

SELECTED FINANCIAL DATA

(In thousands, except per share and statistical data)

For the Fiscal Years Ended ⁽¹⁾	December 28, 1997	December 29, 1996	December 31, 1995	January 1, 1995	January 2, 1994
OPERATING DATA:					
Net revenue	\$356,390	\$276,443	\$101,667	\$46,618	\$28,912
Cost of services	269,326	193,967	71,982	30,666	19,790
Selling, general and administrative expenses	48,784	33,397	16,398	9,322	5,070
Special charges ⁽²⁾	23,038	—	—	—	—
Income from operations	15,242	49,079	13,287	6,630	4,052
Interest expense, net	1,489	29	804	664	203
Income taxes ⁽³⁾	12,770	18,500	4,330	—	—
Cumulative effect of accounting change ⁽⁴⁾	(2,200)	—	—	—	—
Net income (loss)	<u>\$ (1,217)</u>	<u>\$ 30,550</u>	<u>\$ 8,153</u>	<u>\$ 5,966</u>	<u>\$ 3,849</u>
Pro forma income data:					
Net income as reported			\$ 8,153	\$ 5,966	\$ 3,849
Pro forma adjustment for income taxes ⁽⁵⁾			670	2,070	1,500
Pro forma net income			<u>\$ 7,483</u>	<u>\$ 3,896</u>	<u>\$ 2,349</u>
Net income (loss) per share (pro forma for fiscal 1993 through 1995):					
Basic	\$ (0.03)	\$ 0.66	\$ 0.19	\$ 0.10	\$ 0.06
Diluted	\$ (0.03)	\$ 0.64	\$ 0.18	\$ 0.10	\$ 0.06
Weighted average shares outstanding:					
Basic	47,453	46,350	40,425	40,086	40,086
Diluted	48,505	47,935	41,624	40,086	40,086
STATISTICAL DATA:					
Number of Customer Optimization Centers	68	62	33	17	12
Number of workstations	10,770	8,450	4,210	1,630	934
BALANCE SHEET DATA:					
Cash and short-term investments	\$ 219	\$ 141	\$ 30,186	\$ 1	\$ 58
Working capital	20,515	13,354	33,045	2,877	454
Capital expenditures, net	44,127	64,417	16,626	6,526	2,314
Total assets	187,745	141,381	74,332	21,181	11,501
Long-term debt, less current maturities	1,863	1,325	1,474	8,218	3,073
Share owners' equity	124,783	88,206	52,707	5,722	4,183

NOTES:

(1) The Company has a 52-/53-week fiscal year that ends on the Sunday closest to December 31. All periods presented in this schedule of selected financial data consist of 52 weeks.

(2) Special charges recorded in fiscal 1997 reflect the write-off of acquired in-process research and development in connection with the Paragren Technologies, Inc. purchase of \$19,800,000 and a provision for software impairment of \$3,238,000 recorded as a result of plans to replace software platforms used by the Company with technologies being developed by Paragren.

(3) Prior to the initial public offering, the Company was an S Corporation and not subject to Federal and certain state corporate income taxes. On October 16, 1995, the Company changed its tax status from an S Corporation to a C Corporation, recorded deferred income taxes totaling \$3,780,000 and began providing for Federal and state corporate income taxes. See Note 4 to the Company's Consolidated Financial Statements.

(4) Cumulative effect of accounting change reflects the adoption of EITF Bulletin No. 97-13 which requires that business process reengineering costs be expensed as incurred. All previously capitalized and unamortized reengineering costs at November 20, 1997, were expensed as the cumulative effect of the accounting change, net of income taxes of \$1,349,000.

(5) The operating data reflects a pro forma adjustment for income taxes as if the Company were subject to Federal and state corporate income taxes for all periods. The pro forma provisions for income taxes represent a combined Federal and state tax rate of 43%, less applicable Federal and state job creation tax credits, which resulted in effective income tax rates ranging from 35% to 40%. See Note 4 to the Company's Consolidated Financial Statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

The following tables set forth client concentration data and consolidated statements of operations data as a percentage of net revenue from services provided by the Company for the years ended December 28, 1997, December 29, 1996, and December 31, 1995.

	Client Concentration Data		
	1997	1996	1995
Net revenue (in millions):			
All other clients	\$206.2	\$118.7	\$ 79.5
Parcel delivery client	90.2	106.7	14.1
Telecommunications client	60.0	51.0	8.1
Total net revenue	<u>\$356.4</u>	<u>\$276.4</u>	<u>\$101.7</u>
Annual revenue growth rates:			
All other clients	73.7%	49.3%	70.5%
Parcel delivery client	(15.5)	656.7	n.m.
Telecommunications client	17.6	529.6	n.m.
Combined	<u>28.9</u>	<u>171.9</u>	<u>118.1</u>
	Operations Data		
	1997	1996	1995
Net revenue:			
Sales Solutions	51.3%	51.3%	71.5%
Service Solutions	<u>48.7</u>	<u>48.7</u>	<u>28.5</u>
Total net revenue	100.0	100.0	100.0
Operating expenses:			
Cost of services	75.5	70.1	70.8
Selling, general and administrative expenses	13.7	12.1	16.1
Acquired in-process research and development	5.6	—	—
Provision for software impairment	0.9	—	—
Total operating expenses	<u>95.7</u>	<u>82.2</u>	<u>86.9</u>
Income from operations	4.3	17.8	13.1
Interest expense, net	<u>0.4</u>	—	<u>0.8</u>
Income before income taxes and cumulative effect of accounting change	3.9	17.8	12.3
Income taxes (pro forma 1995)	<u>3.6</u>	<u>6.7</u>	<u>4.9</u>
Income before cumulative effect of accounting change	0.3	11.1	7.4
Cumulative effect of accounting change, less income taxes	(0.6)	—	—
Net income (loss)	<u>(0.3)%</u>	<u>11.1%</u>	<u>7.4%</u>

Fiscal 1997 Compared to Fiscal 1996

Net revenue increased to \$356.4 million in fiscal 1997 from \$276.4 million in fiscal 1996, an increase of \$80.0 million or 28.9%. The Company was successful in decreasing its concentration of business with its two largest clients in fiscal 1997 by increasing net revenue from other clients by 73.7% during the year. Sales Solutions net revenue increased by \$41.0 million during fiscal 1997. Of this increase, approximately 45% was attributable to services initiated for new clients, while the balance was due to higher call volumes from existing clients. The \$39.0 million increase in Service Solutions net revenue during fiscal 1997 was due to services initiated for new clients and the inclusion of Paragren's software and consulting revenue. Revenue from existing Service Solutions clients was unchanged for the year as increased revenue from higher inbound call volumes with an existing large telecommunications client was offset by a 15.5% revenue reduction from the Company's large parcel delivery client. The revenue reduction from the large parcel delivery client was due to improved operating efficiencies in the management of client-owned call centers and the effects of a three-week labor strike against the client.

Cost of services as a percent of net revenue increased to 75.5% in fiscal 1997 from 70.1% in fiscal 1996. This increase was due to four factors. First, the Company experienced lower margins as a result of client mix and marketplace pricing pressures. Second, a more expensive group health insurance plan was implemented during fiscal 1997 to improve employee retention. Third, the Company's large parcel delivery client reduced the number of billable positions in the client-owned call centers by approximately 20%, resulting in the Company absorbing payroll costs during a three-month adjustment period that otherwise would have been billed to the client. Finally, the Company absorbed fixed costs relating to excess capacity and infrastructure, such fixed costs increasing as a percent of net revenue, due to marketing-related volume reductions by its large telecommunications client and the effects of a labor strike against the large parcel delivery client.

Selling, general and administrative expenses increased to \$48.8 million in fiscal 1997 from \$33.4 million in fiscal 1996, an increase of \$15.4 million or 46.1%. As a percent of net revenue, selling, general and administrative expenses increased to 13.7% in fiscal 1997 from 12.1% in fiscal 1996. The increase in selling, general and administrative expenses during fiscal 1997 was due to expansion of sales and marketing efforts, investments in human resources and administrative functions to support the Company's larger revenue base, and the inclusion of Paragren's selling, general and administrative expenses. The expenses of Paragren are higher per dollar of revenue than the Company's expenses due to sales and marketing and research and development required to support software sales and consulting efforts.

Special charges recorded during fiscal 1997 included the write-off of acquired in-process research and development of \$19.8 million in connection with the Paragren purchase and a provision for software impairment of \$3.2 million as a result of plans to replace software

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

platforms used by the Company with technologies being developed by Paragren. Acquired in-process research and development, which was determined by an independent appraisal, includes the value of software in the development stage and not considered to have reached technological feasibility. Generally accepted accounting principles require that research and development costs be expensed as incurred.

Net interest expense increased by \$1.5 million in fiscal 1997 from fiscal 1996. This increase reflects interest income earned on temporary investments in fiscal 1996 with cash raised in the initial public offering of the Company's Common Shares compared to interest expense incurred on outstanding borrowings in fiscal 1997 as the result of investment in Customer Optimization Centers during the fourth quarter of fiscal 1996 and fiscal 1997.

The effective income tax rate in fiscal 1997 increased to 92.9% from 37.7% in fiscal 1996 principally due to the special charge to operations for acquired in-process research and development related to the Paragren purchase for which no tax benefit was available. The effective income tax rate for fiscal 1997 before the impact of acquired in-process research and development was 43.7%. The change between the actual income tax rate in fiscal 1996 and the adjusted income tax rate in fiscal 1997 was due to the amortization of goodwill related to the Paragren purchase and other non-deductible expenses.

The cumulative effect of accounting change of \$2.2 million, net of applicable income taxes, reflects the adoption of Emerging Issues Task Force Bulletin No. 97-13 ("EITF No. 97-13"), "Accounting for the Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation". EITF No. 97-13 requires that business process reengineering costs be expensed as incurred and that any unamortized reengineering costs at November 20, 1997, also be expensed and reported as a cumulative effect of accounting change. The Company had been capitalizing reengineering costs related to the installation of computer software purchased to provide enterprise-wide business management systems.

Fiscal 1996 Compared to Fiscal 1995

Net revenue increased 171.9% in fiscal 1996 to \$276.4 million, up \$174.7 million from fiscal 1995. Service Solutions net revenue increased by \$105.5 million during fiscal 1996. This increase principally was due to the commencement of a four-year agreement to manage 4 client-owned call centers for a large parcel delivery client. Sales Solutions net revenue increased by \$69.2 million during fiscal 1996. Of this increase, approximately 85% was attributed to services initiated for new clients, principally outbound call activity for a large telecommunications client, while the balance was due to higher call volumes from existing clients.

Cost of services as a percent of net revenue decreased from 70.8% in fiscal 1995 to 70.1% in fiscal 1996. Exclusive of start-up activities relating to new parcel delivery business, cost of services as a percent of net revenue increased by 1.1% in fiscal 1996 as compared to fiscal 1995.

This increase reflects the shift in service mix to the management of client-owned call centers. The management of client-owned call centers has a lower gross margin compared to the Company's other service offerings because of the nature of the outsourced services provided for the large parcel delivery client. Recruiting, training and facility costs incurred in advance of full-scale operations of 29 new Customer Optimization Centers during fiscal 1996 also contributed to the higher service costs.

Selling, general and administrative expenses increased 103.7% in fiscal 1996 to \$33.4 million, up \$17.0 million over fiscal 1995. Approximately 75% of the growth in overhead was due to investments in additional management personnel and systems to support the Company's increased revenue base, with the balance due to expenses associated with the new parcel delivery business. Selling, general and administrative expenses as a percentage of revenue declined as a result of economies of scale associated with spreading fixed and semi-variable costs over a larger revenue base. Selling, general and administrative expenses as a percentage of net revenue were 12.1% for fiscal 1996 compared to 16.1% for fiscal 1995.

Net interest expense decreased \$0.8 million from fiscal 1995 to fiscal 1996. The decrease was due to a reduction of average outstanding borrowings as a result of debt retired in fiscal 1995 with cash raised from the initial public offering of the Company's Common Shares in October 1995.

The provision for income taxes of \$18.5 million recognized in fiscal 1996 is based upon the Company's estimated effective tax rate of 37.7%. Prior to the initial public offering of the Company's Common Shares in fiscal 1995, the Company included its income and expenses with those of its share owners for Federal and certain state income tax purposes (an S Corporation election). In connection with the Company's initial public offering, the Company terminated its S Corporation election. The pro forma income tax rate of 40.1% in fiscal 1995 assumes that the Company was treated as a C Corporation for the entire year and reflects Federal taxes at the statutory rate of 35% plus state taxes, net of Federal benefit and state job creation credits. The change between the pro forma income tax rate in fiscal 1995 and the actual income tax rate in fiscal 1996 was due to tax planning strategies which have reduced state income taxes payable.

New Accounting Standards

As described in Notes 3 and 12 to the Consolidated Financial Statements, the Company adopted SFAS No. 128 and EITF 97-13 during fiscal 1997 and will adopt SFAS Nos. 130 and 131 in fiscal 1998. As of December 31, 1997, the impact of adopting SFAS Nos. 130 and 131 has not been determined.

Inflation

The effects of inflation on the Company's operations were not significant during the years presented in the consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	December 28, 1997	December 29, 1996
A S S E T S		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 219	\$ 141
Receivables:		
Trade, less allowance for doubtful accounts of \$447 in 1997 and \$360 in 1996	69,455	56,148
Share owner/officer	—	300
Other	4,007	3,025
Prepaid expenses	2,473	2,670
Total current assets	<u>76,154</u>	<u>62,284</u>
PROPERTY AND EQUIPMENT:		
Building and leasehold improvements	28,041	17,535
Telecommunications equipment and related software	86,510	51,144
Workstations and office equipment	15,277	12,301
Construction in progress	6,463	15,542
Total property and equipment	136,291	96,522
Less—accumulated depreciation and amortization	38,825	18,078
Property and equipment, net	<u>97,466</u>	<u>78,444</u>
OTHER ASSETS:		
Goodwill and other intangibles, less accumulated amortization of \$894	12,628	—
Other assets	1,497	653
Total other assets	14,125	653
Total assets	<u>\$187,745</u>	<u>\$141,381</u>
LIABILITIES AND SHARE OWNERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 202	\$ 146
Revolving credit facility	23,600	15,900
Book overdraft	4,679	5,113
Accounts payable	6,477	11,967
Accrued payroll and related items	14,555	10,670
Accrued expenses	6,126	5,134
Total current liabilities	<u>55,639</u>	<u>48,930</u>
LONG-TERM DEBT , less current maturities	1,863	1,325
DEFERRED INCOME TAXES	5,460	2,920
COMMITMENTS AND CONTINGENCIES		
SHARE OWNERS' EQUITY:		
Preferred Shares, \$0.01 par value; 50,000,000 shares authorized; none issued	—	—
Common Shares, \$0.01 par value; 200,000,000 shares authorized; issued 48,794,367 shares in 1997 and 46,540,057 shares in 1996	488	465
Additional paid-in capital	91,788	54,017
Retained earnings	32,507	33,724
Total share owners' equity	124,783	88,206
Total liabilities and share owners' equity	<u>\$187,745</u>	<u>\$141,381</u>

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

For the Fiscal Years Ended	December 28, 1997	December 29, 1996	December 31, 1995
NET REVENUE	\$356,390	\$276,443	\$101,667
OPERATING EXPENSES:			
Cost of services	269,326	193,967	71,982
Selling, general and administrative expenses	48,784	33,397	16,398
Acquired in-process research and development	19,800	—	—
Provision for software impairment	3,238	—	—
Total operating expenses	<u>341,148</u>	<u>227,364</u>	<u>88,380</u>
Income from operations	15,242	49,079	13,287
INVESTMENT INCOME	—	280	284
INTEREST EXPENSE	(1,489)	(309)	(1,088)
Income before income taxes and cumulative effect of accounting change	13,753	49,050	12,483
INCOME TAXES:			
Provision for income taxes on C Corporation income	12,770	18,500	550
Deferred income taxes recorded in conjunction with termination of S Corporation election on October 15, 1995	—	—	3,780
Total income taxes	<u>12,770</u>	<u>18,500</u>	<u>4,330</u>
Income before cumulative effect of accounting change	983	30,550	8,153
CUMULATIVE EFFECT OF ACCOUNTING CHANGE, less income taxes of \$1,349	(2,200)	—	—
NET INCOME (LOSS)	<u>\$ (1,217)</u>	<u>\$ 30,550</u>	<u>\$ 8,153</u>
PRO FORMA INCOME DATA (UNAUDITED):			
Net income as reported			\$ 8,153
Pro forma adjustment to recognize C Corporation provision for income taxes			670
Pro forma net income			<u>\$ 7,483</u>
NET INCOME (LOSS) PER SHARE (PRO FORMA FOR FISCAL 1995):			
Basic:			
Income before cumulative effect of accounting change	\$ 0.02	\$ 0.66	\$ 0.19
Cumulative effect of accounting change	(0.05)	—	—
Net income (loss)	<u>\$ (0.03)</u>	<u>\$ 0.66</u>	<u>\$ 0.19</u>
Diluted:			
Income before cumulative effect of accounting change	\$ 0.02	\$ 0.64	\$ 0.18
Cumulative effect of accounting change	(0.05)	—	—
Net income (loss)	<u>\$ (0.03)</u>	<u>\$ 0.64</u>	<u>\$ 0.18</u>
WEIGHTED AVERAGE SHARES OUTSTANDING:			
Basic	47,453	46,350	40,425
Diluted	<u>48,505</u>	<u>47,935</u>	<u>41,624</u>

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHARE OWNERS' EQUITY

(In thousands, except share data)

	Common Shares		Additional Paid-In Capital	Retained Earnings	Total Share Owners' Equity
	Issued	Amount			
BALANCE, JANUARY 1, 1995	39,600,000	\$396	\$ —	\$ 5,326	\$ 5,722
Net income				8,153	8,153
S Corporation distributions paid or accrued	—	—	—	(9,374)	(9,374)
Capitalization of undistributed S Corporation earnings in conjunction with termination of S Corporation election on October 15, 1995	—	—	898	(898)	—
Issuance of Common Shares in connection with initial public offering	6,600,000	66	48,174	(33)	48,207
BALANCE, DECEMBER 31, 1995	46,200,000	462	49,072	3,174	52,708
Net income				30,550	30,550
Exercise of employee stock options, including related tax benefits	273,558	2	4,607	—	4,609
Issuance of Common Shares through employee stock purchase plan	12,059	—	339	—	339
Issuance of Common Shares in connection with the acquisition of The Shechtman Group	54,440	1	(1)	—	—
BALANCE, DECEMBER 29, 1996	46,540,057	465	54,017	33,724	88,206
Net loss				(1,217)	(1,217)
Exercise of employee stock options, including related tax benefits	228,232	2	5,246	—	5,248
Issuance of Common Shares through employee stock purchase plan	34,693	1	654	—	655
Issuance of Common Shares in connection with the acquisition of Paragren Technologies, Inc.	1,991,385	20	31,871	—	31,891
BALANCE, DECEMBER 28, 1997	48,794,367	\$488	\$91,788	\$32,507	\$124,783

The accompanying notes are an integral part of these consolidated financial statements.