DST SYSTEMS INC
Form 10-Q
August 09, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2005

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 1-14036

DST SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**43-1581814**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

333 West 11th Street, Kansas City, Missouri	**64105**
(Address of principal executive offices)	(Zip Code)

(816) 435-1000

(Registrant s telephone number, including area code)

No Changes

(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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Yes ý No o

Number of shares outstanding of the Company s common stock as of July 29, 2005:

Common Stock $0.01 par value 79,326,254

DST Systems, Inc.

Form 10-Q

June 30, 2005

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The brand, service or product names or marks referred to in this Report are trademarks or services marks, registered or otherwise, of DST Systems, Inc. or its subsidiaries or affiliates or of vendors to the Company.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Introductory Comments

The Condensed Consolidated Financial Statements of DST Systems, Inc. (DST or the Company) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to enable a reasonable understanding of the information presented. These Condensed Consolidated Financial Statements should be read in conjunction with the Company s audited financial statements and the notes thereto for the year ended December 31, 2004.

The results of operations for the three and six months ended June 30, 2005, are not necessarily indicative of the results to be expected for the full year 2005.

DST Systems, Inc.

Condensed Consolidated Balance Sheet

(dollars in millions, except per share amounts)

(unaudited)

	June 30, 2005	December 31, 2004
ASSETS		
Current assets		
Cash and cash equivalents	$ 388.6	$ 95.0
Restricted cash	36.9	12.0
Transfer agency investments	61.9	75.2
Accounts receivable	365.2	462.0
Other current assets	117.6	110.4
Assets of businesses held for sale	109.2	41.4
	1,079.4	796.0
Investments	1,229.4	1,473.7
Properties	562.1	654.9
Goodwill	159.0	108.1
Intangibles	108.9	101.5
Other assets	84.9	36.3
Assets of business held for sale		212.9
Total assets	$ 3,223.7	$ 3,383.4
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Debt due within one year	$ 14.1	$ 109.2
Transfer agency deposits	61.9	75.2
Accounts payable	191.2	178.9
Accrued compensation and benefits	89.7	96.9
Deferred revenues and gains	62.2	75.0
Other liabilities	112.1	107.6
Income taxes payable	207.8	
Liabilities of businesses held for sale	35.6	70.7
	774.6	713.5
Long-term debt	1,260.9	1,373.7
Deferred income taxes	329.0	466.2
Other liabilities	89.1	84.2
	2,453.6	2,637.6
Commitments and contingencies (Note 10)		
Stockholders equity		
Common stock, $0.01 par; 400 million shares authorized, 95.3 million shares issued	1.0	1.0
Additional paid-in capital	217.6	226.3
Retained earnings	956.9	737.4
Unearned compensation	(123.8)	(132.6)
Treasury stock (13.5 million and 12.3 million shares, respectively), at cost	(595.0)	(525.4)
Accumulated other comprehensive income	313.4	439.1
Total stockholders equity	770.1	745.8
Total liabilities and stockholders equity	$ 3,223.7	$ 3,383.4

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

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DST Systems, Inc.

Condensed Consolidated Statement of Income

(in millions, except per share amounts)

(unaudited)

	For the Three Months Ended June 30, 2005	For the Three Months Ended June 30, 2004	For the Six Months Ended June 30, 2005	For the Six Months Ended June 30, 2004
Operating revenues	$ 469.2	$ 425.5	$ 906.3	$ 855.5
Out-of-pocket reimbursements	201.1	167.8	392.3	347.3
Total revenues	670.3	593.3	1,298.6	1,202.8
Costs and expenses	549.8	475.1	1,065.5	966.3
Depreciation and amortization	38.4	38.7	74.2	75.1
Income from operations	82.1	79.5	158.9	161.4
Interest expense	(18.2)	(13.2)	(34.8)	(26.7)
Other income, net	82.3	8.4	90.0	14.9
Gain on sale of business	120.4		120.4	
Equity in earnings of unconsolidated affiliates	20.0	5.6	27.9	10.7
Income before income taxes	286.6	80.3	362.4	160.3
Income taxes	116.3	28.5	142.9	56.9
Net income	$ 170.3	$ 51.8	$ 219.5	$ 103.4
Average common shares outstanding	78.6	84.3	78.5	84.2
Diluted shares outstanding	80.9	86.8	80.9	86.6
Basic earnings per share	$ 2.17	$ 0.61	$ 2.79	$ 1.23
Diluted earnings per share	$ 2.11	$ 0.60	$ 2.71	$ 1.19

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

DST Systems, Inc.

Condensed Consolidated Statement of Cash Flows

(in millions)

(unaudited)

	For the Six Months Ended June 30, 2005	For the Six Months Ended June 30, 2004
Cash flows operating activities:		
Net income	$ 219.5	$ 103.4
Depreciation and amortization	74.2	75.1
Equity in earnings of unconsolidated affiliates	(27.9)	(10.7)
Net realized gain on investments	(74.6)	(7.6)
Gain on sale of business	(120.4)	
Amortization of unearned compensation on restricted stock	13.1	
Deferred income taxes	(95.3)	18.0
Changes in restricted cash	(24.9)	(6.3)
Changes in accounts receivable	69.0	(11.1)
Changes in other assets	(38.3)	(1.6)
Changes in transfer agency investments	13.3	(294.8)
Changes in transfer agency deposits	(13.3)	294.8
Changes in accounts payable and accrued liabilities	39.7	(11.7)
Changes in income taxes payable	207.8	(6.0)
Changes in deferred revenues and gains	5.9	(4.8)
Changes in accrued compensation and benefits	(8.7)	(2.1)
Other, net	(6.9)	0.1
Total adjustments to net income	12.7	31.3
Net	232.2	134.7
Cash flows investing activities:		
Capital expenditures	(73.6)	(101.6)
Proceeds from sale of investments	13.5	23.0
Investments in securities	(17.5)	(20.0)
Investments in and advances to unconsolidated affiliates	(3.0)	(19.5)
Proceeds from exchange of CSC common stock	224.6	
Proceeds from sale of EquiServe	216.0	
Contingent payment for purchase of EquiServe		(25.6)
Other, net	11.5	0.9
Net	371.5	(142.8)
Cash flows financing activities:		
Proceeds from issuance of common stock	15.2	26.5
Principal payments on long-term debt	(54.7)	(22.6)
Net increase (decrease) in revolving credit facilities	(158.7)	38.6
Repayment of promissory note	(107.4)	
Debt refinancing costs	(1.7)	
Common stock repurchaseds	(3.5)	(47.5)
Net	(310.8)	(5.0)
Net increase (decrease) in cash and cash equivalents	292.9	(13.1)
Cash and cash equivalents at beginning of period	96.6	91.9
Cash and cash equivalents at end of period	$ 389.5	$ 78.8

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

DST Systems, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Summary of Accounting Policies

The Condensed Consolidated Financial Statements of DST Systems, Inc. (DST or the Company) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to enable a reasonable understanding of the information presented. These Condensed Consolidated Financial Statements should be read in conjunction with the Company s audited financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal interim closing procedures) necessary to present fairly the financial position of the Company and its subsidiaries at June 30, 2005, and the results of operations for the three and six months ended June 30, 2005 and 2004, and cash flows for the six months ended June 30, 2005 and 2004.

Certain amounts in the prior year s consolidated financial statements have been reclassified to conform to the current year presentation.

The results of operations for the three and six months ended June 30, 2005, are not necessarily indicative of the results to be expected for the full year 2005.

2. Sale of EquiServe

On June 17, 2005, the Company completed the sale of its wholly-owned subsidiary, EquiServe, Inc. (EquiServe) to Computershare Ltd. (CPU) in accordance with the terms of an agreement dated October 20, 2004. Under the terms of the agreement, DST sold all of the shares of EquiServe for $216.0 million in cash and 29.6 million shares of CPU common stock which shares had a value, based on the closing price of CPU stock on the closing date of the transaction, of approximately $145.8 million. In addition, the Company has recorded a receivable from CPU at June 30, 2005, included in other current assets on the consolidated balance sheet, in the amount of approximately $20.5 million which represents the estimated amount owed to the Company related to the preliminary closing balance sheet working capital adjustment. Under the terms of the October 20, 2004 agreement, the Company will continue to provide EquiServe various services including transition data processing support, AWD products and services, Output Solutions services, E-Proxy services, and lost instrument surety bond coverage, for which elements a portion of the purchase price has been deferred. In addition, the Company provided a perpetual sourcecode license for Fairway to CPU and agreed to restrict its use of the software. Upon the closing of this transaction, Fairway software was redesignated from software that was developed for internal use in the Company s stock transfer business to software that will be for external use, in accordance with SOP 98-1, Accounting for Costs of Software Obtained or Developed for Internal Use . As a result, $34 million of Fairway capitalized software costs were removed from the consolidated balance sheet and taken into account in the determination of the $120.4 million pretax gain (the net gain was

approximately $70 million after taxes, deferrals and other expenses) from the sale of the EquiServe business during the three months ended June 30, 2005. The Company recorded operating revenues related to EquiServe of $47.1 million and $99.9 million for the three and six months ended June 30, 2005, respectively. EquiServe recorded operating revenues of $234 million for the year ended December 31, 2004. At December 31, 2004, assets and liabilities of EquiServe were categorized as assets and liabilities held for sale in the consolidated balance sheet. The disposition does not qualify to be reported as a discontinued operation due to ongoing cash flows from the aforementioned agreements. The $145.8 million of CPU common stock received by the Company in connection with this acquisition has been treated as non-cash consideration for the sale of the EquiServe business.

3. Health Solutions, Inc. Exchange

On April 29, 2005, the Company completed the exchange of its investment of 7.1 million shares of Computer Sciences Corporation (CSC) common stock for CSC s Health Plan Solutions business (now known as DST Health Solutions, Inc. or HSI). HSI is an enterprise software developer, software application services provider and business process outsourcer for the U.S. commercial healthcare industry. The exchange value of the CSC shares at closing was $45.53 per share and HSI held $224.6 million of cash at the time of the exchange. Under the terms of the exchange agreement, the HSI operating business had a negotiated value of $100.0 million and its assets at closing included additional cash of $224.6 million. For financial reporting purposes, 4.9 million CSC shares were valued at $45.53 (representing the cash element of the HSI exchange) while the remaining 2.2 million shares were valued at $43.06 (representing the exchange value of the HSI operating business based on the closing price of the CSC common stock on April 29, 2005). Accordingly, for financial reporting purposes, the Company recorded a pretax gain of approximately $76.3 million from the exchange of the CSC shares during the quarter ended June 30, 2005, which is included in Other Income on the consolidated statement of income. The $224.6 million of cash received in exchange for 4.9 million shares of CSC common stock has been classified as cash flow from an investing activity on the consolidated statement of cash flows. The HSI business received in exchange for 2.2 million shares has been treated as non-cash consideration. The Company has determined that the HSI financial results should be presented in the Financial Services business segment. The Company has performed a preliminary allocation of purchase price value in excess of the net assets of the HSI business received. At June 30, 2005, the Company s purchase accounting has not been finalized and, as a result, purchase accounting adjustments may be made in future periods. The preliminary purchase price allocation resulted in $20 million of proprietary software, $20.6 million of identifiable intangible assets, and $52.6 million of goodwill. The Company has not yet finalized its accounting for deferred taxes related to the acquired assets; when finalized, it is possible that goodwill will be adjusted. For the two months ended June 30, 2005, amortization of identifiable intangible assets (customer relationships, order backlog, etc.) resulted in $1.8 million of amortization expense. Amortization expense related to these intangible assets and proprietary software for the remainder of 2005 and the years ending December 31, 2006, 2007, 2008 and 2009 is estimated to be $5.4 million, $8.0 million, $6.5 million, $6.5 million and $3.2 million, respectively.

4. Sale of Customer Management Business

On July 1, 2005, the Company completed the sale of the capital stock of its wholly-owned subsidiaries DST Interactive, Inc. and DST Innovis, Inc. (collectively Innovis Entities) to Amdocs Ltd. (Amdocs) for $237.8 million in cash. The Innovis Entities comprised the Company s Video Broadband/Cable/Satellite TV Customer Care and Billing business. The business, which essentially represents the Company s customer management segment, had approximately 700 employees and recorded operating revenues of $183 million for the year ended December 31, 2004. The Company recorded operating revenues related to the Innovis Entities of $49.2 million and $93.9 million for the three and six months ended June 30, 2005, respectively.

As part of the transaction, DST through its subsidiary, DST Output, will continue to provide electronic and print/mail services to customers of the Innovis Entities under a long term contract with Amdocs. DST Output will be a preferred vendor of such services for customers of Amdocs in the United States. Included in the Output Solutions segment are operating revenues (exclusive of out-of-pocket reimbursements) of approximately $11.5 million and $24.2 million for the three and six months ended June 30, 2005, respectively, representing intersegment revenue for output services to the Innovis Entities. Under a separate agreement with Amdocs, DST will also continue to provide support of its AWD software for customers of the Innovis Entities who currently utilize AWD. Elements of the purchase price may be deferred related to these ongoing agreements to provide services to Amdocs. Due to the ongoing cash flows that will be recorded by the Company from the Innovis Entities subsequent to the sale, the Company has determined that the Innovis Entities transaction should not be accounted for as a discontinued operation.

After taxes, deferrals, and other expenses, the Company expects to recognize a net after-tax gain of approximately $100 million during the three months ending September 30, 2005. The Company expects to receive after tax proceeds of approximately $150 million in connection with the sale. In conjunction with the closing of this transaction, certain compensation charges will be incurred, including the vesting of restricted stock

granted to employees of Innovis

Entities. This is expected to result in approximately $8.5 million of compensation charges during the three months ending September 30, 2005.

The assets and liabilities of the Innovis Entities have been presented as held for sale in the consolidated balance sheet at June 30, 2005 and are summarized in the table below. Because these net assets were sold for cash during the three months ending September 30, 2005, the assets and liabilities have been classified as current assets and liabilities of business held for sale.

		(in millions)
Cash	$	0.9
Accounts receivable		32.4
Other current assets		0.9
Properties		69.6
Goodwill		5.4
Total assets		109.2
Accounts payables		9.8
Accrued compensation and benefits		6.1
Deferred revenues and gains		10.0
Other liabilities		9.7
Total liabilities		35.6
Net assets held for sale	$	73.6

5. Investments

Investments are as follows (in millions):

	2005 Ownership Percentage	Carrying Value June 30, 2005	Carrying Value December 31, 2004
Available-for-sale securities:			
State Street Corporation	4%	$ 617.2	$ 628.3
Computershare Ltd.	5%	132.3	
Computer Sciences Corporation			401.9
Euronet Worldwide, Inc.	5%	54.8	49.0
Other available-for-sale securities		137.7	120.8
		942.0	1,200.0
Unconsolidated affiliates:			
Boston Financial Data Services, Inc.	50%	108.9	89.3
International Financial Data Services, U.K.	50%	40.0	37.8
International Financial Data Services, Canada	50%	9.3	7.0
Unconsolidated Real Estate Affiliates		73.0	80.7
Other unconsolidated affiliates		21.3	22.3
		252.5	237.1
Other:			
Trading securities		27.0	25.3
Held-to-maturity		7.9	12.2
		34.9	37.5
Total investments		$ 1,229.4	$ 1,474.6

The table above includes $0.9 million of investments classified as Assets of businesses held for sale in the consolidated balance sheet as of December 31, 2004.

CPU is a global provider of share registry management/transfer agency services and technology to the global securities industry. CPU s common stock is listed on the Australian Stock Exchange under ASX: CPU. The aggregate market value of the Company s investment in CPU s common stock presented above was based on the closing price on the Australian exchange at June 30, 2005. As discussed in Note 2, the Company obtained 29.6 million shares of CPU, which represents slightly less than 5% of CPU s total issued capital, in connection with the sale of the EquiServe business on June 17, 2005.

As discussed in Note 3, the Company exchanged its investment in CSC shares on April 29, 2005 in connection with the HSI Exchange transaction.

Certain information related to the Company s available-for-sale securities is as follows (in millions):

	June 30, 2005	December 31, 2004
Book cost basis	$ 435.2	$ 518.7
Gross unrealized gains	521.9	681.7
Gross unrealized losses	(15.1)	(0.4)
Market value	$ 942.0	$ 1,200.0

The Company has a cash management service for full service mutual fund transfer agency clients, whereby end of day available client bank balances are invested overnight by and in the name of the Company into credit-quality money market funds. All invested balances are returned to the full service mutual fund transfer agency client accounts the following business day. The Company had $61.9 million and $75.2 million of transfer agency investments and deposits at June 30, 2005 and December 31, 2004, respectively.

The following table summarizes the fair value and gross unrealized losses of the Company s investments by the length of time that the securities have been in a continuous loss position, at June 30, 2005 (in millions):

	Less than 12 months		Greater than 12 months		Total	
	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Common Stock	$ 156.3	$ 15.0	$ 1.2	$ 0.1	$ 157.5	$ 15.1

Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment s current carrying value, thereby possibly requiring an impairment charge in the future. Such a charge could have a material effect on the Company s financial position.

The market value of the Company s investment in CPU declined during the period that the Company has held this investment. The value of the Company s investment in CPU on June 17, 2005, the date of acquisition, was $145.8 million. An unrealized loss of $13.5 million on this investment had occurred by June 30, 2005. At July 31, 2005, the unrealized loss on this investment was $7.8 million. The Company will continue to monitor the performance of this investment. An other than temporary decline in value may result in a write-down of this investment in the future.

The Company recognized $2.7 million and $3.1 million of investment impairments for the three and six months ended June 30, 2005, respectively, and $0.1 million and $1.3 million for the three and six months ended June 30, 2004, respectively, which the Company believed were other than temporary. The impairments related to available for sale investments in the Investments and Other Segment and other investments held by the Financial Services Segment. A decline in a security s net realizable value that is other than temporary is treated as a loss based on quoted or derived market value and is reflected in the Other income, net line in the statement of income.

The following table summarizes equity in earnings (losses) of unconsolidated affiliates net of income taxes (in millions):

	For the Three Months Ended June 30, 2005	For the Three Months Ended June 30, 2004	For the Six Months Ended June 30, 2005	For the Six Months Ended June 30, 2004
Boston Financial Data Services, Inc.	$ 15.6	$ 4.9	$ 19.6	$ 8.1
International Financial Data Services, U.K.	2.2	0.8	4.6	2.3
International Financial Data Services, Canada	1.4	0.8	3.2	1.2
Other	0.8	(0.9)	0.5	(0.9)
	$ 20.0	$ 5.6	$ 27.9	$ 10.7

Included in earnings for Boston Financial Data Services, Inc. (BFDS) for the three and six months ended June 30, 2005 is the realization of a $11.2 million deferred gain resulting from the sale of EquiServe. BFDS is a corporate joint venture of DST and State Street Corporation (State Street). In 2002, BFDS sold its partial interest in EquiServe to DST and recorded a gain in its stand-alone financial statements. DST deferred its share of the 2002 equity in earnings of BFDS that related to this related party gain transaction. The gain was realized on June 17, 2005 when DST sold EquiServe to CPU, an unrelated third party.

6. Goodwill, Intangibles and Other Assets

The following table summarizes intangible assets (in millions):

	June 30, 2005		December 31, 2004	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets:				
Customer relationships	$ 122.2	$ 18.6	$ 136.0	$ 20.6
Other	6.3	1.0	0.2	0.1
Total	$ 128.5	$ 19.6	$ 136.2	$ 20.7

The table above includes $14.0 million of intangible assets classified as Assets of business held for sale in the consolidated balance sheet as of December 31, 2004.

Amortization of intangible assets for the three and six months ended June 30, 2005 was $2.9 million and $4.8 million, respectively. Amortization of intangible assets for the three and six months ended June 30, 2004 was $1.9 million and $3.8 million, respectively. Annual amortization amounts for intangible assets recorded as of June 30, 2005 are estimated at $10.2 million for 2005, $9.2 million for 2006, $7.8 million for 2007, $7.4 million for 2008 and $7.1 million for 2009. Except for approximately $20.6 million of intangibles acquired in the HSI transaction, substantially all of the remaining intangibles are tax-deductible.

The following table summarizes the changes in the carrying amount of goodwill for the six months ended June 30, 2005, by Segment (in millions):

	December 31, 2004	Acquisitions	Disposals	Other	June 30, 2005
Financial Services	$ 273.4	$ 56.8	$ (179.9)	$ (0.5)	$ 149.8
Output Solutions	9.2				9.2
Customer Management					
Investments and Other	5.4				5.4
Total	$ 288.0	$ 56.8	$ (179.9)	$ (0.5)	$ 164.4

The table above includes $179.9 million of goodwill classified as Assets of business held for sale in the consolidated balance sheet as of December 31, 2004. Concurrent with the sale of EquiServe during the second quarter of 2005, goodwill was decreased by this amount. The table above includes $5.4 million of goodwill classified as Assets of business held for sale in the consolidated balance sheet as of June 30, 2005. Except for approximately $52.6 million of goodwill acquired in the HSI transaction, substantially all of the remaining goodwill is tax-deductible.

The August 2, 2002 acquisition of lock\line was accounted for as a purchase. The minimum purchase price of $190 million was paid in cash at closing and was financed by debt. There are provisions in the acquisition agreement that allow for additional consideration to be paid in cash if lock\line s revenues, as defined in the acquisition agreement, exceed certain targeted levels for 2004. Goodwill was increased by the amount of additional consideration paid during the second quarter of 2005 and is reflected in the column labeled as Acquisitions in the table above. The Company has been asked to make an additional contingent payment of approximately $4 million. The parties to the lock\line transaction continue to discuss the amount of the final payment related to the acquisition agreement.

7. Debt

Line of credit facility

On June 28, 2005, the Company entered into a new syndicated line of credit facility to replace its existing line of credit facility. The credit agreement provides for a five-year revolving unsecured credit facility in an aggregate principal amount of up to $600 million. The interest rates applicable to loans under the credit agreement are generally based on the offshore (LIBOR), Federal Funds, or prime rates, plus applicable margins. The revolving credit facility has a grid that adjusts borrowing costs up or down based upon the Company s consolidated leverage ratio. The grid may result in fluctuations in borrowing costs. The credit agreement contains customary restrictive covenants, as well as certain customary events of default. The covenant limiting restricted payments, in addition to certain other exceptions, contains exceptions permitting the Company for a specified period to repurchase or redeem a specified amount of its capital stock. Among other provisions, the credit agreement limits consolidated indebtedness, liens, investments, subsidiary indebtedness, and asset dispositions, and requires minimum consolidated net worth and certain leverage and interest coverage ratios to be maintained. If any event of default occurs and is continuing, all amounts payable under the credit agreement may be declared immediately due and payable. The maturity date for the credit facility is July 1, 2010. The administrative agent for the new and old syndicated line of credit facility was the same. On June 28, 2005, the date of the refinancing transaction, the administrative agent transferred $300 million of the outstanding balance under the old credit facility to the new credit facility. This transfer has been treated as a non cash transaction. The Company used a portion of the cash proceeds from the EquiServe sale on June 17, 2005 to repay the remaining amount outstanding under the old line of credit facility.

Repayment of promissory note related to common stock

On June 8, 2005, the Company entered into a promissory note with a bank in the principal amount of $107.4 million. The Company agreed to pay the principal amount plus interest (at an annual rate equal to 1% over LIBOR) on or before the maturity date of June 30, 2005. The Company had the right to prepay the promissory note in whole or in part, without premium or penalty, subject to the requirements of the loan agreement. This promissory note settled the forward stock purchase agreement previously entered into by the Company in January 2005. The Company used a portion of the proceeds from the EquiServe sale to repay the promissory note before June 30, 2005.

8. Income Taxes

In general, the Company provides income taxes during interim periods based on its best estimate of the full year s effective tax rate. Certain items, however, are given discrete period treatment and, as a result, the tax effects of such items are reported in full in the relevant interim period. The Company s effective tax rate was 40.6% and 39.4% for the three and six months ended June 30, 2005, respectively, compared to 35.5% for each of the three and six months ended June 30, 2004. Excluding the effects of the Customer Management business sale on July 1, 2005 (see Note 4), the Company estimates its effective tax rate will be 36.5% for the remainder of 2005. The effective tax rates for 2005 are higher principally due to higher effective tax rates relating to the HSI exchange (see Note 3) and the EquiServe sale (see Note 2). The 2005 and 2004 income tax rates were also affected by tax aspects of certain international operations and state tax income apportionment rules. In addition, the 2005 income tax rate was higher than the 2004 rate as a result of additional tax related interest accruals, net of tax, with respect to the HSI Exchange in 2005 and certain real estate related tax credits realized in 2004. The full year 2005 effective tax rate can be affected as a result of variances among the estimates and amounts of full year sources of taxable income (e.g. domestic consolidated, joint venture and/or international), the realization of tax credits (e.g. historic rehabilitation, research and experimental and state incentive) and adjustments which may arise from the resolution of tax matters under review.

The HSI exchange transaction (see Note 3) has been structured to meet the requirements for treatment as a tax-free reorganization in accordance with Section 355 of the Internal Revenue Code. The Company received two separate tax opinions at the more likely than not level of assurance that the transaction will comply with the provisions of Section 355. The tax opinions are not binding on the IRS. It is possible that the IRS could take a position contrary to the Company s. If the IRS were to take such a contrary position and ultimately prevail, then the Company could be required to recognize a gain on the exchange as if the Company sold the CSC shares at fair market value. The Company estimates, that under those circumstances, it would recognize a tax gain of approximately $283 million and would incur federal and state tax liabilities of approximately $111 million. Given the size and unique nature of the transaction, and the fact that the tax opinions of the Company s tax advisors have not reached the should level of assurance, the Company, for financial accounting purposes, has provided a tax reserve for the potential tax. The Company provided an additional $32 million of tax provision at the time of the exchange transaction, which, when added to previously recorded amounts results in a $111 million accrual for the full amount of the potential tax. The Company will accrue interest, through the Company s tax provision, related to the potential tax. Generally Accepted Accounting Principles require that this $111 million accrual be presented as a current liability in Income Taxes Payable, however, management estimates the resolution of this matter could take more than one year.

9. Stockholders Equity

Earnings per share. The computation of basic and diluted earnings per share is as follows (in millions, except per share amounts):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2005	2004	2005	2004
Net income	$ 170.3	$ 51.8	$ 219.5	$ 103.4
Average common shares outstanding (excluding restricted stock)	78.6	84.3	78.5	84.2
Incremental shares from assumed conversions of stock options and vesting of stock based compensation	2.3	2.5	2.4	2.4
Diluted potential common shares	80.9	86.8	80.9	86.6
Basic earnings per share	$ 2.17	$ 0.61	$ 2.79	$ 1.23
Diluted earnings per share	$ 2.11	$ 0.60	$ 2.71	$ 1.19

The Company has approximately 81.8 million and 83.0 million shares outstanding at June 30, 2005 and December 31, 2004, respectively. For financial reporting purposes, however, restricted shares in the amount of 3.0 million and 2.8 million at June 30, 2005 and December 31, 2004, respectively, are excluded from the determination of average common shares outstanding used in the calculation of basic earnings per share in the above table. Shares from options to purchase shares of common stock that were excluded from the diluted earnings per share calculation because they were anti-dilutive totaled 3.3 million and 3.5 million for the three months ended June 30, 2005 and 2004, respectively and 2.6 million and 4.2 million for the six months ended June 30, 2005 and 2004, respectively. The Company issued convertible senior debentures that if converted in the future would have a potentially dilutive effect on the Company s stock. The Series A debentures are convertible into 11.0 million shares of common stock and the Series B debentures are convertible into 6.1 million shares of common stock, subject to adjustment. The Company intends to settle any conversions with cash for the principal and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amounts. Related to the debentures, the calculation of diluted earnings per share would begin to include an incremental amount of shares assumed to be issued for the conversion spread if the Company s stock price exceeds $49.08 per share. There was no impact during the six months ended June 30, 2005 because the Company s average daily stock price for the six months did not exceed $49.08.

Comprehensive income (loss). Components of comprehensive income (loss) consist of the following

(in millions):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2005	2004	2005	2004
Net income	$ 170.3	$ 51.8	$ 219.5	$ 103.4
Other comprehensive income (loss):				
Unrealized gains (losses) on investments:				
Unrealized holding gains (losses) arising during the period	39.0	19.3	(96.5)	(7.4)
Proportional share of unconsolidated affiliate interest rate swap	(9.9)		(8.2)	
Less reclassification adjustments for net gains (losses) included in net income	(76.8)	(4.1)	(77.9)	(7.6)
Foreign currency translation adjustments	(11.5)	(0.6)	(14.1)	4.6
Deferred income taxes	18.3	(6.0)	71.0	5.2
Other comprehensive income (loss)	(40.9)	8.6	(125.7)	(5.2)
Comprehensive income	$ 129.4	$ 60.4	$ 93.8	$ 98.2

Stock repurchases. Prior to December 31, 2004, DST s Board of Directors had authorized an 11.5 million share repurchase plan. The plan allows, but does not require, the repurchase of common stock in open market and private transactions through F