DST SYSTEMS INC
Form 10-Q
May 09, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2008

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 x No o

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Number of shares outstanding of the Company s common stock as of April 30, 2008:

Common Stock $0.01 par value 54,517,669

DST Systems, Inc.

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March 31, 2008

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

DST Systems, Inc.

Form 10-Q

March 31, 2008

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 included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

The results of operations for the three months ended March 31, 2008, are not necessarily indicative of the results to be expected for the full year 2008.

DST Systems, Inc.

Condensed Consolidated Balance Sheet

(in millions, except per share amounts)

(unaudited)

	March 31, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 103.7	$ 109.4
Transfer agency investments	132.5	177.4
Accounts receivable	309.0	298.0
Deferred income taxes	34.2	30.7
Other assets	86.9	123.5
	666.3	739.0
Investments	1,876.0	1,940.3
Properties	473.1	494.1
Goodwill	117.8	117.9
Intangible assets	33.5	34.5
Other assets	74.4	70.1
Total assets	$ 3,241.1	$ 3,395.9
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Current portion of long-term debt	$ 961.5	$ 963.9
Transfer agency deposits	132.5	177.4
Accounts payable	60.8	69.8
Accrued compensation and benefits	80.6	127.3
Deferred revenues and gains	75.9	69.7
Other liabilities	104.3	118.1
	1,415.6	1,526.2
Long-term debt	474.8	97.2
Income taxes payable	84.5	100.0
Deferred income taxes	412.4	452.8
Other liabilities	68.0	60.6
Total liabilities	2,455.3	2,236.8
Commitments and contingencies (Note 9)		
Stockholders equity		
Common stock, $0.01 par; 400 million shares authorized, 95.3 million shares issued	1.0	1.0
Additional paid-in capital	143.1	142.1
Retained earnings	2,401.1	2,328.9
Treasury stock (40.1 million and 34.5 million shares, respectively), at cost	(2,369.3)	(1,979.7)
Accumulated other comprehensive income	609.9	666.8
Total stockholders equity	785.8	1,159.1
Total liabilities and stockholders equity	$ 3,241.1	$ 3,395.9

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 March 31, 2008	2007
Operating revenues	$ 430.8	$ 426.2
Out-of-pocket reimbursements	157.0	159.1
Total revenues	587.8	585.3
Costs and expenses	472.8	475.8
Depreciation and amortization	30.6	29.9
Income from operations	84.4	79.6
Interest expense	(12.7)	(18.2)
Other income (loss), net	(4.4)	12.8
Equity in earnings of unconsolidated affiliates	8.7	24.8
Income before income taxes	76.0	99.0
Income taxes	3.8	33.6
Net income	$ 72.2	$ 65.4
Average common shares outstanding	56.0	63.1
Average diluted shares outstanding	64.3	71.8
Basic earnings per share	$ 1.29	$ 1.04
Diluted earnings per share	$ 1.12	$ 0.90

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 Three Months Ended March 31,	
	2008	**2007**
Cash flows operating activities:		
Net income	$ 72.2	$ 65.4
Depreciation and amortization	30.6	29.9
Net realized (gain) loss on investments	10.5	(4.2)
Amortization of share-based compensation	7.5	6.4
Equity in earnings of unconsolidated affiliates	(8.7)	(24.8)
Deferred income taxes	(13.7)	1.1
Changes in accounts receivable	(11.1)	(7.6)
Changes in accounts payable and accrued liabilities	(60.1)	(42.2)
Changes in income taxes payable	15.1	27.2
Other, net	9.9	7.9
Total adjustments to net income	(20.0)	(6.3)
Net	52.2	59.1
Cash flows investing activities:		
Capital expenditures	(16.5)	(19.0)
Proceeds from (investments in and advances to) unconsolidated affiliates	(0.5)	36.7
Investments in securities	(31.0)	(46.1)
Proceeds from sale of investments	11.3	16.5
Other, net	(0.4)	5.2
Net	(37.1)	(6.7)
Cash flows financing activities:		
Proceeds from issuance of common stock	1.5	28.0
Principal payments on debt	(21.9)	(7.7)
Net borrowings on revolving credit facilities	397.7	41.3
Common stock repurchased	(398.6)	(94.0)
Excess tax benefits from share based compensation	0.5	5.3
Net	(20.8)	(27.1)
Net increase (decrease) in cash and cash equivalents	(5.7)	25.3
Cash and cash equivalents, beginning of period	109.4	60.6
Cash and cash equivalents, end of period	$ 103.7	$ 85.9

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 (GAAP) 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. The Condensed Consolidated Balance Sheet as of December 31, 2007 has been derived from the audited Consolidated Balance Sheet at that date, but does not include all of the information and notes required by GAAP for complete financial statements. 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, 2007.

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 March 31, 2008, and the results of operations for the three months ended March 31, 2008 and 2007, and cash flows for the three months ended March 31, 2008 and 2007.

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

The results of operations for the three months ended March 31, 2008, are not necessarily indicative of the results to be expected for the full year 2008.

2. Other Current Assets

Included in other current assets are the following items (in millions):

	March 31, 2008	December 31, 2007
Receivable from Asurion	$ 39.2	$ 39.2
Income tax recoverable		29.8
Prepaid expenses	25.0	29.6
Inventories	14.8	16.0

Other		7.9		8.9
Total	$	86.9	$	123.5

3. Investments

Investments are as follows (in millions):

	2008 Ownership Percentage	Carrying Value March 31, 2008	Carrying Value December 31, 2007
Available-for-sale securities:			
State Street Corporation	3%	$ 893.5	$ 918.4
Computershare Ltd.	5%	236.6	256.0
Euronet Worldwide	4%	36.3	56.5
Other available-for-sale securities		268.7	279.2
		1,435.1	1,510.1
Unconsolidated affiliates:			
Boston Financial Data Services	50%	156.9	151.0
International Financial Data Services, U.K.	50%	60.3	57.3
International Financial Data Services, Canada	50%	24.8	24.4
Argus Health Systems	50%	16.4	16.1
Unconsolidated real estate affiliates		54.7	62.3
Other unconsolidated affiliates		9.5	9.8
		322.6	320.9
Other:			
Trading securities		47.0	51.3
Held-to-maturity		3.3	3.7
Investments, at cost		68.0	54.3
		118.3	109.3
Total investments		$ 1,876.0	$ 1,940.3

The following table summarizes certain information related to the Company s available-for-sale securities (in millions):

	March 31, 2008	December 31, 2007
Book cost basis	$ 463.7	$ 466.3
Gross unrealized gains	981.0	1,053.9
Gross unrealized losses	(9.6)	(10.1)
Market value	$ 1,435.1	$ 1,510.1

The Company provides 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. Invested balances are returned to the full service mutual fund transfer agency client accounts the following business day. The Company had $132.5 million and $177.4 million of transfer agency investments and deposits at March 31, 2008 and December 31, 2007, 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, as of March 31, 2008 (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	$ 78.9	$ 9.4	$ 1.4	$ 0.2	$ 80.3	$ 9.6

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. These 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 and results of operations.

The Company recognized $10.2 million and $0.5 million of investment impairments for the three months ended March 31, 2008 and 2007, respectively, which the Company believed were other than temporary. The impairments recorded during the three months ended March 31, 2008 and 2007 relate to available-for-sale investments in the Investments and Other Segment and 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 other income (loss), net line in the statement of income.

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

	For the Three Months Ended March 31,	
	2008	2007
BFDS	$ 5.9	$ 7.9
IFDS, U.K.	3.0	3.5
IFDS, Canada	0.5	2.4
Argus	0.3	1.2
Asurion		11.4
Other	(1.0)	(1.6)
	$ 8.7	$ 24.8

4. Fair Value Measurements

Effective January 1, 2008, the Company adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. The Company did not elect the fair value measurement option under SFAS 159 for any of its financial assets or liabilities and, as a result, there was no impact on the Company s consolidated financial statements.

On January 1, 2008, DST adopted Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair

value by providing a fair value hierarchy based on the source of the information. The FASB delayed the effective date to first quarter 2009 for nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis, in accordance with FASB Staff Position SFAS 157-2, Effective Date of

FASB Statement No. 157. Management is currently evaluating the financial reporting requirements for these assets and liabilities and has not yet determined the impact on the consolidated financial statements. SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of March 31, 2008, the Company held certain investment assets that are required to be measured at fair value on a recurring basis. These investments include the Company s available-for-sale and trading securities whereby fair value is determined using quoted prices in active markets. Accordingly, the fair value measurements of these investments have been classified as Level 1. The Company s derivative instruments, specifically DST s proportional share of an unconsolidated affiliate s interest rate swap, use inputs from quoted prices for similar assets and liabilities in active markets and other observable inputs directly or indirectly related to the derivative instrument being measured. Fair value measurements of DST s derivative instruments have been classified as Level 2.

The following table presents assets and liabilities measured at fair value on a recurring basis (in millions):

		Fair Value Measurements at Reporting Date Using		
	3/31/2008	Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	$ 1,435.1	$ 1,435.1	$	$
Trading securities	47.0	47.0		
Total	$ 1,482.1	$ 1,482.1	$	$

5. Goodwill and Intangible Assets

Goodwill

The following table summarizes the changes in the carrying amount of goodwill for the three months ended March 31, 2008, by segment (in millions):

	December 31, 2007	Acquisitions	Disposals	Other	March 31, 2008
Financial Services	$ 108.5	$ 0.4	$	$ (0.5)	$ 108.4
Output Solutions	9.4				9.4
Total	$ 117.9	$ 0.4	$	$ (0.5)	$ 117.8

Intangible Assets

The following table summarizes intangible assets for the three months ended March 31, 2008, by segment (in millions):

	March 31, 2008		December 31, 2007	
	Gross Carrying Amount	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Amortizable intangible assets:				
Customer relationships	$ 36.7	$ 5.5	$ 36.7	$ 4.6
Other	3.8	1.5	3.8	1.4
Total	$ 40.5	$ 7.0	$ 40.5	$ 6.0

Amortization of intangible assets for the three months ended March 31, 2008 and 2007 was approximately $1.0 million and $0.6 million, respectively. The Company estimates that amortization expense attributable to intangible assets recorded as of March 31, 2008 will be approximately $2.9 million for the remainder of 2008, $3.8 million for 2009, $3.7 million for 2010, $3.1 million for 2011, $3.0 million for 2012 and $17.0 million thereafter.

6. Debt

Senior Convertible Debentures

Holders of the Company s $840 million senior convertible debentures were eligible to convert these bonds during the three months ended March 31, 2008 as a result of DST s common stock trading above 120% of the applicable conversion price ($49.08) for at least 20 trading days during the period of 30 consecutive trading days ended December 31, 2007. Actual conversions for the three months ended March 31, 2008 have been less than $0.1 million and cash was used to settle the principal portion of these conversions. The senior debentures continue to be convertible through June 30, 2008 as the stock price conversion feature was still in effect at March 31, 2008. Conversion rights, and ultimate classification as a current or non-current liability, for subsequent quarters will be a function of future DST stock prices.

7. Income Taxes

In general, the Company records income tax expense 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 5.0% for the three months ended March 31, 2008 compared to 33.9% for the same period in 2007. The lower effective tax rate for 2008 is primarily due to an income tax benefit of approximately $23.9 million resulting from a net reduction in the Company s liabilities for FIN 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB No. 109 (including approximately $10.4 million of interest and penalties). The net decrease in FIN 48 liabilities is principally related to the resolution of an IRS examination matter (associated with a transaction that the Company consummated in the 2000 tax year) that was resolved in DST s favor. The full year 2008 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 experimentation and state

incentive), adjustments which may arise from the resolution of tax matters under review and the Company s assessment of its liability for unrecognized tax benefits.

8. 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 March 31, 2008	2007
Net income	$ 72.2	$ 65.4
Dilutive securities at unconsolidated affiliates		(0.5)
Net income for dilutive computation	$ 72.2	$ 64.9
Average common shares outstanding (excluding restricted stock)	56.0	63.1
Incremental shares from assumed conversions of stock options, vesting of stock based compensation and debenture conversion	8.3	8.7
Average diluted shares outstanding	64.3	71.8
Basic earnings per share	$ 1.29	$ 1.04
Diluted earnings per share	$ 1.12	$ 0.90

The Company had approximately 55.2 million and 65.2 million shares outstanding at March 31, 2008 and 2007, respectively. For financial reporting purposes, however, unvested restricted shares in the amount of 2.7 million and 2.5 million at March 31, 2008 and 2007, 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 common stock that were excluded from the diluted earnings per share calculation because they were anti-dilutive totaled 0.1 million for the three months ended March 31, 2007. There were no anti-dilutive shares from options to purchase common stock during the three months ended March 31, 2008. The Company has 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 includes an incremental amount of shares assumed to be issued for the conversion spread when the Company s average daily stock price exceeds $49.08 per share. For the three months ended March 31, 2008 and 2007, there was additional dilution for each of these periods of approximately 5.3 million shares related to the Company s average daily share price exceeding $49.08 per share.

Stock repurchases

On January 18, 2008, DST s Board of Directors authorized the repurchase of an additional 5.0 million shares under the existing share repurchase authorization. The Company repurchased 5,625,244 shares of DST common stock for $394.9 million or approximately $70.20 per share during the three months ended March 31, 2008. At March 31, 2008, approximately 1.2 million shares remained under the existing share repurchase authorization plan.

Comprehensive income (loss)

Components of comprehensive income (loss) consist of the following (in millions):

	For the Three Months Ended March 31, 2008	2007
Net income	$ 72.2	$ 65.4
Other comprehensive income (loss):		
Unrealized gains (losses) on investments:		
Unrealized holding gains (losses) arising during the period	(91.5)	25.4
Proportional share of unconsolidated affiliate interest rate swap	(7.6)	0.4
Less reclassification adjustments for net (gains) losses included in net income	10.5	(4.2)
Foreign currency translation adjustments	1.4	5.5
Deferred income taxes	30.3	(8.5)
Other comprehensive income (loss)	(56.9)	18.6
Comprehensive income	$ 15.3	$ 84.0

9. Commitments and Contingencies

The Company and its subsidiaries are involved in various legal proceedings arising in the normal course of their businesses. While the ultimate outcome of these legal proceedings cannot be predicted with certainty, it is the opinion of management that the final outcome in such proceedings, in the aggregate, would not have a material adverse effect on the consolidated financial condition, results of operations and cash flows of the Company.

The Company has letters of credit of $6.2 million and $3.3 million outstanding at March 31, 2008 and December 31, 2007, respectively. Letters of credit are secured by the Company s debt facility.

The Company has entered into agreements with certain officers whereby upon defined circumstances constituting a change in control of the Company, certain benefit entitlements are automatically funded and such officers are entitled to specific cash payments upon termination of employment.

The Company has established trusts to provide for the funding of corporate commitments and entitlements of Company officers, directors, employees and others in the event of a change in control of the Company. Assets held in such trusts at March 31, 2008 were not significant.

The Company has entered into an agreement to guarantee 50% of the obligations of a 50% owned joint venture as a tenant under a real estate lease for an office building. The initial term of the lease is 10 years and 7 months, commencing March 1, 2007 and expiring September 30, 2017, with two five-year options to extend. The base rent for the initial term is $4.8 million per year, plus all operating expenses for the building.

The Company has entered into an agreement to guarantee 50% of a $6.1 million line of credit provided to a 50% owned real estate joint venture. The line of credit becomes due and the Company s guarantee thereof expires on June 16, 2009. At March 31, 2008, total borrowings against the line of credit were $5.8 million. In April 2008, this line of credit was repaid.

The Company entered into an agreement to guarantee $2.0 million plus any enforcement costs related to a $32.0 million mortgage loan to a 33% owned real estate joint venture. The $32.0 million loan matures on July 1, 2010. At March 31, 2008, total borrowings on the loan were $28.6 million and the Company s guarantee totaled $2.0 million.

The Company s 50% owned joint ventures are generally governed by shareholder or partnership agreements. The agreements generally entitle the Company to elect one-half of the directors to the board in the case of corporations and to have 50% voting/managing interest in the case of partnerships. The agreements generally provide that the Company or the other party has the option to establish a price payable in cash, or a promise to pay cash, for all of the other s ownership in the joint venture and to submit an offer, in writing, to the other party to sell to the other party all of its ownership interests in the joint venture or to purchase all ownership interests owned by the other party at such offering price. The party receiving the offer generally has a specified period of time to either accept the offer to purchase, or to elect to purchase the offering party s interest at the offering price. The Company cannot estimate the potential aggregate offering price that it could be required to receive or elect to pay in the event this option becomes operable; however, the amount could be material.

Guarantees

In addition to the guarantees entered into as mentioned above, the Company has also guaranteed certain obligations of certain joint ventures under service agreements entered into by the joint ventures and their customers. The amount of such obligations is not stated in the agreements. Depending on the negotiated terms of the guaranty and/or the underlying service agreement, the Company s liability under the guaranty may be subject to time and materiality limitations, monetary caps and other conditions and defenses.

In certain instances in which the Company licenses proprietary systems to customers, the Company gives certain warranties and infringement indemnities to the licensee, the terms of which vary depending on the negotiated terms of each respective license agreement, but which generally warrant that such systems will perform in accordance with their specifications. The amount of such obligations is not stated in the lease agreements. The Company s liability for breach of such warranties may be subject to time and materiality limitations, monetary caps and other conditions and defenses.

From time to time, the Company enters into agreements with unaffiliated parties containing indemnification provisions, the terms of which vary depending on the negotiated terms of each respective agreement. The amount of such obligations is not stated in the agreements. The Company s liability under such indemnification provisions may be subject to time and materiality limitations, monetary caps and other conditions and defenses. Such indemnity obligations include the following:

The Company has entered into purchase and service agreements with its vendors, and consulting agreements with providers of consulting services to the Company, pursuant to which the Company has agreed to indemnify certain of such vendors and consultants, respectively, against third party claims arising from the Company s use of the vendor s product or the services of the vendor or consultant.

In connection with the acquisition or disposition of subsidiaries, operating units and business assets by the Company, the Company has entered into agreements containing indemnification provisions, the terms of which vary depending on the negotiated terms of each respective agreement, but which are generally described as follows: (i) in connection with acquisitions made by the Company, the Company has agreed to indemnify the seller against third-party claims made against the seller relating to the subject subsidiary, operating unit or asset and arising after the closing of the transaction, and (ii) in connection with dispositions made by the Company, the Company has agreed to indemnify the buyer against damages incurred by the buyer due to the buyer s reliance on representations and warranties relating to the subject subsidiary, operating unit or business assets in the disposition agreement if such representations or warranties were untrue when made, or due to any breach of the representations, warranties, agreements or covenants contained in the agreement.

The Company has entered into agreements with certain third parties, including banks and escrow agents, which provide software escrow, fiduciary and other services to the Company or to its benefit plans or customers. Under such agreements, the Company has agreed to indemnify such service providers for third party claims relating to the carrying out of their respective duties under such agreements.

The Company has entered into agreements with lenders providing financing to the Company pursuant to which the Company agrees to indemnify such lenders for third party claims arising from or relating to such financings. In connection with real estate mortgage financing, the Company has entered into environmental indemnity

agreements in which the Company has agreed to indemnify the lenders for any damage sustained by the lenders relating to any environmental contamination on the subject properties.

In connection with the acquisition or disposition of real estate by the Company, the Company has entered into real estate contracts containing indemnification provisions, the terms of which vary depending on the negotiated terms of each respective contract, but which are generally described as follows: (i) in connection with acquisitions by the Company, the Company has agreed to indemnify the seller against third-party claims made against the seller arising from the Company s on-site inspections, tests and investigations of the subject property made by the Company as part of its due diligence and against third-party claims relating to the operations on the subject property after the closing of the transaction, and (ii) in connection with dispositions by the Company, the Company has agreed to indemnify the buyer for damages incurred by the buyer due to the buyer s reliance on representations and warranties relating to the subject property made by the Company in the real estate contract if such representations or warranties were untrue when made and against third-party claims relating to operations on the subject property prior to the closing of the transaction.

In connection with the leasing of real estate by the Company, as landlord and as tenant, the Company has entered into occupancy leases containing indemnification provisions, the terms of which vary depending on the negotiated terms of each respective lease, but which are generally described as follows: (i) in connection with leases in which the Company is the tenant, the Company has agreed to indemnify the landlord against third party claims relating to the Company s occupancy of the subject property, including claims arising from loss of life, bodily injury and/or damage to property thereon, and (ii) in connection with leases in which the Company is the landlord, the Company has agreed to indemnify the tenant against third party claims to the extent occasioned wholly or in part by any negligent act or omission of the Company or arising from loss of life, bodily injury and/or damage to property in or upon any of the common areas or other areas under the Company s control.

At March 31, 2008 and December 31, 2007, the Company had not accrued any liability on the aforementioned guarantees or indemnifications as they relate to future performance criteria or indirect guarantees of indebtedness of others in accordance with FIN 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.

10. Proposed New Accounting Standards

Earnings Per Share

The Financial Accounting Standards Board (the FASB) previously issued an exposure draft on a proposed accounting standard that would amend SFAS No. 128, Earnings per Share (SFAS 128), to clarify guidance for mandatorily convertible instruments, the treasury stock method, contingently issuable shares, and contracts that may be settled in cash or shares.

The proposed amendment, which is designed for convergence with international accounting standards, would require the use of the if-converted method from the date of issuance of the convertible debentures. The proposed amendment would remove the ability of a company to support the presumption that the convertible securities will be satisfied in cash and not converted into shares of common stock. Accordingly, the Company s stated intention to settle conversions of its convertible debentures 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 would no longer be accepted under SFAS 128, if amended as proposed. The final standard has yet to be issued. Retrospective application would be required for all changes to SFAS 128, except that retrospective application would be prohibited for contracts that were either settled in cash prior to adoption or modified prior to adoption to require cash settlement. For DST, adoption of this statement, as proposed, will require retroactive restatement of the Company s

diluted earnings per share calculations subsequent to the issuance of the convertible debentures. In calculating diluted earnings per share under the revised SFAS 128 if converted method included in the exposure draft, the Company would need to increase net income for the interest

expense associated with the convertible debentures, net of tax, and increase the incremental shares assumed to be issued upon conversion by 17.1 million shares (less shares already included in diluted earnings per share), the amount of shares that would be issued if all $840 million of convertible debentures would be converted to equity. The revised SFAS 128 exposure draft also contains other EPS computational changes (e.g., treasury stock method considerations) that may have an effect on the Company s diluted earnings per share calculation. DST is continuing to monitor the FASB s progress towards finalizing this proposed accounting standard.

The proposed change in accounting principle would affect the calculation of diluted earnings per share during the period the debentures are outstanding, but would not affect DST s ability to ultimately settle the convertible debentures in cash, shares or any combination thereof.

The estimated impact of this new accounting standard reflects the Company s current estimates based upon the exposure draft in its current form. There may be material differences between these estimates and the actual impact of the standard when issued as final.

Accounting for Convertible Debt Instruments

In March 2008, the FASB recommended the issuance of proposed FASB Staff Position (FSP) No. APB 14-a, Accounting for Convertible Debt Instruments that may be Settled in Cash upon Conversion (Including Partial Cash Settlement). This FSP clarifies that issuers of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) should separately account for the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The FSP would be effective for financial statements issued for fiscal years beginning after December 15, 2008, and early adoption is not permitted. This FSP would be applied retrospectively to all periods presented. DST is still evaluating the impact of this FSP and currently believes that the adoption of this proposed standard would result in higher interest expense on DST s $840 million of senior convertible debentures and may cause the separation of the debt and equity components of the senior convertible debentures on the Condensed Consolidated Balance Sheet.

11. Segment Information

The Company s operating business units offer sophisticated information processing and software services and products. The Company has elected to organize and report on these business units as two operating Segments (Financial Services and Output Solutions). In addition, investments in equity securities, private equity fund investments, and certain financial interests, and the Company s real estate subsidiaries and affiliates have been aggregated into an Investments and Other Segment.

In first quarter 2008, the Company changed the measurement of certain cost components of its Output Solutions Segment. The Output Solutions Segment leases its Connecticut, Missouri and California production facilities from the Investments and Other Segment. Beginning in 2008, the Company began reporting financial results for the Output Solutions Segment on the basis that the Output Solutions Segment owned (instead of leased) these three production facilities. Management believes this action will improve its ability to analyze the Output Solutions Segment operating results taking into consideration the special purpose nature of the production plants. Reported results for the Output Solutions Segment and the Elimination Adjustments for periods prior to 2008 have been restated to reflect this change. The Company s restated segment results for the three months ended March 31, 2007 and the years ended December 31, 2007, 2006 and 2005 are included in the tables below. The Investments and Other Segment continues to present rental revenues from the Output Solutions Segment along with the related depreciation expense associated with the properties, while the elimination of the inter-segment activity is included in the Elimination Adjustments. The impact of this change increased Output Solutions income from operations by $1.7 million and $1.8 million for the three months ended March 31, 2008 and 2007,

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respectively, and correspondingly increased the Segment Eliminations loss from operations by $1.7 million and $1.8 million for the three months ended March 31, 2008 and 2007, respectively.

Information concerning total assets by reporting segment is as follows (in millions):

	March 31, 2008	December 31, 2007
Financial Services	$ 1,713.6	$ 1,770.9
Output Solutions	229.3	261.0
Investments and Other	1,576.6	1,651.7
Elimination Adjustments	(278.4)	(287.7)
	$ 3,241.1	$ 3,395.9

The Company evaluates the performance of its Segments based on income before income taxes, non-recurring items and interest expense. Intersegment revenues are reflected at rates prescribed by the Company and may not be reflective of market rates.

Summarized financial information concerning the Segments is shown in the following tables (in millions):

	For the Three Months Ended March 31, 2008				
	Financial Services	Output Solutions	Investments/ Other	Elimination Adjustments	Consolidated Total
Operating revenues	$ 284.9	$ 142.7	$ 3.2	$	$ 430.8
Intersegment operating revenues	1.9		11.8	(13.7)	
Out-of-pocket reimbursements	17.8	139.2	0.1	(0.1)	157.0
Total revenues	304.6	281.9	15.1	(13.8)	587.8
Costs and expenses	215.3	258.9	10.1	(11.5)	472.8
Depreciation and amortization	19.9	9.2	2.1	(0.6)	30.6
Income from operations	69.4	13.8	2.9	(1.7)	84.4
Other income (loss), net	(4.5)	(0.2)	0.3		(4.4)
Equity in earnings (losses) of unconsolidated affiliates	9.2		(0.5)		8.7
Earnings before interest and income taxes	$ 74.1	$ 13.6	$ 2.7	$ (1.7)	$ 88.7

	For the Three Months Ended March 31, 2007				
	Financial Services	Output Solutions	Investments/ Other	Elimination Adjustments	Consolidated Total
Operating revenues	$ 273.7	$ 149.2	$ 3.3	$	$ 426.2
Intersegment operating revenues	1.8		12.5	(14.3)	
Out-of-pocket reimbursements	16.3	142.8	0.1	(0.1)	159.1
Total revenues	291.8	292.0	15.9	(14.4)	585.3
Costs and expenses	209.6	268.1	10.0	(11.9)	475.8
Depreciation and amortization	18.4	9.8	2.4	(0.7)	29.9
Income from operations	63.8	14.1	3.5	(1.8)	79.6
Other income, net	3.2		9.6		12.8
Equity in earnings (losses) of unconsolidated affiliates	26.7		(1.9)		24.8
Earnings before interest and income taxes	$ 93.7	$ 14.1	$ 11.2	$ (1.8)	$ 117.2

Earnings before interest and income taxes in the segment reporting information above less interest expense of $12.7 million and $18.2 million for the three months ended March 31, 2008 and 2007, respectively, is equal to the Company s income before income taxes on a consolidated basis for the corresponding periods.

	Year Ended December 31, 2007				
	Financial Services	Output Solutions	Investments/ Other	Elimination Adjustments	Consolidated Total
Operating revenues	$ 1,127.0	$ 555.1	$ 13.3	$	$ 1,695.4
Intersegment operating revenues	7.6		49.8	(57.4)	
Out-of-pocket reimbursements	65.0	542.0	0.4	(0.3)	607.1
Total revenues	1,199.6	1,097.1	63.5	(57.7)	2,302.5
Costs and expenses	831.0	1,016.0	28.5	(47.5)	1,828.0
Depreciation and amortization	81.9	42.3	9.1	(2.7)	130.6
Income from operations	286.7	38.8	25.9	(7.5)	343.9
Other income, net	4.8		40.2		45.0
Gain on sale of Asurion	998.0				998.0
Equity in earnings (losses) of unconsolidated affiliates	72.8		(10.2)		62.6
Earnings before interest and income taxes	$ 1,362.3	$ 38.8	$ 55.9	$ (7.5)	$ 1,449.5

	Year Ended December 31, 2006				
	Financial Services	Output Solutions	Investments/ Other	Elimination Adjustments	Consolidated Total
Operating revenues	$ 1,005.0	$ 535.9	$ 15.3	$	$ 1,556.2
Intersegment operating revenues	6.2		48.1	(54.3)	
Out-of-pocket reimbursements	60.8	619.2	0.5	(0.9)	679.6
Total revenues	1,072.0	1,155.1	63.9	(55.2)	2,235.8
Costs and expenses	699.7	1,107.3	39.7	(46.1)	1,800.6
Depreciation and amortization	83.1	37.1	12.3	(2.6)	129.9
Income from operations	289.2	10.7	11.9	(6.5)	305.3
Other income, net	12.0	0.1	37.9		50.0
Gain on sale of business	52.8				52.8
Equity in earnings (losses) of unconsolidated affiliates	52.1		(4.4)		47.7
Earnings before interest and income taxes	$ 406.1	$ 10.8	$ 45.4	$ (6.5)	$ 455.8

	Year Ended December 31, 2005					
	Financial Services	Output Solutions	Customer Management	Investments/ Other	Elimination Adjustments	Consolidated Total
Operating revenues	$ 1,175.7	$ 453.4	$ 96.6	$ 18.9	$	$ 1,744.6
Intersegment operating revenues	8.0	33.8		48.2	(90.0)	
Out-of-pocket reimbursements	167.4	613.6	26.4	0.4	(37.3)	770.5
Total revenues	1,351.1	1,100.8	123.0	67.5	(127.3)	2,515.1
Costs and expenses						