.9 of equity. This results in a total debt-to-total capital ratio of 35.4% at September 30, 2009, compared to 36.7% at December 31, 2008.

We have borrowed the entire amount available under our $400 Five-Year Competitive Advance and Revolving Credit Facility. This borrowing was mainly to fund our acquisition of Intervoice that closed on September 3, 2008. The maturity date of the Revolving Credit Facility Agreement is October 20, 2011. The participating agents in the credit facility include JPMorgan Chase Bank, Citicorp USA, PNC Bank and Deutsche Bank AG. The Company s credit facility includes certain restrictive covenants including maintenance of interest coverage and debt-to-EBITDA ratios. Our interest coverage ratio, defined as the ratio of consolidated earnings before interest, tax, depreciation and amortization (EBITDA) to consolidated interest expense, cannot be less than 4.00 to 1.00 for four consecutive quarters. Our debt-to-EBITDA ratio cannot be greater than 3.25 to 1.0 at any time. We were in compliance with all covenants at September 30, 2009.

In December 2004, the Company issued $250.0 in 4.875% Unsecured Senior Notes due December 15, 2009. The notes were offered and sold pursuant to a universal shelf registration statement, previously declared effective in June 2003. During the first nine months of 2009, we retired $58.2 of the outstanding debt. At September 30, 2009 and December 31, 2008, the senior notes had an outstanding balance of $192.6 and $249.8, respectively. See Note 17 for a description of an exchange offer completed related to the senior notes.

We lease certain facilities and equipment used in 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 Wells Fargo & Company, 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 $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, Convergys is entitled to collect the excess. As of September 30, 2009, we have recognized a liability of approximately $12 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. Convergys does not expect such amounts, if any, to be material. The Company has concluded that we are not required to consolidate the Lessor pursuant to authoritative guidance for the consolidation of variable interest entities included within FASB Topic 810, *Consolidation*, in the ASC.

We did not repurchase any shares during the first nine months of 2009. We repurchased 7.7 million shares for $116.6 during the first nine months of 2008 pursuant to outstanding authorizations. The timing and terms of any future transactions depend on a number of considerations including market conditions and our liquidity. At September 30, 2009, the Company has the authority to repurchase an additional 7.1 million common shares.

At September 30, 2009, we had outstanding letters of credit of approximately $45 and other bond obligations of approximately $41 related to performance and payment guarantees. We do not believe that any obligation that may arise will be material.

Historically, the Company believed that its ability to borrow was greater than its established credit facilities in place. Due to current financial and credit market conditions, we believe that there is only limited ability to borrow additional funds. At September 30, 2009, we had cash of $336.3 and $125 available under the accounts receivable securitization facility that was established on June 30, 2009.

The majority of the liability for unrecognized tax benefits under FASB Topic 720, *Income Taxes* in the ASC of $67.3 at September 30, 2009 is expected to be settled within a three-year period.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to a variety of market risks, including the effects of changes in foreign currency exchange rates and interest rates. Market risk is the potential loss arising from adverse changes in market rates and prices. Our risk management strategy includes the use of derivative instruments to reduce the effects on our operating results and cash flows from fluctuations caused by volatility in currency exchange and interest rates. In using derivative financial instruments to hedge exposures to changes in exchange rates and interest rates, we expose ourselves to counterparty credit risk. We manage exposure to counterparty credit risk by entering into derivative financial instruments with highly-rated institutions that can be expected to perform fully under the terms of the agreements and by diversifying the number of financial institutions with which we enter into such agreements.

Interest Rate Risk

At September 30, 2009, we had $411.2 in outstanding variable rate borrowings. The carrying amount of our borrowings reflects fair value due to their short-term and variable interest rate features. Based upon our exposure to variable rate borrowings, a one percentage point change in the weighted average interest rate would change our annual interest expense by approximately $4.

We sometimes use interest rate swaps to hedge our interest rate exposure. These instruments are hedges of the variability of cash flows to be received or paid related to a recognized asset or liability. These contracts are entered into to protect against the risk that the eventual cash flows resulting from such transactions will be adversely affected by changes in interest rates. There were no outstanding interest rate swaps covering interest rate exposure at September 30, 2009.

Foreign Currency Exchange Rate Risk

Our Company serves many of our U.S.-based clients using contact center capacity in Canada, India and the Philippines. Although the contracts with these clients are typically priced in U.S. dollars, a substantial portion of the costs incurred to render services under these contracts are denominated in Canadian dollars (CAD), Philippine pesos (PHP) or Indian rupees (INR), which represents a foreign exchange exposure. As of September 30, 2009, we have hedged a portion of our exposure related to the anticipated cash flow requirements denominated in these foreign currencies by entering into forward contracts with several financial institutions to acquire a total of CAD 130.5 at a fixed price of $112.6 through December 2010, PHP 13,512.2 at a fixed price of $294.2 through September 2012 and INR 11,366.3 at a fixed price of $267.0 through June 2012. Additionally, we entered into option contracts to purchase approximately PHP 1,369.9 for a fixed price of $34.0 through June 2010. The fair value of these derivative instruments as of September 30, 2009 is presented in Note 15 of the Notes to Consolidated Financial Statements. The potential loss in fair value at September 30, 2009 for such contracts resulting from a hypothetical 10% adverse change in all foreign currency exchange rates is approximately $71. This loss would be mitigated by corresponding gains on the underlying exposures.

Other foreign currency exposures arise from transactions denominated in a currency other than the functional currency and foreign denominated revenue and profit translated into U.S. dollars. We periodically enter into forward exchange contracts that are not designated as hedges. The purpose of these derivative instruments is to protect the Company against foreign currency exposure pertaining to receivables and payables that are denominated in currencies different from the functional currencies of the Company or the respective subsidiaries. As of September 30, 2009, the fair value of these derivatives was a net payable of $1.1.

ITEM 4. CONTROLS AND PROCEDURES

The Company s Chief Executive Officer and Chief Financial Officer evaluated, together with the Company s General Counsel, Chief Accounting Officer and other key employees, the effectiveness of design and operation of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Act)) as of the end of the quarter ended September 30, 2009. Based on this evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this report such that the information required to be disclosed by the Company in the reports that it files or submits under the Act is accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure, and are effective to ensure that such information is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

There has been no change in the Company s internal control over financial reporting that occurred during the quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

Client consolidations could result in a loss of clients and adversely affect our operating results.

We serve clients in industries that have experienced a significant level of consolidation. We cannot assure that additional consolidations will not occur in which our clients acquire additional businesses or are acquired themselves. Such consolidations may result in the termination of an existing client contract, which could have an adverse effect on our operating results.

AT&T, our largest client, is in the process of migrating its subscribers from the legacy wireless billing system that we currently support through a managed services agreement onto AT&T s other wireless billing system. In addition, AT&T acquired several other Convergys clients. We anticipate the loss of revenue resulting from the AT&T related migrations to be approximately $30 in 2009 compared to our 2008 Information Management revenues and $40 in 2010 compared to our 2009 Information Management revenues. In September 2005, Sprint PCS, a large data processing outsourcing client, completed its acquisition of Nextel Communications. In 2006, Sprint Nextel informed us that it intended to consolidate its billing systems onto a competitor s system. The migration began in 2006 and was substantially completed by June 30, 2008. Revenues from Sprint Nextel were down approximately $48 for the first nine months of 2009 compared to the corresponding period last year. We expect revenue from Sprint Nextel to be down by approximately $50 for the full year 2009 compared to our 2008 Information Management revenues and down by approximately $10 in 2010 compared to our 2009 Information Management revenues.

A large portion of our revenue is generated from a limited number of clients in the communications industry, and the loss of one or more of our clients, or weakness in the communications industry, could cause a reduction in our revenues and earnings.

We rely on several clients for a large percentage of our revenues. Our three largest clients, as discussed under the header Client Concentration, collectively represented 34.8% of our revenues for the first nine months of 2009. Our relationship with AT&T is represented by separate contracts/work orders with Customer Management and Information Management. Our relationships with DirecTV and Comcast Corporation are represented by contracts under Customer Management. We do not believe that it is likely that our entire relationship with AT&T would terminate at one time; and, therefore, we are not substantially dependent on any particular contract/work order. However, the loss of all of the contracts/work orders with a particular client at the same time or the loss of one or more of the larger contracts/work orders with a client would adversely affect our total revenues if the revenues from such client were not replaced with revenues from that client or other clients. Our revenues and earnings would also be negatively impacted by general weakness or slowdown in the communications industry.

A large portion of our accounts receivable are payable by a limited number of clients and the inability of any of these clients to pay its accounts receivable could cause a reduction in our revenues and earnings.

Several significant clients account for a large percentage of our accounts receivable. As of September 30, 2009, our largest clients, AT&T, DirecTV and Comcast Corporation, collectively accounted for 31.5% of our accounts receivable. During the past four years, each of these clients has generally paid its accounts receivable on a timely basis, and write-downs that we have incurred in connection with such accounts receivable were consistent with write-downs that we incurred with other clients. We anticipate that several clients will continue to account for a large percentage of our accounts receivable. Although we currently do not expect payment issues with any of these clients, if any of them were unable or unwilling, for any reason, to pay our accounts receivable, our income would decrease. We have several important clients that are in industries, including automotive, that have been severely impacted by the current global economic slowdown. We also carry significant receivable balances with other clients whose declaration of bankruptcy could decrease our income. In addition, our income could be materially impacted by a number of small clients declaring bankruptcy in a short period of time.

If our clients are not successful, the amount of business that they outsource and the prices that they are willing to pay for such services may diminish and could result in a reduction of our revenues and earnings.

Our revenues depend on the success of our clients. If our clients or their specific programs are not successful, the amount of business that they outsource may be diminished. Thus, although we have signed contracts, many of which contain minimum revenue commitments, to provide services to our clients, there can be no assurance that the level of revenues generated by such contracts will meet expectations. This could result in stranded capacity and additional costs. In addition, we may face pricing pressure from clients, which could negatively affect our operating results. Revenues in most of our larger HR Management contracts are partially based on our clients headcount. Our revenues could be negatively impacted by headcount reductions and restructuring actions taken by our clients.

We process, transmit and store personally identifiable information and unauthorized access to or the unintended release of this information could result in a claim for damage or loss of business and create unfavorable publicity.

We process, transmit and store personally identifiable information, both in our role as a service provider and as an employer. This information may include social security numbers, financial and health information, as well as other personal information. As a result, we are subject to certain contractual terms, as well as federal, state and foreign laws and regulations designed to protect personally identifiable information. We take measures to protect against unauthorized access and to comply with these laws and regulations. We use the internet as a mechanism for delivering our services to clients, which may expose us to potential disruptive intrusions. Unauthorized access, system denials of service, or failure to comply with data privacy laws and regulations may subject us to contractual liability and damages, loss of business, damages from individual claimants, fines, penalties, criminal prosecution and unfavorable publicity, any of which could negatively affect our operating results and financial condition. In addition, third party vendors that we engage to perform services for us may have an unintended release of personally identifiable information.

The global scope, size and complexity of implementations in our HR Management business could cause delays and cost overruns in those projects, which could adversely affect our revenues, cash flows, profitability and Balance Sheet in a material manner.

Our large HR Management outsourcing contracts with global clients are complex as they involve providing multiple services such as payroll, recruiting, benefits administration, learning, compensation, talent management and human resources administration across many countries. Implementations of the contracts typically take a number of years to complete. Due to the complexity of the implementations and changes in customer requirements (e.g., an acquisition or disposition by a customer during the implementation or changes or developments in the customer s business), implementation cost overruns and delays are possible, especially on larger projects. Cost overruns can result in additional expense during the implementation period and over the life of the contract, which would likely affect the profitability of the contract and potentially result in charges and possibly dispute resolution proceedings. Delays in completing the implementations can cause us to recognize revenue and profit from the contracts later than we anticipated when the initial contract was signed. In addition, depending upon circumstances, restructuring contracts that have previously been entered into could impact their future profitability and result in significant charges.

Our ability to deliver our services is at risk if the technology and network equipment that we rely upon is not maintained or upgraded in a timely manner.

Technology is a critical foundation in our service delivery. We utilize and deploy internally developed and third party software solutions across various hardware environments. We operate an extensive internal voice and data network that links our global sites together in a multi-hub model that enables the rerouting of traffic. Also, we rely on multiple public communication channels for connectivity to our clients. Maintenance of and investment in these foundational components are critical to our success. If the reliability of technology or network operations falls below required service levels, or a systemic fault affects the organization broadly, business from our existing and potential clients may be jeopardized and cause our revenue to decrease.

Emergency interruption of data centers and Customer Management and HR Management contact centers could have a materially adverse effect on our results of operations and financial condition.

In the event that we experience a temporary or permanent interruption at one or more of our data or contact centers, through casualty, operating malfunction or other causes, we may be unable to provide the data processing, customer management and HR management services we are contractually obligated to deliver. This could result in us being required to pay contractual damages to some clients or to allow some clients to terminate or renegotiate their contracts. Notwithstanding disaster recovery and business continuity plans and precautions instituted to protect our clients and us from events that could interrupt delivery of services (including property and business interruption insurance that we maintain), there is no guarantee that such interruptions would not result in a prolonged interruption in our ability to provide support services to our clients or that such precautions would adequately compensate us for any losses we may incur as a result of such interruptions.

Defects or errors within our software could adversely affect our business and results of operations.

Design defects or software errors may delay software introductions or reduce the satisfaction level of clients and may have a materially adverse effect on our business and results of operations. Our software is highly complex and may, from time to time, contain design defects or software errors that may be difficult to detect and/or correct. Since both our clients and we use our software to perform critical business functions, design defects, software errors or other potential problems within or outside of our control may arise from the use of our software. It may also result in financial or other damages to our clients, for which we may be held responsible. Although our license agreements with our clients often contain provisions designed to limit our exposure to potential claims and liabilities arising from client problems, these provisions may not effectively protect us against such claims in all cases and in all jurisdictions. Claims and liabilities arising from client problems could result in monetary damages to us and could cause damage to our reputation, adversely affecting our business and results of operations.

If the global trend toward outsourcing does not continue, our financial condition and results of operations could be materially affected.

Revenue growth depends, in large part, on the trend toward outsourcing, particularly as it relates to our Customer Management and HR Management outsourcing operations. Outsourcing involves companies contracting with a third party, such as Convergys, to provide customer management and HR management services rather than performing such services in-house. There can be no assurance that this trend will continue, as organizations may elect to perform such services in-house. A significant change in this trend could have a materially adverse effect on our financial condition and results of operations.

We are susceptible to business and political risks from domestic and international operations that could result in reduced revenues or earnings.

We operate a global business and have facilities located throughout North and South America, Europe, the Middle East and the Asia Pacific region. As part of our strategy, we plan to capture more of the international BSS/OSS, customer management and HR management markets. Additionally, North American companies require offshore customer management outsourcing capacity. As a result, we expect to continue expansion through start-up operations and acquisitions in foreign countries. Expansion of our existing international operations and entry into additional countries will require management attention and financial resources. In addition, there are certain risks inherent in conducting business internationally including: exposure to currency fluctuations, longer payment cycles, greater difficulties in accounts receivable collection, difficulties in complying with a variety of foreign laws, changes in legal or regulatory requirements, difficulties in staffing and managing foreign operations, political instability and potentially adverse tax consequences. To the extent that we are adversely affected by these risks, our business could be adversely affected and our revenues and/or earnings could be reduced.

In addition, there has been political discussion and debate related to worldwide competitive sourcing, labor-related legislation and regulation, healthcare reform legislation and regulation and information-flow restrictions, particularly from the United States to offshore locations. Federal and state legislation and regulations have been proposed that relate to these issues. Future legislation and regulation, if enacted, could have an adverse effect on our results of operations and financial condition. In particular, proposed legislation, known as the Employee Free Choice Act, if enacted in its current form or a similar variation thereof, could make it easier for union organizing drives to be successful and could give third party arbitrators the ability to impose terms of collective bargaining upon both the Company and a labor union if the parties are unable to agree to the terms of a collective bargaining agreement within specified timelines.

Our earnings are affected by changes in foreign currency.

Customer Management serves an increasing number of its U.S.-based clients using contact center capacity in Canada, India and the Philippines. About one-half of our approximately 65,000 contact center employees are located outside the U.S. Although the contracts with these clients are typically priced in U.S. dollars, a substantial portion of the costs incurred by Customer Management to render services under these contracts is denominated in Canadian dollars, Indian rupees or Philippine pesos, which represents a foreign exchange exposure to the Company. We enter into forward exchange contracts and options to limit potential foreign currency exposure. As the U.S. dollar weakens, the operating expenses of these contact centers, translated into U.S. dollars, increase. The increase in operating expenses will be partially offset by gains realized through the settlement of the hedged instruments. As the derivative instruments that limit our potential foreign currency exposures are entered into over a period of several years, the overall impact to earnings will be determined by both the timing of the derivative instruments and the movement of the U.S. dollar. In addition to the impact on our operating expenses that support dollar-denominated Customer Management contracts, changes in foreign currency impact the results of our international business units that are located outside of North America.

If we do not effectively manage our capacity, our results of operations could be adversely affected.

Our ability to profit from the global trend toward outsourcing can be impacted by how effectively we manage our Customer Management and HR Management contact center capacity. In order to create the additional capacity necessary to accommodate new or expanded outsourcing projects, we may need to open new contact centers. The opening or expansion of a contact center may result, at least in the short term, in idle capacity until we fully implement the new or expanded program. Expanded use of home agents is helping to mitigate this risk. We periodically assess the expected long-term capacity utilization of our contact centers. As a result, we may, if deemed necessary, consolidate, close or partially close under-performing contact centers to maintain or improve targeted utilization and margins. There can be no guarantee that we will be able to achieve or maintain optimal utilization of our contact center capacity.

As part of our effort to consolidate our facilities, we seek to sublease a portion of our surplus space, if any, and recover certain costs associated with it. To the extent that we fail to sublease such surplus space, our expenses will increase.

If we are unable to hire or retain qualified personnel in certain areas of our business, our ability to execute our business plans in those areas could be impaired and revenues could decrease.

We employ approximately 75,000 employees worldwide. At times, we have experienced difficulties in hiring personnel with the desired levels of training or experience. Additionally, in regard to the labor-intensive business of Customer Management, quality service depends on our ability to retain employees and control personnel turnover. Any increase in the employee turnover rate could increase recruiting and training costs and could decrease operating effectiveness and productivity. We may not be able to continue to hire, train and retain a sufficient number of qualified personnel to adequately staff new client projects. Because a significant portion of our operating costs relates to labor costs, an increase in wages, costs of employee benefits or employment taxes could have a materially adverse effect on our business, results of operations or financial condition.

War and terrorist attacks or other civil disturbances could lead to economic weakness and could disrupt our operations resulting in a decrease of our revenues and earnings.

In the recent past, war and terrorist attacks have caused uncertainty in the global financial markets and economy. Additional attacks and wars could contribute to economic instability in the United States and disrupt our operations in the U.S. and abroad. Such disruptions could cause service interruptions or reduce the quality level of the services that we provide, resulting in a reduction of our revenues. These activities may also cause our clients to delay or defer decisions regarding their use of our services and, thus, delay receipt of additional revenues. In addition, war and terrorist attacks in other regions could disrupt our operations and/or create economic uncertainty with our clients, which could cause a reduction in revenues and earnings.

General economic and market conditions may adversely affect our financial condition, cash flow and results of operations.

Our results of operations are affected directly by the level of business activity of our clients, which in turn are affected by the level of economic activity in the industries and markets that they serve. Economic slowdowns in some markets, particularly in the United States, may cause lower call volumes and reductions in spending by our clients, which may result in reductions in the growth of new business as well as reductions in existing business. If our clients enter bankruptcy or liquidate their operations, our revenues could be adversely affected. There can be no assurance that weakening economic conditions throughout the world will not adversely impact our results of operations, cash flow and/or financial position. Further deterioration in equity markets will reduce the funded status of our pension plan, which will increase future required contributions. Reduced demand for our services could increase price competition.

We need to maintain adequate liquidity in order to have sufficient cash to meet operating cash flow requirements and to repay maturing debt and other obligations. If we fail to comply with the covenants contained in our various borrowing agreements, it may adversely affect our liquidity, results of operations and financial condition.

Our liquidity is a function of our ability to successfully generate cash flows from a combination of operations and access to capital markets. As of September 30, 2009, total cash and cash equivalents was $336.3. We believe our liquidity (including operating and other cash flows that we expect to generate) will be sufficient to meet operating requirements and required debt repayments as they occur; however, our ability to maintain sufficient liquidity going forward depends on our ability to generate cash from operations and access capital markets. As further described in the Capital Resources section of the Management Discussion and Analysis, our $400.0 revolving credit agreement contains certain restrictive covenants. At September 30, 2009, we were in compliance with all covenants in the agreements.

Our results of operations could be adversely affected by litigation and other commitments and contingencies.

We face risks arising from various unasserted and asserted litigation matters, including, but not limited to, labor, commercial, securities law and patent infringement claims. Unfavorable outcomes in pending litigation matters, or in future litigation, could negatively affect us. Aggressive plaintiffs counsel often file litigation on a wide variety of allegations, and even when the allegations are groundless, we may need to expend considerable funds and other resources to respond to and resolve such litigation.

In the ordinary course of business, we may make certain commitments, including representations, warranties and indemnities relating to current and past operations, including those related to acquired or divested businesses and issue guarantees of third party obligations.

If we were required to make payments as a result of any of these matters, they could exceed the amounts accrued, thereby adversely affecting our results of operations, cash flows, financial condition, or business.

Our failure to successfully integrate or acquire businesses could cause our business to suffer.

Our expansion and growth may be dependent in part on our ability to make acquisitions. The risks we face related to acquisitions include that we could overpay for acquired businesses, face integration challenges, have difficulty finding appropriate acquisition candidates, and any acquired business could significantly under-perform relative to our expectations. If acquisitions are not successfully integrated, our revenues and profitability could be adversely affected as well as adversely impact our reputation.

Our debt ratings are no longer considered investment grade.

In 2008, Moody s and Standard and Poor s both downgraded our debt ratings to below investment grade. This could impact our ability to raise capital in the future as well as increase borrowing costs. In addition, prospective clients and vendors may be less willing to do business with a provider with higher perceived credit risk or demand more onerous terms.

We may incur additional non-cash goodwill impairment charges in the future.

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, 2008, we are required to test goodwill for impairment annually as of October 1 and at other times if events have occurred or circumstances exist that indicates the carrying value of goodwill may no longer be recoverable. During 2008, we recorded a non-cash goodwill impairment charge of $61.1. There can be no assurances that we will not incur additional charges in the future, particularly in the event of a prolonged economic slowdown.

We sometimes rely on business partners to market, develop and deliver our solutions. Their failure to perform could negatively impact our financial results and harm our reputation in the marketplace.

We use third party business partners to assist in project implementations, to provide components of our solutions and to expand our ability to sell into new markets. Failure of third parties to perform in a timely manner could result in contractual or regulatory penalties, project delays or cost overruns as well as a failure to close new business.

An outbreak of swine flu or a pandemic, or the threat of a pandemic, may adversely impact our ability to perform our services or may adversely impact client and consumer demand.

We are in a labor-intensive business, employing approximately 75,000 employees worldwide. A significant or widespread outbreak of swine flu, or a similar pandemic, or even a perceived threat of such an outbreak, could cause significant disruptions to our employee base and could adversely impact our ability to provide our services and deliver our products. This could have a significant impact on our business and our results of operations.

Our accounting for our long-term contracts requires using estimates and projections that may change over time. Such changes may have a significant or adverse effect on our reported results of operations and Consolidated Balance Sheet.

Projecting contract profitability on our long-term outsourcing contracts requires us to make assumptions and estimates of future contract results. All estimates are inherently uncertain and subject to change. In an effort to maintain appropriate estimates, we review each of our long-term outsourcing contracts, the related contract reserves and intangible assets on a regular basis. If we determine that we need to change our estimates for a contract, we will change the estimates in the period in which the determination is made. These assumptions and estimates involve the exercise of judgment and discretion, which may also evolve over time in light of operational experience, regulatory direction, developments in accounting principles and other factors. Further, initially foreseen effects could change over time as a result of changes in assumptions, estimates or developments in the business or the application of accounting principles related to long-term outsourcing contracts. Any such changes may have a significant or adverse effect on our reported results of operations and Consolidated Balance Sheet.

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ITEM 1. LEGAL PROCEEDINGS

The information required by Item 1 is included in Note 12 of the notes to the Consolidated Financial Statements of this Form 10-Q and incorporated by reference herein.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no shares repurchased during the first nine months of 2009 or from October 1, 2009 through the date of filing of this report. At September 30, 2009, the Company was authorized to repurchase up to 7.1 million additional common shares.

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ITEM 6. EXHIBITS

(a) Exhibits.
The following are filed as Exhibits to Part II of this Form 10-Q:

Exhibit Number	
3.1	Amended Articles of Incorporation of the Company. (Incorporated by reference from Exhibit 3.1 to Form S-3 Registration Statement (File No. 333-43404) filed on August 10, 2000.)
3.2	Amended and Restated Code of Regulations of the Company. (Incorporated by reference from Exhibit 3.2 to Form 10-Q filed on May 5, 2009.)
4.1	Indenture, dated October 13, 2009, by and between Convergys Corporation and U.S. Bank National Associated, as trustee, relating to Convergys Corporation s 5.75% Junior Subordinated Convertible Debentures due 2029. (Incorporated by reference from Exhibit 4.1 to Current Report on Form 8-K filed October 13, 2009.)
4.2	Form of 5.75% Junior Subordinated Convertible Debenture due 2029. (Incorporated by reference from Exhibit 4.1 for Form 8-K filed October 13, 2009.)
31.1	Rule 13(a) - 14(a) Certification by Chief Executive Officer.
31.2	Rule 13(a) - 14(a) Certification by Chief Financial Officer.
32.1	Certification by Chief Executive Officer of Periodic Financial Reports Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Chief Financial Officer of Periodic Financial Reports Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The Company will furnish, without charge, to a security holder upon request, a copy of the documents, or the portions thereof, which are incorporated by reference, and will furnish any other exhibit at cost.

ITEMS 3, 4 and 5 Are Not Applicable and Have Been Omitted

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Convergys Corporation

Date: November 4, 2009

/s/ Earl C. Shanks
Earl C. Shanks
Chief Financial Officer
(On behalf of the Registrant and as
Chief Financial Officer)