

DST SYSTEMS INC  
Form 10-Q  
August 06, 2010  
Table of Contents

**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 June 30, 2010**

**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**  
(State or other jurisdiction of  
incorporation or organization)

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

**43-1581814**  
(I.R.S. Employer  
Identification No.)

**64105**  
(Zip Code)

Edgar Filing: DST SYSTEMS INC - Form 10-Q

(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(do not check if a smaller reporting company)

Smaller reporting company

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

Number of shares outstanding of the Company's common stock as of July 31, 2010:

Common Stock \$0.01 par value 46,741,260

---

Table of Contents

**DST Systems, Inc.**

**Form 10-Q**

**June 30, 2010**

**Table of Contents**

	<b>Page(s)</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1.</u></b>	
	<b><u>Financial Statements (unaudited)</u></b>
	<b><u>Introductory Comments</u></b> 3
	<b><u>Condensed Consolidated Balance Sheet June 30, 2010 and December 31, 2009</u></b> 4
	<b><u>Condensed Consolidated Statement of Income Three and six months ended June 30, 2010 and 2009</u></b> 5
	<b><u>Condensed Consolidated Statement of Cash Flows Six months ended June 30, 2010 and 2009</u></b> 6
	<b><u>Notes to Condensed Consolidated Financial Statements</u></b> 7-23
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b> 24-56
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b> 56-57
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b> 57
<b><u>Item 4T.</u></b>	<b><u>Controls and Procedures</u></b> 57
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b> 57
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b> 57-63
<b><u>Item 2.</u></b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b> 64
<b><u>Item 3.</u></b>	<b><u>Defaults Upon Senior Securities</u></b> 64
<b><u>Item 4.</u></b>	<b><u>(Removed and Reserved)</u></b> 64
<b><u>Item 5.</u></b>	<b><u>Other Information</u></b> 64-65
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b> 65

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.



Table of Contents

**DST Systems, Inc.**

**Form 10-Q**

**June 30, 2010**

**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, 2009.

The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results to be expected for the full year 2010.

Table of Contents**DST Systems, Inc.****Condensed Consolidated Balance Sheet***(in millions, except per share amounts)**(unaudited)*

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 78.7	\$ 106.2
Funds held on behalf of clients	261.5	208.3
Client funding receivable	58.7	103.8
Accounts receivable	285.9	167.2
Deferred income taxes	18.3	19.2
Other assets	36.6	74.2
	739.7	678.9
Investments	1,247.8	1,411.8
Properties	513.2	536.3
Goodwill	186.7	183.6
Intangible assets	40.5	43.0
Other assets	58.2	59.2
Total assets	\$ 2,786.1	\$ 2,912.8
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities		
Current portion of debt	\$ 313.7	\$ 658.1
Client funds obligations	320.2	312.1
Accounts payable	47.5	69.9
Accrued compensation and benefits	85.8	90.8
Deferred revenues and gains	56.7	59.1
Income tax payable	5.8	
Other liabilities	86.2	91.2
	915.9	1,281.2
Long-term debt	905.0	563.8
Income taxes payable	59.7	57.1
Deferred income taxes	255.7	312.0
Other liabilities	73.2	64.3
Total liabilities	2,209.5	2,278.4
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	243.1	235.6
Retained earnings	2,906.2	2,749.6
Treasury stock (48.6 million and 46.2 million shares, respectively), at cost	(2,799.1)	(2,704.3)
Accumulated other comprehensive income	225.4	352.5
Total stockholders' equity	576.6	634.4
Total liabilities and stockholders' equity	\$ 2,786.1	\$ 2,912.8

Edgar Filing: DST SYSTEMS INC - Form 10-Q

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

Table of Contents**DST Systems, Inc.****Condensed Consolidated Statement of Income***(in millions, except per share amounts)**(unaudited)*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Operating revenues	\$ 465.6	\$ 404.5	\$ 875.0	\$ 800.1
Out-of-pocket reimbursements	148.3	149.5	305.6	314.8
Total revenues	613.9	554.0	1,180.6	1,114.9
Costs and expenses	436.0	454.5	904.1	912.7
Depreciation and amortization	35.6	31.0	65.9	59.3
Income from operations	142.3	68.5	210.6	142.9
Interest expense	(11.7)	(9.5)	(21.6)	(20.1)
Other income, net	4.0	11.2	58.4	27.4
Equity in earnings of unconsolidated affiliates	9.8	10.5	18.1	16.2
Income before income taxes	144.4	80.7	265.5	166.4
Income taxes	50.4	32.0	94.6	44.5
Net income	\$ 94.0	\$ 48.7	\$ 170.9	\$ 121.9
Average common shares outstanding	46.7	49.7	47.5	49.7
Average diluted shares outstanding	47.0	50.0	47.8	49.9
Basic earnings per share	\$ 2.01	\$ 0.98	\$ 3.60	\$ 2.45
Diluted earnings per share	\$ 2.00	\$ 0.97	\$ 3.57	\$ 2.44
Cash dividends per share of common stock	\$	\$	\$ 0.30	\$

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



Table of Contents**DST Systems, Inc.****Condensed Consolidated Statement of Cash Flows***(in millions)**(unaudited)*

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows operating activities:</b>		
Net income	\$ 170.9	\$ 121.9
Depreciation and amortization	65.9	59.3
Net (gains) losses on investments	(40.6)	27.0
Net gain on the extinguishment of senior convertible debentures	(0.1)	(5.8)
Gain on equity interest in Argus Health Systems, Inc.		(41.7)
Amortization of share based compensation	10.7	14.2
Equity in earnings of unconsolidated affiliates	(18.1)	(16.2)
Dividends from unconsolidated affiliates	2.4	29.3
Deferred income taxes	16.7	(6.3)
Changes in accounts receivable	(118.9)	45.3
Proceeds from accounts receivable securitization program, net		10.0
Changes in accounts payable and accrued liabilities	(8.8)	(28.9)
Changes in income taxes payable	32.8	(41.5)
Other, net	13.7	12.6
Total adjustments to net income	(44.3)	57.3
Net	126.6	179.2
<b>Cash flows investing activities:</b>		
Capital expenditures	(54.3)	(39.1)
Proceeds from (investments in and advances to) unconsolidated affiliates	8.4	(1.8)
Investments in securities	(92.9)	(52.9)
Proceeds from sales/maturities of investments	112.6	43.6
Net (increase) decrease in restricted cash and cash equivalents held to satisfy client funds obligations	(53.2)	135.1
Acquisition of interest in Argus Health Systems, Inc., net of cash acquired		(47.8)
Other, net	0.1	0.1
Net	(79.3)	37.2
<b>Cash flows financing activities:</b>		
Proceeds from issuance of common stock	9.8	4.7
Principal payments on debt	(7.7)	(7.4)
Repurchases of senior convertible debentures	(155.0)	(121.8)
Net proceeds from accounts receivable securitization program	125.0	
Net increase (decrease) in client funds obligations	53.2	(146.1)
Net borrowings on revolving credit facilities	29.2	27.6
Payment of debt issuance costs	(6.6)	
Common stock repurchased	(108.7)	(4.9)
Payment of cash dividends	(14.3)	
Excess tax benefits from share based compensation	0.3	
Net	(74.8)	(247.9)
Net decrease in cash and cash equivalents	(27.5)	(31.5)
Cash and cash equivalents, beginning of period	106.2	78.7
Cash and cash equivalents, end of period	\$ 78.7	\$ 47.2

Edgar Filing: DST SYSTEMS INC - Form 10-Q

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

Table of Contents

**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 ( "SEC" ). 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, 2009 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, 2009.

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 consolidated financial position of the Company and its subsidiaries at June 30, 2010, and the results of operations for the three and six months ended June 30, 2010 and 2009, and cash flows for the six months ended June 30, 2010 and 2009.

The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results to be expected for the full year 2010.

**2. Business Combination**

On July 30, 2010, DST, through its wholly-owned U.K. subsidiary, Innovative Output Solutions Limited ( "IOS" ), completed an agreement (the "Purchase Agreement" ) to acquire the entire issued share capital of dsicmm Group Limited. Prior to closing the transaction, IOS held DST's debt-free U.K. print/mail operations, and dsicmm was a U.K. based, private company that provided integrated print and communication solutions. On July 30, 2010, the stockholders of dsicmm (the "Sellers" ) exchanged their dsicmm shares for IOS shares and cash, with the result that the equity of IOS is owned approximately 65% by DST and approximately 35% by a group of the Sellers. The percentage of IOS stock that will be owned by each stockholder is subject to adjustment after the closing in the event the closing date working capital and total debt of dsicmm or IOS deviates from amounts set forth in the Purchase Agreement. DST believes that the acquisition of dsicmm complements its existing Output Solutions business in the U.K., increases the overall size of the business, broadens the service/product offerings and expands and diversifies the client base. dsicmm has approximately 1,200 employees and annual revenues of approximately \$160 million. DST will consolidate the financial results of the combined IOS business from the closing date. DST management does not expect the transaction to have a material impact on DST's net income or earnings per share for 2010.



Table of Contents**3. Investments**

Investments are as follows (in millions):

	2010 Ownership Percentage	June 30, 2010	Carrying Value December 31, 2009
<b>Available-for-sale securities:</b>			
State Street Corporation	2%	\$ 357.8	\$ 460.7
Computershare Ltd.	3%	156.1	228.8
Euronet Worldwide	4%	24.1	41.4
Other available-for-sale securities		166.6	162.4
		704.6	893.3
<b>Unconsolidated affiliates:</b>			
Boston Financial Data Services, Inc.	50%	162.2	154.5
International Financial Data Services, U.K.	50%	66.5	65.1
International Financial Data Services, L.P.	50%	38.7	38.5
Unconsolidated real estate affiliates		72.0	88.0
Other unconsolidated affiliates		11.9	13.4
		351.3	359.5
<b>Other:</b>			
Trading securities		46.6	48.8
Held-to-maturity		9.9	6.9
Investments, at cost		135.4	103.3
		191.9	159.0
<b>Total investments</b>		<b>\$ 1,247.8</b>	<b>\$ 1,411.8</b>

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

	June 30, 2010	December 31, 2009
Book cost basis	\$ 316.8	\$ 319.4
Gross unrealized gains	388.5	557.8
Gross unrealized losses	(6.6)	(0.9)
Unrealized gain from changes in foreign currency exchange rates	5.9	17.0
Market value	\$ 704.6	\$ 893.3

During the six months ended June 30, 2010 and 2009, the Company received \$110.7 million and \$32.6 million, respectively, from the sale of investments in available-for-sale securities. Gross realized gains of \$3.9 million and \$4.4 million and gross realized losses of \$0.8 million and \$0.2 million, respectively, were recorded during the three months ended June 30, 2010 and 2009 from available-for-sale securities. Gross realized gains of \$41.7 million and \$5.5 million and gross realized losses of \$1.1 million and \$2.1 million, respectively, were recorded during the six months ended June 30, 2010 and 2009 from available-for-sale securities. In addition, the Company recorded unrealized losses on available-for-sale securities of \$0.3 million and \$0.4 million for the three and six months ended June 30, 2010, respectively, as compared to \$1.2 million and \$26.8 million for the three and six months ended June 30, 2009, respectively, related to other than temporary investment impairments. Included in the \$110.7 million received from sale/maturities of investments is \$52.4 million of proceeds resulting from the sale of 4.8 million shares of Computershare Ltd., which resulted in a gain of \$28.8 million.



## Edgar Filing: DST SYSTEMS INC - Form 10-Q

### Table of Contents

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, 2010 (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	\$ 46.5	\$ 6.6	\$	\$	\$ 46.5	\$ 6.6

In addition to recording other than temporary investment impairments on available for sale securities, the Company records lower of cost or market valuation adjustments on private equity fund investments and other cost method investments when impairment conditions are present. During the three and six months ended June 30, 2010, the Company recorded \$0.4 million and \$0.8 million, respectively, of impairments on private equity and other investments as compared to the three and six months ended June 30, 2009 when the Company recorded impairments of \$0.2 million and \$4.2 million, respectively. The impairments recorded related primarily to investments in the Financial Services Segment and the Investments and Other 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, net in the Condensed Consolidated Statement of Income.

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.

Equity in earnings (losses) of unconsolidated affiliates, net of income taxes provided by the unconsolidated affiliates follows (in millions):

	Three Months Ended		Six Months Ended	
	2010	June 30, 2009	2010	June 30, 2009
BFDS	\$ 4.1	\$ 3.1	\$ 7.7	\$ 6.8
IFDS, U.K.	3.1	2.3	6.5	3.8
IFDS, L.P.	2.7	1.7	4.0	2.6
Argus				(1.5)
Other	(0.1)	3.4	(0.1)	4.5
	\$ 9.8	\$ 10.5	\$ 18.1	\$ 16.2

DST acquired the remaining 50% equity interest in Argus Health Systems, Inc. ( Argus ) on March 31, 2009 and no longer records equity in earnings of Argus, but rather consolidates the Argus results in DST's financial statements.

The Company is a limited partner in various private equity funds. At June 30, 2010 and December 31, 2009, the Company's carrying value of these private equity fund investments was approximately \$117.8 million and \$94.4 million, respectively. At June 30, 2010, the Company had future capital commitments related to these private equity fund investments of approximately \$118.7 million.





Table of Contents**4. Fair Value Measurements**

Authoritative accounting guidance on fair value measurements 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 June 30, 2010 and December 31, 2009, 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 equity securities 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 in the table below. Included in funds held on behalf of clients at June 30, 2010 and December 31, 2009 are approximately \$16.5 million and \$11.1 million, respectively, of available-for-sale fixed income securities held to satisfy client funds obligations. In addition, the Company entered into a forward starting interest rate swap in January 2009 that is required to be reported at fair value. Fair value for the available-for-sale fixed income securities and for the interest rate swap was determined using inputs from quoted prices for similar asset and liabilities in active markets and other observable inputs directly or indirectly. Accordingly, these investments have been classified as Level 2 in the table below.

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

	Fair Value Measurements at Reporting Date Using			
	June 30, 2010	Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$ 734.4	\$ 734.4	\$	\$
Fixed income securities	33.3		33.3	
Interest rate swap liability	(5.1)		(5.1)	
Total	\$ 762.6	\$ 734.4	\$ 28.2	\$

	Fair Value Measurements at Reporting Date Using			
	December 31, 2009	Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$ 937.7	\$ 937.7	\$	\$
Fixed income securities	15.5		15.5	
Interest rate swap liability	(1.9)		(1.9)	
Total	\$ 951.3	\$ 937.7	\$ 13.6	\$



Table of Contents

At June 30, 2010 and December 31, 2009, one of DST's unconsolidated affiliates had an interest rate swap with a fair market value liability of \$57.3 million and \$35.6 million, respectively. The unconsolidated affiliate used inputs from quoted prices for similar assets and liabilities in active markets and other observable inputs directly or indirectly related to the measurement of the interest rate swap. The fair value measurement of the interest rate swap has been classified as Level 2 by the unconsolidated affiliate. The above table presents only assets and liabilities measured at fair value for which the Company controls, and accordingly excludes items held by unconsolidated affiliates.

**5. Goodwill and Intangible Assets***Goodwill*

The following table summarizes the changes in the carrying amount of goodwill for the six months ended June 30, 2010, by Segment (in millions):

	December 31, 2009	Acquisitions	Disposals	Other	June 30, 2010
Financial Services	\$ 174.9	\$	\$	\$ 3.1	\$ 178.0
Output Solutions	8.7				8.7
<b>Total</b>	<b>\$ 183.6</b>	<b>\$</b>	<b>\$</b>	<b>\$ 3.1</b>	<b>\$ 186.7</b>

*Intangible Assets*

The following table summarizes intangible assets (in millions):

	June 30, 2010		December 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets:				
Customer relationships	\$ 51.2	\$ 13.6	\$ 51.2	\$ 11.6
Other	6.0	3.1	6.0	2.6
<b>Total</b>	<b>\$ 57.2</b>	<b>\$ 16.7</b>	<b>\$ 57.2</b>	<b>\$ 14.2</b>

Amortization of intangible assets for the three and six months ended June 30, 2010 was approximately \$1.2 million and \$2.5 million compared to \$1.1 million and \$2.0 million for the three and six months ended June 30, 2009. Annual amortization for intangible assets recorded as of June 30, 2010 is estimated to be \$2.2 million for the remainder of 2010, \$4.5 million for 2011, \$4.3 million for 2012, \$3.6 million for 2013, \$3.5 million for 2014 and \$22.4 million thereafter.



Table of Contents**6. Debt**

The Company is obligated under notes and other indebtedness as follows (in millions):

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Accounts receivable securitization program	\$ 125.0	\$ 8.9
Secured promissory notes	6.0	8.8
Equipment credit facilities	9.0	111.6
Real estate credit agreement	110.1	151.8
Convertible senior debentures		171.3
Series A	84.1	257.0
Series B	165.5	
Series C	178.5	
Revolving credit facilities	430.4	416.3
Related party promissory note	90.0	75.0
Other indebtedness	20.1	21.2
	1,218.7	1,221.9
Less current portion of debt	313.7	658.1
Long-term debt	\$ 905.0	\$ 563.8

*Accounts Receivable Securitization Program*

On January 1, 2010, the Company adopted new authoritative accounting guidance related to transfers of financial assets. This guidance changed the accounting for securitizations of mortgages and other financial instruments and the consolidation requirements for qualifying special-purpose entities ( QSPE ). Besides removing the concept of a QSPE, this new accounting guidance: a) clarified the determination of whether a transferor and all the entities included in the transferor's financial statements being presented have surrendered control over transferred financial assets; b) defined the term participating interest to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale; c) required a transferor to recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer of financial assets accounted for as a sale; and d) enhanced disclosures to provide financial statement users with greater transparency about transfers of financial assets and a transferor's continuing involvement with transferred financial assets.

Prior to the adoption of this new authoritative accounting guidance on January 1, 2010, the periodic transfers by the SPE of undivided interests in accounts receivable to the third-party, multi-seller, asset-backed commercial paper conduit met the requirements for sale accounting treatment and were considered an off-balance sheet arrangement. After January 1, 2010, the periodic transfers of undivided interests in accounts receivable no longer qualify for sale accounting treatment in accordance with the new accounting guidance and are accounted for as secured borrowings. DST has continuing involvement with the transferred assets because it maintains servicing responsibilities for the accounts receivable assets included in the accounts receivable securitization program. Accounts receivable assets transferred from DST and certain of its domestic subsidiaries to its wholly-owned, bankruptcy remote special purpose subsidiary contain restrictions because they are not available to satisfy the creditors of any other person, including DST or any of its subsidiaries or affiliates.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

At June 30, 2010, the outstanding amount of undivided interests in the receivables held by the conduit was \$125.0 million, unchanged from December 31, 2009. During the six months ended June 30, 2010, the Company's accounts receivable increased by \$125.0 million resulting in a cash outflow being reported in the operating section of the cash flow statement and the current portion of debt associated with the accounts receivable securitization program increased by \$125.0 million resulting in a cash inflow being reported in the financing section of the cash flow statement. During the six months ended June 30, 2010, total proceeds from the accounts receivable securitization program were approximately \$415.0 million and total repayments were approximately \$290.0 million.

Table of Contents

million which comprises the net cash inflow in the financing section of the statement of cash flows. Costs associated with the accounts receivable securitization program were included in other income during 2009, but are included in interest expense effective January 1, 2010.

On May 20, 2010, the Company renewed the accounts receivable securitization program. In connection with the renewal, the maximum size of the program decreased from \$175 million to \$150 million and the expiration date for the conduit's purchase commitment was changed to May 19, 2011.

Aggregate transfers of undivided interests in the receivables from the SPE to the conduit were \$886.7 million and \$888.3 million for the six months ended June 30, 2010 and 2009, respectively.

*Equipment credit facilities*

The draw period under the Company's existing \$50 million equipment credit facility expired on June 30, 2010. The maturity date for each loan drawn under that facility is the earlier of approximately three years from the initial draw or August 1, 2013.

On June 30, 2010, the Company entered into a new \$50.0 million unsecured credit facility with the same vendor. Proceeds from loans made under the new credit facility can be used to make purchases of the vendor's eligible equipment, software or services. Loans under this credit facility must be made prior to December 31, 2012, the draw period termination date. The maturity date for each loan under this credit facility is the earlier of i) the last day of the thirty first (31st) calendar month following the loan date or ii) June 30, 2015. Interest rates applicable to the loans under this credit facility are generally based on the LIBOR rate plus an applicable margin of 1.5% to 2.5%. The applicable margin is based on a grid schedule that adjusts borrowing costs up or down based upon the Company's consolidated leverage ratio. No amounts were drawn under this facility at June 30, 2010.

*Convertible Senior Debentures*

During the three and six months ended June 30, 2010, the Company recorded a gain of \$0.7 million and \$0.1 million, respectively, associated with the repurchase of a portion of the Company's senior convertible debentures at a discount to carrying value. The Company repurchased \$67.7 million in principal amount of the original Series A senior convertible debentures, \$8.8 million in principal amount of the original Series B convertible debentures and \$78.5 million in principal of the original Series C senior convertible debentures during the six months ended June 30, 2010. During the three and six months ended June 30, 2009, the Company recorded a gain of \$2.1 million and \$5.8 million, respectively, associated with the repurchase of a portion of the Company's senior convertible debentures at a discount to carrying value.

*Revolving credit facilities*

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

On April 16, 2010, the Company entered into a new syndicated line of credit facility to replace its syndicated revolving line of credit facility that matured on July 1, 2010. The new credit agreement provides for a revolving unsecured credit facility in an aggregate principal amount of up to \$600 million. The interest rates applicable to loans under the new credit agreement are generally based on LIBOR, Federal Funds or prime rates plus applicable margins as defined in the agreement. The revolving credit facility contains grid schedules that adjust borrowing costs up or down based upon the Company's consolidated leverage ratio. The grid schedules may result in fluctuations in borrowing costs ranging from 1.75% to 2.375% over LIBOR and 0.75% to 1.375% over base rate as defined. Additionally, an annual facility fee of 0.25% to 0.625% is required on this revolving syndicated line of credit. The credit agreement contains customary restrictive covenants, as well as certain customary events of default. Among other provisions, the credit agreement limits consolidated indebtedness, liens, investments, subsidiary indebtedness, asset dispositions and restricted payments (including stock repurchases and cash dividends), and requires 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 new credit facility is July 1, 2013. On April 16, 2010,



Table of Contents

the date of the refinancing transaction, the administrative agent transferred \$443.4 million of the outstanding balance under the old credit facility to the new credit facility. The Company was in compliance with its debt covenants at June 30, 2010.

*Related party promissory note*

On June 25, 2010, the Company renewed its related party promissory note with Boston Financial Data Services, Inc. ( BFDS ). The agreement provides for unsecured revolving borrowings by the Company of up to \$100 million and matures on July 1, 2013. From time to time, BFDS may, subject to a ten day notice period, demand a prepayment of the loan by the Company in an amount not to exceed \$25 million in each instance. The interest rate applicable to the loan is based on LIBOR plus an applicable margin correlating to the applicable margin under the Company's \$600 million syndicated line of credit facility. The loan agreement incorporates by reference and requires the Company to comply with the affirmative and negative covenants contained in the Company's \$600 million syndicated line of credit facility.

**7. Income Taxes**

The Company records income tax expense during interim periods based on its best estimate of the full year's tax rate. Certain items 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 tax rate was 34.9% and 35.6% for the three and six months ended June 30, 2010 compared to 39.7% and 26.7% for the three and six months ended June 30, 2009. The Company's tax rate for the three and six months ended June 30, 2010 was different from the statutory federal income tax rate of 35% primarily because of the effects of state income taxes, valuation allowances against deferred tax assets (primarily international operating losses) and the utilization of dividend received deductions and foreign tax credits. During the three months ended March 31, 2009, DST recorded a \$41.7 million gain on the purchase of the remaining 50% equity interest in Argus with no related income tax expense, reversed approximately \$0.9 million of deferred tax liabilities related to the elimination of deferred tax liabilities previously established for equity in earnings of Argus, and recorded an income tax benefit of approximately \$5.7 million resulting from a reduction in income tax related liabilities principally associated with the completion of an IRS examination in February 2009 for the tax years ended December 31, 2002 through 2005.

The full year 2010 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, foreign tax and state incentive), adjustments which may arise from the resolution of tax matters under review and the Company's assessment of its liability for uncertain tax positions.

Table of Contents**8. Stockholders Equity***Earnings per share*

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income	\$ 94.0	\$ 48.7	\$ 170.9	\$ 121.9
Average common shares outstanding	46.7	49.7	47.5	49.7
Incremental shares from assumed conversions of stock options and debenture conversion	0.3	0.3	0.3	0.2
Average diluted shares outstanding	47.0	50.0	47.8	49.9
Basic earnings per share	\$ 2.01	\$ 0.98	\$ 3.60	\$ 2.45
Diluted earnings per share	\$ 2.00	\$ 0.97	\$ 3.57	\$ 2.44

The Company had approximately 46.7 million and 49.7 million shares outstanding at June 30, 2010 and 2009, respectively. Shares from options to purchase common stock, excluded from the diluted earnings per share calculation because they were anti-dilutive, totaled 3.9 million and 4.1 million for the three and six months ended June 30, 2010 compared to 3.5 million and 3.6 million for the three and six months ended June 30, 2009. The Company's convertible senior debentures would have a potentially dilutive effect on the Company's stock if converted in the future. At June 30, 2010, outstanding Series A debentures were convertible into 1.7 million shares of common stock, outstanding Series B debentures were convertible into 3.2 million shares of common stock and outstanding Series C debentures were convertible into 3.6 million shares of common stock, subject to adjustment. The Company intends to settle any conversions with cash for the principal amount of the bonds and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amount. 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 the average accreted bond price per share. There was no additional dilution for the three and six months ended June 30, 2010 and 2009 because the Company's average share price was less than average accreted price per share.

*Share Based Compensation*

The Company has a share based compensation plan covering its employees. During the six months ended June 30, 2010, the Company issued approximately 0.1 million common stock options, 0.4 million restricted stock units (RSU's) and exchanged 0.1 million of previously awarded restricted stock shares for the same amount of RSU's. The 0.4 million RSU grant contains performance features and is expected to vest over a three to five year period. Approximately 0.7 million previously issued restricted stock shares vested in January 2010 and in connection with the vesting of those shares, the Company retained approximately 0.3 million vested shares in settlement of employee tax-withholding obligations.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

At June 30, 2010, the Company had outstanding 0.5 million unvested RSU s, 0.2 million unvested restricted shares and 5.7 million stock options (of which 1.3 million are not yet exercisable).

Grants of RSU s are valued at the date of grant based on the value of DST s common stock. The grant date fair value of the 0.4 million RSU s granted during the six months ended June 30, 2010 was approximately \$16.2 million. Certain of these RSU s contain separate service and performance vesting requirements, while other grants contain performance vesting requirements with service required through the date of certification of performance. The grant date fair value of the awards is generally being amortized over three to five year periods

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

### Table of Contents

assuming full achievement of the required performance features of the awards. The Company will continue to monitor and evaluate its assumptions over the performance period. Unvested RSU s may be forfeited upon termination of employment with the Company depending on the circumstances of the termination. Holders of RSU s are able to participate in cash dividends, if any, (paid in the form of additional RSU s, subject to the same vesting terms as the underlying RSU s), but do not have full stockholders rights, including voting rights, during the term of restriction.

At June 30, 2010, the Company had \$31.3 million of total unrecognized compensation expense (included in additional paid-in-capital on the Condensed Consolidated Balance Sheet) related to its share based compensation arrangements, net of estimated forfeitures. The Company estimates that the amortized compensation expense attributable to the stock option, restricted stock and restricted stock unit grants will be approximately \$11.6 million for the remainder of 2010, \$12.9 million for 2011, \$6.3 million for 2012 and \$0.5 million for 2013, based on awards currently outstanding.

### *Other comprehensive income (loss)*

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income	\$ 94.0	\$ 48.7	\$ 170.9	\$ 121.9
Other comprehensive income (loss):				
Unrealized gains (losses) on investments:				
Unrealized holding gains (losses) arising during the period	(181.6)	227.3	(135.2)	130.8
Proportional share of unconsolidated affiliate interest rate swap	2.1	0.5	2.4	0.8
Unrealized gain (loss) on interest rate swap	(1.9)	2.9	(3.2)	0.4
Less reclassification adjustments for net (gains) losses included in net income	(2.8)	(2.7)	(40.2)	23.7
Foreign currency translation adjustments	(16.6)	37.7	(23.7)	31.5
Deferred income taxes	75.3	(97.5)	72.8	(67.7)
Other comprehensive income (loss):	(125.5)	168.2	(127.1)	119.5
Comprehensive income (loss)	\$ (31.5)	\$ 216.9	\$ 43.8	\$ 241.4

One of DST s unconsolidated affiliates had an interest rate swap liability with a fair market value of \$57.3 million and \$35.6 million at June 30, 2010 and December 31, 2009, respectively. DST s 50% proportionate share of this interest rate swap liability was \$28.6 million and \$17.8 million at June 30, 2010 and December 31, 2009, respectively. The Company records in investments and accumulated other comprehensive income its proportionate share of this liability in an amount not to exceed the carrying value of its investment in this unconsolidated affiliate. At June 30, 2010 and December 31, 2009, the Company s proportionate share of this liability (in an amount not to exceed the carrying value of its investment in this unconsolidated affiliate) was \$2.6 million and \$5.0 million, respectively.

### *Stock repurchases*

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

On May 11, 2010, DST's Board of Directors authorized the repurchase of an additional 1.0 million shares under the existing share repurchase authorization plan, which allows for the repurchase of common stock in open market and private transactions through December 31, 2012. At June 30, 2010, there were approximately 1.0 million shares remaining to be repurchased under the Company's existing share repurchase authorization plan. The

Table of Contents

Company repurchased 150,300 shares of DST common stock for \$6.2 million or approximately \$41.25 per share during the three months ended June 30, 2010. The Company repurchased 2.3 million shares of DST common stock for \$91.1 million or approximately \$40.09 per share during the six months ended June 30, 2010.

*Dividend declared*

On March 4, 2010, DST declared its first cash dividend since going public in 1995 and paid a \$0.30 per share dividend on April 8, 2010 to shareholders of record as of the close of business on March 17, 2010. The aggregate amount of the cash dividend was \$14.3 million.

**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, after consultation with legal counsel, 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 \$8.0 million and \$8.3 million outstanding at June 30, 2010 and December 31, 2009, 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 June 30, 2010 and December 31, 2009 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 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, 2013. At June 30, 2010 and December 31, 2009, total borrowings on the loan were \$30.8 million and \$31.1 million, respectively, and the Company's guarantee totaled \$1.0 million for both June 30, 2010 and

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

December 31, 2009.

In April 2010, the Company entered into an agreement to guarantee 29% of the outstanding principal amount related to a mortgage loan to a 50% owned real estate joint venture. The loan matures in April 2015. At June 30, 2010 total borrowings on the loan were \$13.7 million and the Company's guarantee was approximately \$4.0 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.

Table of Contents

*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 license 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 that 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

Table of Contents

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 June 30, 2010 and December 31, 2009, 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 accounting and reporting guidance on guarantees, including indirect guarantees of indebtedness of others.

**10. Restructuring Charge**

On January 29, 2010, DST began implementing a plan to reduce its workforce by approximately 7% in 2010. This plan was necessitated by the extended economic downturn which has negatively impacted the financial services industry. The reduction in workforce is part of the Company's ongoing cost management initiatives which have included a general freeze on hiring and management salaries, and other controls over operating expenses. As a result of this workforce reduction, the Company anticipates a \$19.5 million pre-tax charge in 2010 for the payment of related termination benefits. The Company incurred \$2.8 million and \$14.6 million of termination benefit expense associated with this plan during the three and six months ended June 30, 2010, respectively, and expects approximately \$4.9 million of related expenses for the remainder of 2010. These termination benefit expenses have been included in Costs and expenses in the Condensed Consolidated Statement of Income. The Company is approximately 70% complete with the workforce reduction plan as of June 30, 2010.

The following table (in millions) presents termination benefit expenses at June 30, 2010 and summarizes the remainder of 2010 restructuring activities described above.

	Plan Estimate, as Revised	Costs Paid or Settled Six Months Ended June 30, 2010	Remaining Costs	Estimated Settlement Three Months Ended September 30, 2010	December 31, 2010	Total
Financial						
Services	\$ 13.5	\$ (11.4)	\$ 2.1	\$ 0.1	\$ 2.0	\$ 2.1
Output Solutions	6.0	(3.2)	2.8	2.1	0.7	2.8
	\$ 19.5	\$ (14.6)	\$ 4.9	\$ 2.2	\$ 2.7	\$ 4.9



Table of Contents

**11. Authoritative Accounting Guidance**

*Variable Interest Entities*

On January 1, 2010, the Company adopted new authoritative accounting guidance related to variable interest entities. Among other items, this accounting guidance responds to concerns about the application of certain key provisions of the current accounting guidance for variable interest entities, including those regarding the transparency of the involvement with variable interest entities. The adoption of this new accounting guidance did not have a significant impact on the consolidated financial statements.

*Multiple-Element Revenue Arrangements*

In October 2009, the FASB issued new authoritative accounting guidance related to multiple element revenue arrangements. This update provides guidance on whether multiple elements (deliverables) exist, how the deliverables should be separated and how the consideration should be allocated. The new guidance established a hierarchy for determining the selling price of a deliverable. For DST, the new authoritative guidance is effective prospectively for revenue arrangements entered into or materially modified after January 1, 2011. Early adoption is permitted. The Company has not determined the impact this new authoritative accounting guidance may have on the consolidated financial statements.

*Certain Revenue Arrangements That Include Software Elements*

In October 2009, the FASB issued a new authoritative accounting guidance related to certain revenue arrangements that include software elements. This new guidance changes the accounting model for revenue arrangements that include both tangible products and software elements and also provides guidance on how consideration should be allocated in an arrangement that includes both tangible products and software. For DST, the new authoritative guidance is effective prospectively for revenue arrangements entered into or materially modified after January 1, 2011. Early adoption is permitted. The Company has not determined the impact this guidance may have on the consolidated financial statements.

*Earnings per Share Proposed Accounting Standard*

In August 2008, the FASB issued a revised exposure draft, that would amend current earnings per share accounting guidance 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 final authoritative accounting guidance has yet to be issued. In April 2009, the FASB decided to pause the earnings per share project.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

The proposed guidance, 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 guidance 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 the proposed guidance. Retrospective application would be required for all changes, 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 accounting guidance, 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 using the 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 approximately 8.5 million shares (less shares already included in diluted earnings per share, if any), the amount of shares that would be issued if all \$428.1 million of the senior convertible debentures at June 30, 2010 would be converted to equity. The revised exposure draft also contains

Table of Contents

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 guidance.

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 guidance 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 guidance when issued as final.

**12. 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 the Company's real estate subsidiaries and affiliates, equity securities, private equity investments and certain financial interests have been aggregated into an Investments and Other Segment.

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

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Financial Services	\$ 1,493.0	\$ 1,477.8
Output Solutions	313.3	253.4
Investments and Other	1,062.7	1,267.0
Elimination Adjustments	(82.9)	(85.4)
	<b>\$ 2,786.1</b>	<b>\$ 2,912.8</b>

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

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Table of Contents

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

	<b>Three Months Ended June 30, 2010</b>					<b>Consolidated Total</b>
	<b>Financial Services</b>	<b>Output Solutions</b>	<b>Investments / Other</b>	<b>Eliminations Adjustments</b>		
Operating revenues	\$ 287.5	\$ 174.7	\$ 3.4	\$	\$	\$ 465.6
Intersegment operating revenues	2.7	2.0	11.3	(16.0)		
Out-of-pocket reimbursements	10.9	138.8	0.1	(1.5)		148.3
Total revenues	301.1	315.5	14.8	(17.5)		613.9
Costs and expenses	205.8	235.9	9.2	(14.9)		436.0
Depreciation and amortization	20.5	13.2	2.5	(0.6)		35.6
Income (loss) from operations	74.8	66.4	3.1	(2.0)		142.3
Other income, net	2.6		1.4			4.0
Equity in earnings of unconsolidated affiliates	9.3		0.5			9.8
Earnings (loss) before interest and income taxes	\$ 86.7	\$ 66.4	\$ 5.0	\$ (2.0)		\$ 156.1

	<b>Three Months Ended June 30, 2009</b>					<b>Consolidated Total</b>
	<b>Financial Services</b>	<b>Output Solutions</b>	<b>Investments / Other</b>	<b>Eliminations Adjustments</b>		
Operating revenues	\$ 285.6	\$ 115.9	\$ 3.0	\$	\$	\$ 404.5
Intersegment operating revenues	2.1	1.6	11.7	(15.4)		
Out-of-pocket reimbursements	12.9	137.8	0.2	(1.4)		149.5
Total revenues	300.6	255.3	14.9	(16.8)		554.0
Costs and expenses	219.6	239.4	9.6	(14.1)		454.5
Depreciation and amortization	19.1	10.0	2.6	(0.7)		31.0
Income (loss) from operations	61.9	5.9	2.7	(2.0)		68.5
Other income (expense), net	2.0	0.2	9.1	(0.1)		11.2
Equity in earnings of unconsolidated affiliates	10.4		0.1			10.5
Earnings (loss) before interest and income taxes	\$ 74.3	\$ 6.1	\$ 11.9	\$ (2.1)		\$ 90.2

Earnings before interest and income taxes in the segment reporting information above less interest expense of \$11.7 million and \$9.5 million for the three months ended June 30, 2010 and 2009, respectively, is equal to the Company's income before income taxes on a consolidated basis for the corresponding periods.

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Table of Contents

	Six Months Ended June 30, 2010					Consolidated Total
	Financial Services	Output Solutions	Investments / Other	Eliminations Adjustments		
Operating revenues	\$ 568.4	\$ 300.2	\$ 6.4	\$	\$	875.0
Intersegment operating revenues	5.2	3.9	23.0	(32.1)		
Out-of-pocket reimbursements	23.7	284.7	0.2	(3.0)		305.6
Total revenues	597.3	588.8	29.6	(35.1)		1,180.6
Costs and expenses	428.3	487.2	18.5	(29.9)		904.1
Depreciation and amortization	39.2	23.0	5.0	(1.3)		65.9
Income (loss) from operations	129.8	78.6	6.1	(3.9)		210.6
Other income, net	7.4	0.1	50.9			58.4
Equity in earnings of unconsolidated affiliates	17.7		0.4			18.1
Earnings (loss) before interest and income taxes	\$ 154.9	\$ 78.7	\$ 57.4	\$ (3.9)	\$	287.1

	Six Months Ended June 30, 2009					Consolidated Total
	Financial Services	Output Solutions	Investments / Other	Eliminations Adjustments		
Operating revenues	\$ 551.1	\$ 242.9	\$ 6.1	\$	\$	800.1
Intersegment operating revenues	4.3	1.6	23.8	(29.7)		
Out-of-pocket reimbursements	30.0	286.0	0.3	(1.5)		314.8
Total revenues	585.4	530.5	30.2	(31.2)		1,114.9
Costs and expenses	420.9	498.5	19.3	(26.0)		912.7
Depreciation and amortization	36.6	18.9	5.1	(1.3)		59.3
Income (loss) from operations	127.9	13.1	5.8	(3.9)		142.9
Other income (expense), net	41.6	0.2	(14.3)	(0.1)		27.4
Equity in earnings of unconsolidated affiliates	16.5		(0.3)			16.2
Earnings (loss) before interest and income taxes	\$ 186.0	\$ 13.3	\$ (8.8)	\$ (4.0)	\$	186.5

Earnings before interest and income taxes in the segment reporting information above less interest expense of \$21.6 million and \$20.1 million for the six months ended June 30, 2010 and 2009, respectively, is equal to the Company's income before income taxes on a consolidated basis for the corresponding periods.



Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The discussions set forth in this Quarterly Report on Form 10-Q contain statements concerning potential future events. Such forward-looking statements are based upon assumptions by the Company's management as of the date of this Quarterly Report, including assumptions about risks and uncertainties faced by the Company. In addition, management may make forward-looking statements orally or in other writings, including, but not limited to, in press releases, in the annual report to shareholders and in the Company's other filings with the Securities and Exchange Commission (SEC). Readers can identify these forward-looking statements by the use of such verbs as expects, anticipates, believes or similar verbs or conjugations of such verbs. If any of management's assumptions prove incorrect or should unanticipated circumstances arise, the Company's actual results could materially differ from those anticipated by such forward-looking statements. The differences could be caused by a number of factors or combination of factors including, but not limited to, those factors referred to below in Part II, Item 1A, Risk Factors. Readers are strongly encouraged to consider the factors referred to in such section and any amendments or modifications thereof when evaluating any forward-looking statements concerning the Company. The Company's reports filed with or furnished to the SEC on Form 8-K, Form 10-K, Form 10-Q and other forms and any amendments to those reports, may be obtained by contacting the SEC's Public Reference Branch at 1-800-SEC-0330 or by accessing the forms electronically, free of charge, through the SEC's Internet website at <http://www.sec.gov> or through the Company's Internet website, as soon as reasonably practicable after filing with the SEC, at <http://www.dstsystems.com>. The Company undertakes no obligation to update any forward-looking statements in this Quarterly Report to reflect future events or developments.*

*The information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto included in this Form 10-Q and the audited Consolidated Financial Statements and Notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.*

**INTRODUCTION**

The business units of DST Systems, Inc. (DST or the Company) offer sophisticated information processing and software services and products. These business units are reported as two operating segments, Financial Services and Output Solutions. In addition, investments in the Company's real estate subsidiaries and affiliates, equity securities, private equity funds and certain financial interests have been aggregated into the Investments and Other Segment.

A summary of each of the Company's segments follows:

**Financial Services**

The Company's Financial Services Segment provides sophisticated information processing and computer software services and products using proprietary software systems primarily to mutual funds, investment managers, insurance companies, healthcare providers, banks, brokers, financial planners, healthcare payers, real estate partnerships, third party administrators and medical practice groups. The Company's proprietary software systems include mutual fund shareowner, subaccount and unit trust recordkeeping systems for U.S. and international mutual fund companies; a defined-contribution participant recordkeeping system for the U.S. retirement plan market; platforms for distribution support solutions and services offered to financial advisors and broker/dealers; investment management systems offered to U.S. and international

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

investment managers and fund accountants; a business process management and customer contact system offered to mutual funds, insurance companies, brokerage firms, banks, healthcare payers, healthcare providers, cable television operators and mortgage servicing organizations; healthcare claims administration processing systems and services offered to providers of healthcare plans, third party administrators and medical practice groups; pharmacy claims processing systems offered to healthcare plans, insurance companies, third party administrators and pharmacy benefit managers; and an electronic file system offered to mutual fund companies, insurance companies and professional service (legal, accounting and others) firms.

Table of Contents

The Financial Services Segment distributes its services and products on a direct basis and through subsidiaries and joint venture affiliates in the U.S., United Kingdom ( U.K. ), Canada, Europe, Australia, South Africa, Asia-Pacific and the Middle East and, to a lesser degree, distributes such services and products through various strategic alliances.

**Output Solutions**

The Company's Output Solutions Segment provides single source, integrated print and electronic statement and billing output solutions, including customized statement and bill production, marketing and personalization services, postal optimization, and electronic presentment, payment and distribution solutions. These capabilities enable the Output Solutions Segment to provide services to industries that place a premium on customer communications that require high quality, accurate and timely statement and billing output processing.

The Output Solutions Segment conducts its operations from five operating facilities located throughout North America and the U.K. DST Output is among the largest users of continuous, high-speed, full-color inkjet printing systems and among the largest First-Class mailers in the United States.

The Output Solutions Segment's research and development efforts have resulted in two mail and postal processing initiatives, Smart Commingling and Intelligent Mail barcode, in compliance with United States Postal Services requirements. In addition, the Digital Press Technology ( DPT ) high-speed color printing and inserting platform enables the Output Solutions Segment to produce high-speed transactional printing combined with dynamic color printing. DST Output believes DPT is a technologically-differentiated service offering that enables them to provide better and more efficient products and services to clients.

The Output Solutions Segment distributes its product directly to customers and through relationships in which its services are combined with or offered concurrently through providers of data processing services. The Output Solutions Segment's products are also distributed or bundled with product offerings to customers of the Financial Services Segment.

On July 30, 2010, DST, through its wholly-owned U.K. subsidiary, Innovative Output Solutions Limited ( IOS ), completed an agreement (the Purchase Agreement ) to acquire the entire issued share capital of dsicmm Group Limited. Prior to closing the transaction, IOS held DST's debt-free U.K. print/mail operations, and dsicmm was a U.K. based, private company that provided integrated print and communication solutions. On July 30, 2010, the stockholders of dsicmm (the Sellers ) exchanged their dsicmm shares for IOS shares and cash, with the result that the equity of IOS is owned approximately 65% by DST and approximately 35% by a group of the Sellers. The percentage of IOS stock that will be owned by each stockholder is subject to adjustment after the closing in the event the closing date working capital and total debt of dsicmm or IOS deviates from amounts set forth in the Purchase Agreement. DST believes that the acquisition of dsicmm complements its existing Output Solutions business in the U.K., increases the overall size of the business, broadens the service/product offerings and expands and diversifies the client base. dsicmm has approximately 1,200 employees and annual revenues of approximately \$160 million. DST will consolidate the financial results of the combined IOS business from the closing date. DST management does not expect the transaction to have a material impact on DST's net income or earnings per share for 2010.

**Investments and Other**

The Investments and Other Segment is comprised of the Company's real estate subsidiaries and affiliates, investments in equity securities, private equity funds and other financial interests. The assets held by the Investments and Other Segment are primarily passive in nature. The Company owns and operates real estate mostly in the U.S. and U.K., which is held primarily for lease to the Company's other business segments. The Company is a partner in certain real estate joint ventures that lease office space to the Company, certain of its unconsolidated affiliates and unrelated third parties. The Company is a 50% partner in a limited purpose real estate joint venture formed to develop and lease approximately 1.1 million square feet of office space to the U.S. government. The Investments and Other Segment holds investments in available-for-sale equity securities with a market value of approximately \$655.9 million at June 30, 2010, including approximately 10.6 million shares of State Street Corporation ( State Street ), 17.5 million shares of Computershare Ltd. ( Computershare ) and

Table of Contents

1.9 million shares of Euronet Worldwide, Inc., with a market value of \$357.8 million, \$156.1 million and \$24.1 million, respectively, based on closing exchange values at June 30, 2010.

Table of Contents**RESULTS OF OPERATIONS**

The following table summarizes the Company's operating results (in millions, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Revenues</b>				
<b>Operating revenues</b>				
Financial Services	\$ 290.2	\$ 287.7	\$ 573.6	\$ 555.4
Output Solutions	176.7	117.5	304.1	244.5
Investments and Other	14.7	14.7	29.4	29.9
Elimination Adjustments	(16.0)	(15.4)	(32.1)	(29.7)
	465.6	404.5	875.0	800.1
% change from prior year period	15.1%		9.4%	
<b>Out-of-pocket reimbursements</b>				
Financial Services	10.9	12.9	23.7	30.0
Output Solutions	138.8	137.8	284.7	286.0
Investments and Other	0.1	0.2	0.2	0.3
Elimination Adjustments	(1.5)	(1.4)	(3.0)	(1.5)
	148.3	149.5	305.6	314.8
% change from prior year period	(0.8)%		(2.9)%	
<b>Total revenues</b>	\$ 613.9	\$ 554.0	\$ 1,180.6	\$ 1,114.9
% change from prior year period	10.8%		5.9%	
<b>Income from operations</b>				
Financial Services	\$ 74.8	\$ 61.9	\$ 129.8	\$ 127.9
Output Solutions	66.4	5.9	78.6	13.1
Investments and Other	3.1	2.7	6.1	5.8
Elimination Adjustments	(2.0)	(2.0)	(3.9)	(3.9)
	142.3	68.5	210.6	142.9
Interest expense	(11.7)	(9.5)	(21.6)	(20.1)
Other income, net	4.0	11.2	58.4	27.4
Equity in earnings of unconsolidated affiliates	9.8	10.5	18.1	16.2
<b>Income before income taxes</b>	144.4	80.7	265.5	166.4
Income taxes	50.4	32.0	94.6	44.5
<b>Net income</b>	\$ 94.0	\$ 48.7	\$ 170.9	\$ 121.9
Basic earnings per share	\$ 2.01	\$ 0.98	\$ 3.60	\$ 2.45
Diluted earnings per share	\$ 2.00	\$ 0.97	\$ 3.57	\$ 2.44
Non-GAAP diluted earnings per share	\$ 1.23	\$ 0.90	\$ 2.33	\$ 1.73
Cash dividends per share of common stock	\$	\$	\$ 0.30	\$

Table of Contents**Consolidated revenues**

Consolidated total revenues (including out-of-pocket ( OOP ) reimbursements) for the three and six months ended June 30, 2010 were \$613.9 million and \$1,180.6 million, an increase of \$59.9 million or 10.8% and \$65.7 million or 5.9% compared to the three and six months ended June 30, 2009. Consolidated operating revenues for the three and six months ended June 30, 2010 increased \$61.1 million or 15.1% and \$74.9 million or 9.4% compared to the same periods in 2009. The increases in consolidated operating revenues are attributable to increases of \$59.2 million and \$59.6 million in the Output Solutions Segment for the three and six months ended June 30, 2010 and increases of \$2.5 million and \$18.2 million in the Financial Services Segment for the three and six months ended June 30, 2010, both as compared to the same periods in 2009. An Output Solutions telecommunications client, representing approximately 6.6% of 2009 annual Output Solutions Segment operating revenues, terminated its contract and internalized its bill production processing effective April 30, 2010 resulting in a contract termination payment to the Company of approximately \$63.0 million. Absent this contract termination payment of \$63.0 million, Output Solutions operating revenues for the three and six months ended June 30, 2010 decreased \$3.8 million or 3.2% and \$3.4 million or 1.4% compared to the same periods in 2009. On this basis, the decrease in Output Solutions operating revenues for the three and six months ended June 30, 2010 resulted from lower volumes of images produced and lower revenue per unit (packages and images) processed, partially offset by the impact of foreign currency exchange effects which increased operating revenues by approximately \$0.9 million and \$3.4 million during the three and six months ended June 30, 2010, respectively, as compared to the same periods in the prior year. The increase in Financial Services operating revenues for the three months ended June 30, 2010 is attributable to higher revenues at DST Global Solutions and Argus, partially offset by lower revenues at DST Health Solutions. Absent \$26.0 million of net incremental operating revenues resulting from the acquisition and consolidation of Argus Health Systems, Inc. ( Argus ) on March 31, 2009, Financial Services operating revenues for the six months ended June 30, 2010 decreased \$7.8 million or 1.4% as compared to the same period in 2009. On this basis, the decrease in Financial Services operating revenues is attributable to lower mutual fund shareowner processing service revenues and DST Health Solutions revenues, partially offset by higher Global Solutions and Argus revenues.

Consolidated OOP reimbursements during the three and six months ended June 30, 2010 decreased \$1.2 million or 0.8% and \$9.2 million or 2.9% compared to the same periods in 2009 primarily due to decreases in Financial Services associated with lower processing volumes. OOP reimbursements for Output Solutions increased \$1.0 million or 0.7% during the three months ended June 30, 2010 and decreased \$1.3 million or 0.5% during the six months ended June 30, 2010.

**Income from operations**

Consolidated income from operations for the three and six months ended June 30, 2010 increased \$73.8 million or 107.7% and \$67.7 million or 47.4% compared to the three and six months ended June 30, 2009. Absent the \$63.0 million Output Solutions contract termination payment mentioned above, expenses associated with the contract termination including asset impairment charges of \$3.1 million and termination benefit costs of \$1.5 million, and termination benefit costs of \$2.8 million and \$14.6 million for the three and six months ended June 30, 2010 related to a reduction in workforce, income from operations increased \$18.2 million or 26.6% and \$23.9 million or 16.7% compared to the same periods in 2009. On this basis, the increase in consolidated income from operations is attributable to an increase of \$15.2 million and \$13.3 million in Financial Services and an increase of \$2.6 million and \$10.3 million in Output Solutions during the three and six months ended June 30, 2010, respectively, both compared to the same periods in 2009. The increase in Financial Services income from operations during the three months ended June 30, 2010 is attributable to lower deferred compensation costs of \$6.5 million (the effect of which is offset as unrealized depreciation on trading securities in other non-operating income), lower compensation and benefit costs from lower staffing levels and higher software license revenues. The increase in Financial Services income from operations during the six months ended June 30, 2010 is attributable to lower deferred compensation costs of \$2.0 million and lower compensation and benefit costs attributable to the reduction in force that began in early 2010. The \$2.6 million and \$10.3 million increase in Output Solutions income from operations during the three and six months ended June 30, 2010, respectively, primarily resulted from lower operating expenses.





Table of Contents

*Restructuring Charge - Reduction in Workforce*

In first quarter 2010, DST began implementing a plan to reduce its workforce by approximately 7% in 2010. This plan was necessitated by the extended economic downturn which has negatively impacted the financial services industry. When fully implemented, the Company anticipates a reduction in annual pre-tax operating costs of approximately \$67.0 million. The reduction in workforce is part of the Company's ongoing cost management initiatives which have included a general freeze on hiring and management salaries, and other controls over operating expenses. As a result of this workforce reduction, the Company anticipates a \$19.5 million pre-tax charge in 2010 for the payment of related termination benefits. The Company incurred \$2.8 million and \$14.6 million of termination benefit expense during the three and six months ended June 30, 2010, respectively, and expects approximately \$4.9 million of related expenses for the remainder of 2010. These termination benefit expenses have been included in Costs and expenses in the Condensed Consolidated Statement of Income. The Company is approximately 70% complete with the workforce reduction plan as of June 30, 2010.

The following table (in millions) presents termination benefit expenses at June 30, 2010 and summarizes the remainder of 2010 restructuring activities described above.

	Plan Estimate, as Revised	Costs Paid or Settled Six Months Ended June 30, 2010	Remaining Costs	Estimated Settlement Three Months Ended September 30, 2010	December 31, 2010	Total
Financial Services	\$ 13.5	\$ (11.4)	\$ 2.1	\$ 0.1	\$ 2.0	\$ 2.1
Output Solutions	6.0	(3.2)	2.8	2.1	0.7	2.8
	\$ 19.5	\$ (14.6)	\$ 4.9	\$ 2.2	\$ 2.7	\$ 4.9

**Interest expense**

Interest expense for the three and six months ended June 30, 2010 was \$11.7 million and \$21.6 million, an increase of \$2.2 million or 23.2% and \$1.5 million or 7.5% compared to the same periods in 2009. Interest expense increased for the three and six months ended June 30, 2010 primarily from higher average interest rates on the Company's syndicated revolving credit facility which was renewed on April 16, 2010 and from recording accounts receivable securitization program costs as interest expense beginning January 1, 2010, partially offset by lower average debt balances.

On April 16, 2010, DST entered into a new \$600 million revolving syndicated bank facility, which matures July 1, 2013, to replace its old revolving facility scheduled to expire on July 1, 2010. The terms of the facility are in most material respects similar to the facility replaced, although the interest rate spreads increased to reflect current market conditions. The new facility has covenants and events of default similar to the replaced facility.



Table of Contents**Other income, net**

The components of other income, net are as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,			
	2010	2009	2010	2009		
Gain on equity interest in Argus Health Systems	\$	\$	\$	\$	41.7	
Other than temporary impairments / unrealized losses on available-for-sale securities		(0.3)	(1.2)	(0.4)	(26.8)	
Net gains (losses) on private equity funds and other investments		0.5	1.3	1.3	(3.1)	
Net realized gains from sale of available-for-sale securities		3.1	4.2	40.6	3.4	
Net gain on extinguishment of senior convertible debentures		0.7	2.1	0.1	5.8	
Dividend income		1.3	1.3	13.1	4.7	
Interest income		2.0	1.4	3.0	2.7	
Miscellaneous items		(3.3)	2.1	0.7	(1.0)	
Other income, net	\$	4.0	\$	11.2	\$	27.4

Other income, net was \$4.0 million and \$58.4 million during the three and six months ended June 30, 2010, respectively, compared to \$11.2 million and \$27.4 million during the three and six months ended June 30, 2009, respectively.

The Company recorded a gain of \$41.7 million during 2009 related to its purchase of the remaining 50% equity interest of Argus for \$57.0 million. In accordance with authoritative accounting guidance on business combinations, the acquisition of the remaining 50% of Argus on March 31, 2009 was treated as a step acquisition. Accordingly, DST remeasured its previously held equity interest in Argus to fair value, in the amount of \$57.0 million, and recorded a gain of \$41.7 million.

The Company records investment impairment charges for available-for-sale securities with gross unrealized holding losses resulting from a decline in value that is other than temporary. The Company recognized \$0.3 million and \$0.4 million of investment impairments for the three and six months ended June 30, 2010 compared to \$1.2 million and \$26.8 million for the three and six months ended June 30, 2009, which were other than temporary. The decrease in impairments compared to the same periods in 2009 is from improved financial market conditions. 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, which could have a material effect on the Company's financial position.

Net realized gains from the sale of available-for-sale securities were \$3.1 million and \$40.6 million during the three and six months ended June 30, 2010, respectively, compared to \$4.2 million and \$3.4 million during the three and six months ended June 30, 2009, respectively. Included in the \$40.6 million of gains from the sale of available-for-sale securities for the six months ended June 30, 2010 is a \$28.8 million gain from the sale of approximately 4.8 million shares of Computershare Ltd.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

During the three and six months ended June 30, 2010, the Company recorded a net gain of \$0.7 million and \$0.1 million, respectively, associated with the repurchase of a portion of the Company's senior convertible debentures at a discount to carrying value. During the three and six months ended June 30, 2009, the Company recorded a gain of \$2.1 million and \$5.8 million, respectively, associated with the repurchase of a portion of the Company's senior convertible debentures at a discount to carrying value.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

### Table of Contents

The Company receives dividend income from certain investments held. Dividend income was \$1.3 million during the three months ended June 30, 2010 and 2009. Dividend income increased \$8.4 million during the six months ended June 30, 2010 compared to the same period in 2009 primarily from the receipt of an \$8.3 million dividend from a private equity investment during first quarter 2010. The sale of approximately 12.1 million shares of Computershare Ltd. since July 1, 2009 is expected to have a negative impact on the Company's future dividend income.

Interest income was \$2.0 million and \$3.0 million during the three and six months ended June 30, 2010, an increase of \$0.6 million and \$0.3 million compared to the same periods in 2009. The increase in interest income in 2010 is attributable to higher amounts of short-term investments.

Miscellaneous items include unrealized gains and losses on marketable securities designated as trading securities, program fees related to the Company's accounts receivable securitization program during 2009, realized foreign currency gains and losses, amortization of deferred non-operating gains and other non-operating items. Miscellaneous items was a loss of \$3.3 million during the three months ended June 30, 2010 and income of \$0.7 million during the six months ended June 30, 2010 compared to income of \$2.1 million during the three months ended June 30, 2009 and a loss of \$1.0 million during the six months ended June 30, 2009. The decrease in miscellaneous items for the three months ended June 30, 2010 is primarily from unrealized depreciation on marketable securities designated as trading (the effect of which is offset in Financial Services Segment as a decrease in costs and expenses), partially offset by the absence of accounts receivable securitization program costs which are now recorded in interest expense beginning January 1, 2010.

### **Equity in earnings (losses) of unconsolidated affiliates**

The following table summarizes the Company's equity in earnings (losses) of unconsolidated affiliates (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
BFDS	\$ 4.1	\$ 3.1	\$ 7.7	\$ 6.8
IFDS, U.K.	3.1	2.3	6.5	3.8
IFDS, L.P.	2.7	1.7	4.0	2.6
Argus				(1.5)
Other	(0.1)	3.4	(0.1)	4.5
	\$ 9.8	\$ 10.5	\$ 18.1	\$ 16.2

DST's equity in earnings of unconsolidated affiliates decreased \$0.7 million or 6.7% for the three months ended June 30, 2010 compared to the same period in 2009, primarily attributable to lower earnings of other unconsolidated affiliates, partially offset by higher equity in earnings of BFDS, IFDS, U.K. and IFDS L.P. DST's equity in earnings of unconsolidated affiliates increased \$1.9 million or 11.7% during the six months ended June 30, 2010 compared to the same period in 2009, primarily attributable to higher equity in earnings of BFDS, IFDS, U.K. and IFDS L.P., partially offset by lower earnings of other unconsolidated affiliates.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

DST's equity in BFDS earnings for the three and six months ended June 30, 2010 increased \$1.0 million or 32.2% and \$0.9 million or 13.2% compared to the same periods in 2009, primarily from the release of a previously established income tax valuation allowance and lower occupancy costs from vacating a facility in 2009. BFDS derives investment earnings related to cash balances maintained on behalf of customers. Average daily balances invested by BFDS were \$0.9 billion during the three and six months ended June 30, 2010 compared to \$0.8 billion during the same periods in 2009 from higher levels of transaction activity. Average interest rates earned

Table of Contents

on the balances increased from 0.16% during the three months ended June 30, 2009 to 0.20% during the three months ended June 30, 2010. The aggregate effect of these fluctuations resulted in an approximate \$0.2 million increase in interest earnings by BFDS during the three months ended June 30, 2010. Average interest rates earned on the balances declined from 0.39% during the six months ended June 30, 2009 to 0.16% during the six months ended June 30, 2010. The aggregate effect of these fluctuations resulted in a minimal impact in interest earnings by BFDS during the six months ended June 30, 2010.

DST's equity in earnings of IFDS U.K. increased \$0.8 million and \$2.7 million during the three and six months ended June 30, 2010 compared to the same periods in 2009. The increase in equity in earnings during the three and six months ended June 30, 2010 is primarily attributable to higher levels of shareowner accounts serviced from both new and existing clients and improvements in operations. Accounts serviced by IFDS U.K. were 7.0 million at June 30, 2010, an increase of 0.3 million accounts or 4.5% from March 31, 2010, an increase of 0.4 million accounts or 6.1% from December 31, 2009, and an increase of 0.9 million accounts or 14.8% from June 30, 2009.

DST's equity in earnings of IFDS L.P. (which includes IFDS Canada, Ireland and Luxembourg) increased \$1.0 million and \$1.4 million during the three and six months ended June 30, 2010 compared to the same periods in 2009. The increase during the three and six months ended June 30, 2010 is attributable to improvements in the Canada, Luxembourg and Ireland operations. Accounts serviced by IFDS Canada were 10.8 million at June 30, 2010, an increase of 0.3 million accounts or 2.9% from both March 31, 2010 and June 30, 2009 and an increase of 0.6 million accounts or 5.9% from December 31, 2009.

As previously announced, DST acquired the remaining 50% equity interest in Argus on March 31, 2009 and no longer records equity in earnings of Argus, but consolidates Argus' results into DST's consolidated financial statements.

**Income taxes**

The Company records income tax expense during interim periods based on its best estimate of the full year's tax rate. Certain items 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 income tax rate was 34.9% and 35.6% for the three and six months ended June 30, 2010 compared to 39.7% and 26.7% for the three and six months ended June 30, 2009. The decrease in the Company's income tax rate for the three months ended June 30, 2010 as compared to the same period in 2009 is attributable to lower levels of international operating losses requiring valuation allowances and higher utilization of foreign tax credits.

The Company's income tax rate for the six months ended June 30, 2010 included a benefit from a dividend received deduction on an \$8.3 million cash dividend received from a private equity investment that was received during the three months ended March 31, 2010. In addition, lower levels of international operating losses requiring valuation allowances and higher utilization of foreign tax credits favorably impacted the Company's tax rate in 2010. During the six months ended June 30, 2009, DST recorded a \$41.7 million gain on the purchase of the remaining 50% equity interest in Argus with no related income tax expense, reversed approximately \$0.9 million of deferred tax liabilities related to the elimination of deferred tax liabilities previously established for equity in earnings of Argus, and recorded an income tax benefit of approximately \$5.7 million resulting from a reduction in income tax liabilities principally associated with the completion of an IRS examination in February 2009 for the tax years ended December 31, 2002 through 2005.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

Excluding the effects of discrete period items, the Company expects its tax rate to be approximately 36.4% for the remainder of 2010 but this rate will likely vary on a quarterly basis between 34.5% and 38.0% depending on the timing of estimated 2010 sources of taxable income (e.g. domestic consolidated, international and / or joint venture). The full year 2010 tax rate can be affected as a result of variances among the estimates and amounts of full year sources of taxable income, the realization of tax credits (e.g., historic rehabilitation, research and experimentation, foreign tax and state incentive), adjustments which may arise from the resolution of tax matters under review and the Company's assessment of its liability for uncertain tax positions.



Table of Contents

**Business Segment Comparisons**

**FINANCIAL SERVICES SEGMENT**

**Revenues**

Financial Services Segment total revenues for the three and six months ended June 30, 2010 were \$301.1 million and \$597.3 million, an increase of \$0.5 million or 0.2% and \$11.9 million or 2.0% compared to the same periods in 2009. Financial Services Segment operating revenues for the three months ended June 30, 2010 were \$290.2 million, an increase of \$2.5 million or 0.9% compared to the same period in 2009. The increase in Financial Services operating revenues is attributable to higher revenues at DST Global Solutions and Argus, partially offset by lower revenues at DST Health Solutions.

The increased revenues at DST Global Solutions resulted from higher software license revenues, increased demand for professional services and changes in foreign currency exchange rates (primarily between the U.S. Dollar and the Australian Dollar) which increased operating revenues by approximately \$2.2 million. The increase in Argus revenues is due to higher volumes of pharmacy claims paid and related services. These operating revenue increases were partially offset by a decrease in DST Health Solutions professional services attributable to lower client demand for professional services, the expiration of a client processing agreement in July 2009 and the timing of certain client consulting projects. U.S. Investment Recordkeeping Solutions operating revenues during the three months ended June 30, 2010 were essentially unchanged as increased revenues from a higher volume of subaccounts serviced, defined contribution participants and increased distribution support solutions volumes offset the absence of a \$2.1 million client contract termination fee for a full-service processing client recognized in second quarter 2009.

Financial Services Segment operating revenues for the six months ended June 30, 2010 were \$573.6 million, an increase of \$18.2 million or 3.3% compared to the same period in 2009. Absent \$26.0 million of net incremental operating revenues resulting from the acquisition and consolidation of Argus on March 31, 2009, Financial Services operating revenues for the six months ended June 30, 2010 decreased \$7.8 million or 1.4% as compared to the same period in 2009. On this basis, the decrease in Financial Services operating revenues is attributable to lower U.S. Investment Recordkeeping Solutions processing service revenues and DST Health Solutions revenues, partially offset by higher Global Solutions and Argus revenues. The net decrease in U.S. Investment Recordkeeping Solutions processing service revenues resulted from lower full-service processing revenues. This operating revenue decrease was partially offset by changes in foreign currency exchange rates which increased operating revenues by approximately \$7.9 million.

U.S. operating revenues for the three months ended June 30, 2010 were \$262.1 million, a decrease of \$1.0 million or 0.4% compared to the same period in 2009. The decrease during the three months ended June 30, 2010 is attributable to lower volumes of DST Health Solutions professional service revenues, absence of a \$2.1 million client contract termination fee for a full-service processing client recognized in second quarter 2009, lower software license fee revenues for AWD, partially offset by higher revenues at Argus due to higher volumes of pharmacy claims paid and related services. U.S. operating revenues for the six months ended June 30, 2010 were \$516.1 million, an increase of \$9.5 million or 1.9% compared to the same period in 2009. Absent the \$26.0 million net incremental increase in U.S. operating revenues resulting from the consolidation of Argus, as mentioned above, U.S. operating revenues decreased \$16.5 million or 3.3% compared to the same period in 2009. On this basis, the decrease during the six months ended June 30, 2010 is attributable to lower U.S. Investment Recordkeeping Solutions processing service revenues and the same reasons mentioned above.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

International operating revenues for the three and six months ended June 30, 2010 were \$28.1 million and \$57.5 million, an increase of \$3.5 million or 14.2% and \$8.7 million or 17.8% compared to the same periods in 2009. International operating revenues for the three and six months ended June 30, 2010 increased primarily from the change in foreign currency exchange rates between the U.S. Dollar and other foreign currencies of approximately \$2.2 million and \$7.9 million as compared to the same periods in 2009 and due to higher investment management license fee revenue.

Table of Contents

Financial Services Segment software license fee revenues are derived principally from AWD (business process management - BPM), DST Global Solutions (investment management) and DST Health Solutions (medical claims processing). Operating revenues include approximately \$12.4 million and \$22.3 million of software license fee revenues for the three and six months ended June 30, 2010, an increase of \$1.6 million or 14.8% and an increase of \$0.8 million or 3.7% compared to the same periods in 2009. The increase during the three and six months ended June 30, 2010 is primarily due to higher investment management license fee revenue, partially offset by lower AWD software license fee revenues. While license revenues are not a significant percentage of DST's total operations, they can significantly impact earnings in the period in which they are recognized. Revenues and operating results from individual license sales depend heavily on the timing, size and nature of the contract.

**Costs and expenses**

Financial Services Segment costs and expenses (including OOP costs) were \$205.8 million and \$428.3 million during the three and six months ended June 30, 2010, a decrease of \$13.8 million or 6.3% and an increase of \$7.4 million or 1.8% compared to the same periods in 2009. Costs and expenses in the Financial Services Segment are primarily comprised of compensation and benefits costs, but also include reimbursable operating expenses and other costs. Reimbursable operating expenses included in costs and expenses were \$10.9 million and \$23.7 million during the three and six months ended June 30, 2010, a decrease of \$2.0 million and \$6.3 million compared to the same periods in 2009. Excluding reimbursable operating expenses and termination benefit expenses of \$2.3 million related to a reduction in force incurred during the three months ended June 30, 2010, costs and expenses decreased \$14.1 million or 6.8% during the three months ended June 30, 2010 to \$192.6 million. On this basis and after excluding the effects of deferred compensation costs which decreased costs by \$6.5 million as compared to the three months ended June 30, 2009, costs and expenses decreased \$7.6 million or 3.7% during the three months ended June 30, 2010 to \$195.2 million. The decrease in costs and expenses, on this basis, is primarily attributable to lower compensation and benefit related costs from lower staffing levels due to the reduction in workforce that began in first quarter 2010, partially offset by higher costs from foreign currency exchange effects between the U.S. Dollar and other currencies of approximately \$2.1 million. Excluding reimbursable operating expenses, costs of Argus during the three months ended March 31, 2010 of \$27.6 million and termination benefit expenses of \$11.4 million related to a reduction in force, costs and expenses decreased \$25.3 million or 6.5% during the six months ended June 30, 2010 to \$365.6 million. On this basis (and after excluding the effects of deferred compensation costs which decreased costs by \$2.0 million as compared to the six months ended June 30, 2010), costs and expenses decreased \$23.3 million or 6.0% during the six months ended June 30, 2010 to \$365.5 million. The decrease in costs and expenses is primarily attributable to lower compensation and benefit related costs from lower staffing levels, partially offset by higher costs from foreign currency exchange effects between the U.S. Dollar and other currencies of approximately \$6.9 million.

**Depreciation and amortization**

Financial Services Segment depreciation and amortization costs for the three and six months ended June 30, 2010 increased \$1.4 million or 7.3% and \$2.6 million or 7.1% compared to the same periods in 2009. The increase during the three months ended June 30, 2010 is attributable to higher amounts of third party software purchases and capitalized software activity, partially offset by the Company's use of accelerated depreciation methods and lower depreciation from certain assets becoming fully depreciated. The increase in depreciation and amortization during the six months ended June 30, 2010 as compared to 2009 is primarily related to higher purchase accounting amortization expense from the consolidation of Argus on March 31, 2009.

**Income from operations**

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

Financial Services Segment income from operations for the three and six months ended June 30, 2010 was \$74.8 million and \$129.8 million, an increase of \$12.9 million or 20.8% and \$1.9 million or 1.5% compared to the same periods in 2009. Excluding the impact of the termination benefit expenses of \$2.3 million and the impact of the \$6.5 million decrease in deferred compensation costs described above, income from operations increased \$8.7 million during the three months ended June 30, 2010 compared to the same period in 2009. On this basis, the

Table of Contents

increase in Financial Services income from operations during the three months ended June 30, 2010 is attributable to lower compensation and benefit related costs from lower staffing levels and higher software license revenues of \$1.6 million. Excluding the impact of the termination benefit expenses of \$11.4 million and the impact of the \$2.0 million decrease in deferred compensation costs described above, income from operations increased \$11.3 million during the six months ended June 30, 2010 compared to the same period in 2009. On this basis, the increase in Financial Services income from operations during the six months ended June 30, 2010 is attributable to lower compensation and benefit related costs from lower staffing levels and higher software license revenues of \$0.8 million.

*Financial Services Segment Account Statistics:*

The following table summarizes mutual fund shareowner accounts serviced (in millions):

	June 30, 2010	March 31, 2010	December 31, 2009	June 30, 2009
<b>Registered accounts:</b>				
Non tax-advantaged	60.3	60.4	63.6	63.7
Tax-advantaged	47.0	46.6	46.3	46.3
	107.3	107.0	109.9	110.0
<b>Subaccounts</b>				
Subaccounts	17.6	15.1	11.2	8.9
<b>Total</b>	<b>124.9</b>	<b>122.1</b>	<b>121.1</b>	<b>118.9</b>

Registered accounts serviced increased 0.3 million accounts or 0.3% from the comparable amount at March 31, 2010. The net increase was attributable to new client conversions of 1.2 million and growth in existing clients of 0.2 million, partially offset by the deconversion of 0.6 million accounts to non-DST subaccounting platforms and 0.5 million accounts to DST's subaccounting platform. Tax-advantaged accounts were 47.0 million at June 30, 2010, an increase of 0.4 million accounts or 0.9% as compared to March 31, 2010. Tax-advantaged accounts represent 43.8% of total registered accounts serviced at June 30, 2010 as compared to 42.1% at June 30, 2009.

The 2.6 million decrease in total registered accounts from December 31, 2009 is comprised of deconversions to DST's subaccounting platform of 3.9 million accounts and deconversions to non-DST subaccounting platforms of 1.2 million accounts, partially offset by new client conversions of 1.3 million accounts and net increases in existing client accounts of 1.2 million.

The 2.7 million decrease in total registered accounts from June 30, 2009 is comprised of deconversions to DST's subaccounting platform of 4.6 million accounts and deconversions to non-DST subaccounting platforms of 2.5 million accounts, partially offset by net increases in existing client accounts of 2.5 million and new client conversions of 1.9 million accounts.

Subaccounts serviced were 17.6 million at June 30, 2010, an increase of 2.5 million subaccounts or 16.6% as compared to March 31, 2010. New client conversions of 1.6 million subaccounts, conversions of 0.5 million registered accounts from TA2000 and net increases in existing subaccounts of 0.4 million comprise the increase. The increase of 6.4 million accounts as compared to December 31, 2009 is comprised of conversions of 3.9 million registered accounts from TA2000, new client conversions of 1.8 million, and net increases in existing client accounts of 0.7 million. The increase of 8.7 million accounts as compared to June 30, 2009 is comprised of conversions of 4.6 million registered accounts

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

from TA2000, new client conversions of 2.8 million accounts and net increases in existing customers of 1.3 million accounts.

During second quarter 2010, the Company received new client commitments that will result in approximately 0.1 million new registered accounts in fourth quarter 2010. The Company had previously announced client

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

### Table of Contents

commitments of approximately 0.3 million registered accounts that are scheduled to convert in the second half of 2010.

The Company also expects 7.2 million registered accounts will deconvert to subaccounting platforms during the remainder of 2010 of which 0.5 million accounts will deconvert to TA2000 Subaccounting.

The Company's subaccounting clients have indicated they plan to convert a total of 1.0 million new subaccounts to TA2000 Subaccounting from non-DST platforms during the second half of 2010. As previously announced, two existing subaccounting clients of the Company, as a result of mergers, have announced their intention to terminate their processing agreements with DST and deconvert approximately 5.5 million subaccounts to non-DST subaccounting platforms. The Company expects that 4.9 million subaccounts will deconvert in third quarter 2010 and 0.6 million subaccounts will deconvert in first quarter 2011.

The third quarter 2010 subaccounting deconversion is expected to result in a contract termination payment to the Company of approximately \$9.0 million. The Company will incur charges of approximately \$1.5 million to \$2.0 million in connection with the termination. The Company expects to record in the third quarter 2010 a net pretax gain of approximately \$7.0 million to \$7.5 million related to this contract termination.

The following table presents mutual fund shareowner accounts at June 30, 2010 and summarizes the remainder of 2010 conversion activities described above (and without taking into account any other changes in accounts serviced during 2010) to arrive at an estimated total accounts at December 31, 2010.

(in millions)	Registered Accounts	Subaccounts	Total Accounts
Balance at June 30, 2010	107.3	17.6	124.9
New client conversions	0.4	1.0	1.4
Transfers to DST Subaccounting	(0.5)	0.5	
Deconversions to non-DST platforms	(6.7)	(4.9)	(11.6)
Estimated balance at December 31, 2010	100.5	14.2	114.7

The actual number of accounts estimated to convert to and from various DST platforms, as well as the timing of those events, is dependent upon a number of factors. Actual results could differ from the Company's estimates and those differences could be material.

Defined contribution (DC) participants were 3.8 million at June 30, 2010, a decrease of 0.5 million participants or 11.6% from March 31, 2010, a decrease of 0.4 million participants or 9.5% from December 31, 2009 and an increase of 0.4 million participants or 11.8% from June 30, 2009. The decrease in participants from March 31, 2010 and December 31, 2009 represents the annual removal of prior year terminated participants. The increase from June 30, 2009 is primarily from increases in participants of existing clients and conversions of new participants. As previously reported, the Company has new client commitments for approximately 0.5 million new participants which are expected to convert in fourth quarter 2010.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

Pharmacy claims paid by Argus during three months ended June 30, 2010 were 95.8 million, an increase of 0.9 million claims or 0.9% compared to the three months ended March 31, 2010 and an increase of 1.0 million claims or 1.1% from the three months ended June 30, 2009.



Table of Contents

DST Health Solutions covered lives were 23.2 million at June 30, 2010, an increase of 0.3 million covered lives or 1.3% as compared to March 31, 2010, a decrease of 0.3 million covered lives or 1.3% as compared to December 31, 2009 and a decrease of 0.2 million covered lives or 0.9% as compared to June 30, 2009.

AWD workstations were 195,600 at June 30, 2010, an increase of 800 workstations or 0.4% from March 31, 2010, an increase of 2,100 workstations or 1.1% from December 31, 2009 and an increase of 300 workstations or 0.2% from June 30, 2009 levels. U.S. AWD workstations were 162,600 at June 30, 2010, an increase of 400 workstations or 0.2% from March 31, 2010, an increase of 1,600 workstations or 1.0% from December 31, 2009 and an increase of 2,200 workstations or 1.4% from June 30, 2009 levels. International AWD workstations were 33,000 at June 30, 2010, an increase of 400 workstations or 1.2% from March 31, 2010, an increase of 500 workstations or 1.5% from December 31, 2009 and a decrease of 1,900 workstations or 5.4% from June 30, 2009 levels.

## **OUTPUT SOLUTIONS SEGMENT**

### **Revenues**

Output Solutions Segment total revenues for the three and six months ended June 30, 2010 were \$315.5 million and \$588.8 million, respectively, an increase of \$60.2 million or 23.6% and \$58.3 million or 11.0% compared to the same periods in 2009. Output Solutions Segment operating revenues for the three and six months ended June 30, 2010 were \$176.7 million and \$304.1 million, an increase of \$59.2 million or 50.4% and \$59.6 million or 24.4% compared to the same periods in 2009. An Output Solutions telecommunications client, representing approximately 6.6% of 2009 annual Output Solutions Segment operating revenues, terminated its contract and internalized its bill production processing effective April 30, 2010 resulting in a contract termination payment to the Company of approximately \$63.0 million. Absent this contract termination payment of \$63.0 million, Output Solutions operating revenues for the three and six months ended June 30, 2010 decreased \$3.8 million or 3.2% and \$3.4 million or 1.4% compared to the same periods in 2009. The decrease in Output Solutions operating revenues for the three and six months ended June 30, 2010 resulted from lower volumes of images produced primarily associated with the loss of volumes from the terminated client, and lower revenue per unit (packages and images) processed. Revenue per unit (packages and images) declined attributable to higher relative volumes from clients with lower unit pricing. These operating revenue decreases were partially offset by foreign currency exchange effects of approximately \$0.9 million and \$3.4 million during the three and six months ended June 30, 2010, respectively, between the U.S. dollar and both the Canadian Dollar and British Pound, as compared to the same periods in the prior year.

Out-of-pocket reimbursement revenues for the three and six months ended June 30, 2010 were \$138.8 million and \$284.7 million, an increase of \$1.0 million or 0.7% during the three months ended June 30, 2010 and a decrease of \$1.3 million or 0.5% during the six months ended June 30, 2010, both as compared to the same periods in the prior year.

Items mailed during the three and six months ended June 30, 2010 were 556.4 million and 1,166.6 million, a decrease of 2.2 % during the three months ended June 30, 2010 and an increase of 1.4% during the six months ended June 30, 2010, both as compared to the same periods in the prior year. Images produced during three and six months ended June 30, 2010 were 2.8 billion and 6.2 billion, a decrease of 9.7% as compared to the three months ended June 30, 2009 and unchanged as compared to the six months ended June 30, 2009. The decrease during the three months ended June 30, 2010 in items mailed and images produced is primarily due to the previously mentioned client contract termination and lower volumes from existing customers, partially offset by higher volumes from new clients. Increases from new client volumes during the six months ended June 30, 2010 were offset by lower volumes from the contract termination and lower volumes of existing clients.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

During second quarter 2010, Output Solutions received three new client commitments representing, when fully transitioned, approximately 110 million of aggregate packages annually, based on current volume levels. Full conversion activities related to these new clients is expected to be completed by in the first half of 2011. In

Table of Contents

connection with the third quarter 2010 deconversion of 4.9 million subaccounts mentioned in the Financial Services Segment discussion (accounts statistics section) above, the Output Solutions Segment expects to receive a contract termination payment of approximately \$1.3 million.

**Costs and expenses**

Output Solutions Segment costs and expenses (including OOP costs) during the three and six months ended June 30, 2010 decreased \$3.5 million or 1.5% and \$11.3 million and 2.3% compared to the same periods in 2009. Costs and expenses in the Output Solutions Segment are primarily comprised of reimbursable operating expenses, compensation and benefits costs, material costs (principally paper and ink) and other operating costs. Reimbursable operating expenses included in costs and expenses were \$138.8 million and \$284.7 million during the three and six months ended June 30, 2010, an increase of \$1.0 million or 0.7% and a decrease of \$1.3 million or 0.5% compared to the same periods in 2009. Excluding reimbursable operating expenses, termination benefit expenses associated with the Output Solutions contract termination of \$1.5 million during the three months ended June 30, 2010, mentioned above and termination benefit expenses of \$0.5 million related to a reduction in force, costs and expenses decreased \$6.5 million or 6.4% during the three months ended June 30, 2010 to \$95.1 million. On this basis, the decrease in costs and expenses is mostly attributable to lower material costs and lower staffing levels from lower volumes, partially offset by higher costs related to the effect of foreign currency exchange rates of approximately \$0.4 million. Excluding reimbursable operating expenses, termination benefit expenses of \$3.2 million related to a reduction in force and termination benefit expenses associated with the Output Solutions contract termination of \$1.5 million mentioned above, costs and expenses decreased \$14.7 million or 6.9% during the six months ended June 30, 2010 to \$197.8 million. On this basis, the decrease in cost and expenses is attributable to lower material costs, lower compensation and benefit related costs from reduced staffing levels and lower leased equipment costs from the continued implementation of owned digital print technologies, partially offset by higher costs related to the effect of foreign currency exchange rates of approximately \$2.0 million.

**Depreciation and amortization**

Output Solutions Segment depreciation and amortization for the three and six months ended June 30, 2010 increased \$3.2 million or 32.0% and \$4.1 million or 21.7% compared to the same periods in 2009. Absent the asset impairment charge of \$3.1 million associated with the client contract termination, depreciation and amortization increased \$0.1 million or 1.0% and \$1.0 million or 5.3% for the three and six months ended June 30, 2010, respectively. On this basis, the increase during the six months ended June 30, 2010 is attributable to additional equipment to support new client requirements and higher costs associated with foreign currency exchange effects between the U.S. Dollar and other currencies.

**Income from operations**

Output Solutions Segment income from operations for the three and six months ended June 30, 2010 was \$66.4 million and \$78.6 million, an increase of \$60.5 million and \$65.5 million compared to the same periods in 2009 primarily attributable to a contract termination payment of approximately \$63.0 million received in April 2010. Absent the \$58.4 million contract termination payment, net of expenses, and the \$0.5 million and \$3.2 million of termination benefit expenses related to a reduction in workforce for the three and six months ended June 30, 2010, respectively, income from operations increased \$2.6 million or 44.1% and \$10.3 million or 78.6%, compared to the same periods in 2009, primarily from lower operating costs.

**Use of EBITDA**

DST defines EBITDA as earnings from operations before interest expense, income taxes, depreciation and amortization. This supplemental non-GAAP liquidity measure is provided in addition to, but not as a substitute for, cash flow from operations. As a measure of liquidity, the Company believes EBITDA is useful as an indicator of its ability to generate cash flow. EBITDA, as calculated by the Company, may not be consistent with computation of EBITDA by other companies. The Company believes a useful measure of Output Solutions' contribution to DST's results is to focus on cash flow and DST's management believes EBITDA is useful for this

Table of Contents

purpose. A reconciliation of Output Solutions Segment income from operations to EBITDA is included in the table below. The non-GAAP adjustments to this reconciliation are described in the Use of Non-GAAP Financial Information included in Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

For the three and six months ended June 30, 2010, Output Solutions EBITDA was \$79.6 million and \$101.6 million, an increase of \$63.7 million or 400.6% and \$69.6 million or 217.5% compared to the same periods in 2009 primarily attributable to a contract termination payment of approximately \$63.0 million received in April 2010. Absent the \$61.5 million contract termination payment, net of related cash expenses, and the \$0.5 million and \$3.2 million for the three and six months ended June 30, 2010 termination benefit expenses related to a reduction in workforce, EBITDA was \$18.6 million and \$43.3 million, an increase of \$2.7 million or 17.0% and \$11.3 million or 35.3% compared to the same periods in 2009, primarily attributable to lower operating costs.

The reconciliation of the Output Solutions Segment income from operations to EBITDA as used by management is set forth in the table below (in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Output Solutions Segment income from operations	\$ 66.4	\$ 5.9	\$ 78.6	\$ 13.1
Depreciation and amortization	13.2	10.0	23.0	18.9
EBITDA, before Non-GAAP items	79.6	15.9	101.6	32.0
Contract termination payment, net of expenses	(61.5)		(61.5)	
Termination benefit expenses	0.5		3.2	
EBITDA, after Non-GAAP items	\$ 18.6	\$ 15.9	\$ 43.3	\$ 32.0

**INVESTMENTS AND OTHER SEGMENT****Revenues**

Investments and Other Segment total revenues, including out-of-pocket reimbursements, were \$14.8 million and \$29.6 million for the three and six months ended June 30, 2010, respectively, a decrease of \$0.1 million or 0.7% and \$0.6 million or 2.0% compared to the same periods in 2009. The majority of the revenues are derived from the lease of facilities to the Company's other business segments. Operating revenues (excluding out-of-pocket reimbursements) were \$14.7 million and \$29.4 million for the three and six months ended June 30, 2010, unchanged as compared to the three months ended June 30, 2009 and a decrease of \$0.5 million or 1.7% compared to the six months ended June 30, 2009, primarily due to lower rental activities.

**Costs and expenses**

Occupancy costs are the single largest costs included in costs and expenses in the Investments and Other Segment. Investments and Other Segment costs and expenses decreased \$0.4 million and \$0.8 million during the three and six months ended June 30, 2010 compared to the same periods in 2009, attributable to lower rental activities.

**Depreciation and amortization**

Investments and Other Segment depreciation and amortization for both the three and six months ended June 30, 2010 decreased \$0.1 million compared to the same periods in 2009.

Table of Contents

**Income from operations**

Investments and Other Segment income from operations was \$3.1 million and \$6.1 million for the three and six months ended June 30, 2010, an increase of \$0.4 million or 14.8% and \$0.3 million or 5.2% compared to the same periods in 2009, attributable to lower operating costs.

Table of Contents**Segment Operating Data**

The following table presents operating data for the Company's operating business segments:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>		
<b>Financial Services Operating Data</b>				
Mutual fund shareowner accounts processed (millions)				
U.S.				
Registered accounts:				
Non tax-advantaged	60.3	63.6		
Tax-advantaged:				
IRA mutual fund accounts	27.2	26.8		
Other retirement accounts	9.9	10.0		
Section 529 and Educational IRAs	9.9	9.5		
	47.0	46.3		
Total registered accounts	107.3	109.9		
Subaccounts	17.6	11.2		
Total accounts serviced	124.9	121.1		
International				
United Kingdom (1)	7.0	6.6		
Canada (2)	10.8	10.2		
TRAC participants (millions)	3.8	4.2		
Automated Work Distributor workstations (thousands)	195.6	193.5		
DST Health Solutions covered lives (millions)	23.2	23.5		
	<b>Three Months Ended</b>	<b>Six Months Ended</b>		
	<b>June 30,</b>	<b>June 30,</b>		
	<b>2010</b>	<b>2009</b>		
	<b>2010</b>	<b>2009</b>		
<b>Other Financial Services Operating Data</b>				
Pharmacy claims paid by Argus (millions) (3)	95.8	94.8	190.7	189.8
<b>Output Solutions Operating Data</b>				
Images produced (billions)	2.8	3.1	6.2	6.2
Items mailed (billions)	0.6	0.6	1.2	1.2

(1) Processed by International Financial Data Services (U.K.) Limited, an unconsolidated affiliate of the Company.

(2) Processed by International Financial Data Services L.P., an unconsolidated affiliate of the Company comprised of businesses in Canada, Ireland and Luxembourg.

(3) Argus Health Systems, Inc. became a wholly-owned subsidiary of DST on March 31, 2009 when DST acquired the remaining 50% equity interest.





Table of Contents

**USE OF NON-GAAP FINANCIAL INFORMATION**

In addition to reporting operating income, pretax income, net income and earnings per share on a GAAP basis, DST has also made certain non-GAAP adjustments which are described below in the section titled "Description of Non-GAAP Adjustments" and are reconciled to the corresponding GAAP measures in the attached financial schedules titled "Reconciliation of Reported Results to Income Adjusted for Certain Non-GAAP Items" below. In making these non-GAAP adjustments, the Company takes into account the impact of items that are not necessarily ongoing in nature, that do not have a high level of predictability associated with them or that are non-operational in nature. Generally, these items include net gains on dispositions of business units, net gains (losses) associated with securities and other investments, restructuring and impairment costs and other similar items. Management believes the exclusion of these items provides a useful basis for evaluating underlying business unit performance, but should not be considered in isolation and is not in accordance with, or a substitute for, evaluating business unit performance utilizing GAAP financial information. Management uses non-GAAP measures in its budgeting and forecasting processes and to further analyze its financial trends and operational run-rate, as well as making financial comparisons to prior periods presented on a similar basis. The Company believes that providing such adjusted results allows investors and other users of DST's financial statements to better understand DST's comparative operating performance for the periods presented.

DST's management uses each of these non-GAAP financial measures in its own evaluation of the Company's performance, particularly when comparing performance to past periods. DST's non-GAAP measures may differ from similar measures by other companies, even if similar terms are used to identify such measures. Although DST's management believes non-GAAP measures are useful in evaluating the performance of its business, DST acknowledges that items excluded from such measures may have a material impact on the Company's income from operations, pretax income, net income and earnings per share calculated in accordance with GAAP. Therefore, management typically uses non-GAAP measures in conjunction with GAAP results. These factors should be considered when evaluating DST's results.

*Description of Non-GAAP Adjustments*

The following items, which occurred during the three months ended June 30, 2010, have been treated as non-GAAP adjustments:

- Contract termination payment, net of termination benefit expenses and asset impairment charges resulting from the termination of an Output Solutions telecommunications client, in the amount of \$58.4 million. The net contract termination gain was comprised of operating revenues of \$63.0 million, partially offset by termination benefit expenses of \$1.5 million that were included in costs and expenses and asset impairment charges of \$3.1 million which are included in depreciation and amortization expense. The aggregate income tax expense associated with this net contract termination gain was approximately \$22.8 million.
- Termination benefit expenses of \$2.8 million associated with reductions in workforce in the Financial Services Segment (\$2.3 million) and the Output Solutions Segment (\$0.5 million), which were included in costs and expenses. The aggregate income tax benefit associated with these costs was approximately \$1.2 million.
- Other net gains, in the amount of \$3.3 million, associated with gains (losses) related to securities and other investments, which were included in other income, net. The income tax expense associated with these gains was approximately \$1.3 million. The \$3.3 million of net gains on securities and other investments for the three months ended June 30, 2010 was comprised of net realized gains from sales of

Edgar Filing: DST SYSTEMS INC - Form 10-Q

available-for-sale securities of \$3.1 million and net gains on private equity funds and other investments of \$0.5 million, partially offset by other than temporary impairments on available-for-sale securities of \$0.3 million.

Table of Contents

- Net gain, in the amount of \$0.7 million, associated with the repurchase and extinguishment of senior convertible debentures. The income tax expense associated with these gains was approximately \$0.3 million.

In addition to the items that occurred in the three months ended June 30, 2010 as described above, the following items, which occurred during the three months ended March 31, 2010, have been previously reported as non-GAAP adjustments:

- Termination benefit expenses of \$11.8 million associated with reductions in workforce in the Financial Services Segment (\$9.1 million) and the Output Solutions Segment (\$2.7 million), which are included in costs and expenses. The aggregate income tax benefit associated with these costs was approximately \$4.6 million.

- Other net gains, in the amount of \$38.2 million, associated with gains (losses) related to securities and other investments, which are included in other income, net. The income tax expense associated with these gains was approximately \$14.8 million. The \$38.2 million of net gains on securities and other investments for the three months ended March 31, 2010 is comprised of net realized gains from sales of available-for-sale securities of \$37.5 million and net gains on private equity funds and other investments of \$0.8 million, partially offset by other than temporary impairments on available-for-sale securities of \$0.1 million.

- Dividend from a private equity investment of \$8.3 million, which is included in other income, net. The income tax expense associated with this dividend was approximately \$1.0 million.

- Loss, in the amount of \$0.6 million, associated with the repurchase and extinguishment of senior convertible debentures. The income tax benefit associated with this loss was approximately \$0.2 million.

The following items, which occurred during the three months ended June 30, 2009, have been treated as non-GAAP adjustments:

- Other net gains, in the amount of \$4.3 million, associated with gains (losses) related to securities and other investments, which are included in other income, net. The income tax expense associated with these gains was approximately \$1.7 million. The \$4.3 million of net gains on securities and other investments for the three months ended June 30, 2009 was comprised of net realized gains from sales of available-for-sale securities of \$4.2 million, net unrealized gains on private equity funds and other investments of \$1.3 million and other than temporary impairments on available-for-sale securities of \$1.2 million.

- Gains in the amount of \$2.1 million, associated with the repurchase and extinguishment of senior convertible debentures. The income tax expense associated with these gains was approximately \$0.8 million.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

In addition to the items that occurred in the three months ended June 30, 2009 as described above, the following items, which occurred during the three months ended March 31, 2009, have been previously reported as non-GAAP adjustments:

- Gain on equity interest in Argus, in the amount of \$41.7 million, included in other income, net associated with DST's purchase of the remaining 50% interest of Argus on March 31, 2009 for \$57.0 million in cash. As required by generally accepted accounting principles, the Company adopted the new business combinations accounting guidance on January 1, 2009. In accordance with the guidance, the acquisition of the remaining 50% of Argus was treated as a step acquisition. Accordingly, DST remeasured its previously held equity interest in Argus to fair value and recorded a \$41.7 million gain. In addition, the Company recorded an income tax benefit associated with this transaction of approximately \$0.9 million

Table of Contents

related to the elimination of deferred tax liabilities previously established for equity in earnings of Argus. In accordance with authoritative income tax accounting guidance, no income taxes were recorded on the \$41.7 million gain on equity interest in Argus.

- Other net losses, in the amount of \$30.8 million, associated with gains (losses) related to securities and other investments, which are included in other income, net. The income tax benefit associated with these losses was approximately \$11.8 million. The \$30.8 million of net losses on securities and other investments for the three months ended March 31, 2009 is comprised of net realized losses from sales of available-for-sale securities of \$0.8 million, other than temporary impairments on available-for-sale securities of \$25.6 million and net unrealized losses on private equity funds and other investments of \$4.4 million.
- Gain in the amount of \$3.7 million, associated with the repurchase and extinguishment of senior convertible debentures, which is included in other income, net. The income tax expense associated with these gains was approximately \$1.4 million.
- An income tax benefit of approximately \$5.7 million resulting from a reduction in income tax related liabilities principally associated with the completion of an IRS examination in February 2009 for the tax years ended December 31, 2002 through 2005.

Table of Contents

## DST SYSTEMS, INC.

## RECONCILIATION OF REPORTED RESULTS TO INCOME ADJUSTED FOR CERTAIN NON-GAAP ITEMS

Three Months Ended June 30,

(Unaudited - in millions, except per share amounts)

			2010			
	Operating Income		Pretax Income		Net Income	Diluted EPS
<b>Reported GAAP income</b>	\$ 142.3	\$	144.4	\$	94.0	\$ 2.00
Adjusted to remove:						
<i>Included in operating income:</i>						
Contract termination payment, net of expenses - Output Solutions	(58.4)		(58.4)		(35.6)	(0.76)
Termination benefit expenses - Financial Services	2.3		2.3		1.3	0.03
Termination benefit expenses - Output Solutions	0.5		0.5		0.3	0.01
<i>Included in non-operating income:</i>						
Net gain on securities and other investments			(3.3)		(2.0)	(0.04)
Net gain on extinguishment of senior convertible debentures			(0.7)		(0.4)	(0.01)
<b>Adjusted Non-GAAP income</b>	\$ 86.7	\$	84.8	\$	57.6	\$ 1.23

			2009			
	Operating Income		Pretax Income		Net Income	Diluted EPS
<b>Reported GAAP income</b>	\$ 68.5	\$	80.7	\$	48.7	\$ 0.97
Adjusted to remove:						
<i>Included in non-operating income:</i>						
Net gain on securities and other investments			(4.3)		(2.6)	(0.05)
Gain on extinguishment of senior convertible debentures			(2.1)		(1.3)	(0.02)
<b>Adjusted Non-GAAP income</b>	\$ 68.5	\$	74.3	\$	44.8	\$ 0.90

**Note:** See the Description of Non-GAAP Adjustments section for a description of each of the above adjustments and see the Use of Non-GAAP Financial Information section for management's reasons for providing non-GAAP financial information.





Table of Contents

## DST SYSTEMS, INC.

## RECONCILIATION OF REPORTED RESULTS TO INCOME ADJUSTED FOR CERTAIN NON-GAAP ITEMS

Six Months Ended June 30,

(Unaudited - in millions, except per share amounts)

	2010			
	Operating Income	Pretax Income	Net Income	Diluted EPS
<b>Reported GAAP income</b>	\$ 210.6	\$ 265.5	\$ 170.9	\$ 3.57
Adjusted to remove:				
<i>Included in operating income:</i>				
Contract termination payment, net of expenses - Output Solutions	(58.4)	(58.4)	(35.6)	(0.74)
Termination benefit expenses - Financial Services	11.4	11.4	6.9	0.14
Termination benefit expenses - Output Solutions	3.2	3.2	1.9	0.04
<i>Included in non-operating income:</i>				
Net gain on securities and other investments		(41.5)	(25.4)	(0.53)
Dividend from a private equity investment		(8.3)	(7.3)	(0.15)
Net gain on extinguishment of senior convertible debentures		(0.1)		
<b>Adjusted Non-GAAP income</b>	\$ 166.8	\$ 171.8	\$ 111.4	\$ 2.33

	2009			
	Operating Income	Pretax Income	Net Income	Diluted EPS
<b>Reported GAAP income</b>	\$ 142.9	\$ 166.4	\$ 121.9	\$ 2.44
Adjusted to remove:				
<i>Included in non-operating income:</i>				
Gain on equity interest in Argus Health Systems		(41.7)	(42.6)	(0.85)
Net loss on securities and other investments		26.5	16.4	0.33
Gain on extinguishment of senior convertible debentures		(5.8)	(3.6)	(0.07)
Reduction in income tax related liabilities			(5.7)	(0.12)
<b>Adjusted Non-GAAP income</b>	\$ 142.9	\$ 145.4	\$ 86.4	\$ 1.73

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

**Note:** See the Description of Non-GAAP Adjustments section for a description of each of the above adjustments and see the Use of Non-GAAP Financial Information section for management's reasons for providing non-GAAP financial information.

### **Management's Analysis of Non-GAAP Results for the three and six months ended June 30, 2010 and 2009**

Taking into account the non-GAAP items described in the above tables, adjusted non-GAAP diluted earnings per share was \$1.23 and \$0.90 during the three months ended June 30, 2010 and 2009, respectively, and \$2.33 and \$1.73 during the six months ended June 30, 2010 and 2009, respectively. Management's discussion of the

Table of Contents

Company's Results of Operations in the sections above are applicable for these changes in non-GAAP diluted earnings per share, when adjusting for the non-GAAP items in the reconciliation tables above. The increase in non-GAAP diluted earnings per share during the three months ended June 30, 2010 is primarily attributable to lower costs resulting from the Company's ongoing cost management initiatives which included a workforce reduction, a general freeze on hiring and management salaries and other controls over operating expenses. Consolidated operating revenues were essentially unchanged as compared to the same period in 2009. Also contributing to the improvement in diluted earnings per share during the three months ended June 30, 2010 was a lower income tax rate and lower average diluted shares outstanding associated with share repurchases.

## LIQUIDITY AND CAPITAL RESOURCES

### Sources and Uses of Cash

The Company's primary source of liquidity has historically been cash provided by operations. Principal uses of cash are operations, reinvestment in the Company's proprietary technologies, capital expenditures, stock repurchases, investment purchases, payments on debt and dividend payments. Information on the Company's consolidated cash flows for the six months ended June 30, 2010 and 2009 is presented in the Condensed Consolidated Statement of Cash Flows, categorized by operating activities, investing activities, and financing activities.

### Operating Activities

Cash flows provided by operating activities were \$126.6 million during the six months ended June 30, 2010 as compared to \$179.2 million for the six months ended June 30, 2009. Cash flows provided by operating activities during the six months ended June 30, 2010 include a cash flow use of \$125.0 million related to an increase in accounts receivable associated with the Company's January 1, 2010 adoption of new authoritative accounting guidance related to the transfer of financial assets. After January 1, 2010, the periodic transfers of undivided interests in accounts receivable no longer qualify for sale accounting treatment in accordance with the new accounting guidance and are accounted for as secured borrowings. At June 30, 2010, the outstanding amount of undivided interests in the receivables held by the conduit was \$125.0 million, unchanged from December 31, 2009. During the six months ended June 30, 2010, the Company's accounts receivable increased by \$125.0 million resulting in a cash outflow being reported in the operating section of the cash flow statement and the current portion of debt associated with the accounts receivable securitization program increased by \$125.0 million resulting in a cash inflow being reported in the financing section of the statement of cash flows. Cash flows after January 1, 2010 associated with the accounts receivable securitization program will be presented as financing activities.

Absent the increase in accounts receivable associated with the adoption of the new accounting guidance described above, operating cash flows increased by \$72.4 million to \$251.6 million during the six months ended June 30, 2010 compared to the same period in 2009. On this basis, the increase in operating cash flows during 2010 is primarily attributable to decreases in working capital and higher earnings in 2010. Operating cash flows during 2010 resulted principally from net income of \$170.9 million adjusted for non-cash items included in the determination of net income, including depreciation and amortization expense of \$65.9 million and equity in earnings of unconsolidated affiliates of \$18.1 million. Contributing to the increase in net income for the six months ended June 30, 2010 was an Output Solutions contract termination payment of approximately \$63.0 million received in April 2010. Significant working capital related adjustments to net income, excluding the \$125.0 million increase in accounts receivable related to the adoption of the new accounting guidance, include decreases in accounts payable and accrued liabilities of \$8.8 million, partially offset by increases in income taxes payable of \$32.8 million and decreases in accounts receivable of \$6.1 million. Cash and cash equivalents were \$78.7 million and \$47.2 million at June 30, 2010 and 2009, respectively.



Table of Contents**Investing Activities**

Cash flows used by investing activities were \$79.3 million during the six months ended June 30, 2010 as compared to cash flows provided by investing activities of \$37.2 million for the six months ended June 30, 2009. The increase in net investing activities during 2010 compared to 2009 is primarily attributable to higher investments in securities, higher capital expenditures and a \$53.2 million increase in restricted cash and cash equivalents held to satisfy client funds obligation for transfer agency and Argus clients, partially offset by higher proceeds from the sale/maturities of investments. Investing cash flows during 2009 include \$47.8 million of cash outflows for the step acquisition of Argus, offset by \$135.1 million from a reduction in restricted cash and cash equivalents held to satisfy client funds obligations for transfer agency and Argus clients in 2009.

*Capital Expenditures*

The following table summarizes capital expenditures by segment (in millions):

	<b>Six Months Ended June 30,</b>			
	<b>2010</b>		<b>2009</b>	
Financial Services Segment	\$	33.7	\$	19.2
Output Solutions Segment		13.5		16.6
Investments and Other Segment		7.1		3.3
	\$	54.3	\$	39.1

Investments and Other Segment capital expenditures are primarily building improvements. Future capital expenditures are expected to be funded primarily by cash flows from operating activities, secured term notes or draws from bank lines of credit, as required.

*Investments*

The Company purchased \$92.9 million and \$52.9 million of investments in available-for-sale securities and other investments during the six months ended June 30, 2010 and 2009, respectively. During the six months ended June 30, 2010, the Company received \$112.6 million from the sale/maturities of investments compared to \$43.6 million during the six months ended June 30, 2009. Included in the \$112.6 million received from sale/maturities of investments during the six months ended June 30, 2010 is the sale of approximately 4.8 million shares of Computershare Ltd. for \$52.4 million resulting in a gain of \$28.8 million.

**Financing Activities**

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

Cash flows used in financing activities were \$74.8 million during the six months ended June 30, 2010 as compared to \$247.9 million for the six months ended June 30, 2009. The decrease in cash flows used in financing activities is primarily related to the January 1, 2010 adoption of new accounting guidance related to transfers of financial assets described above, which required the Company to account for the accounts receivable securitization program as a secured borrowing and present \$125.0 million as a financing cash inflow during the six months ended June 30, 2010. Accordingly, cash flows after January 1, 2010 associated with the accounts receivable securitization program will be presented as financing activities. Absent this \$125.0 million financing cash inflow in 2010, cash flows used in financing activities were \$199.8 million during the six months ended June 30, 2010 as compared to \$247.9 million for the six months ended June 30, 2009, a decrease of \$48.1 million. On this basis, financing cash outflows for 2010 were repurchases of senior convertible debentures of \$155.0 million, share repurchases of \$108.7 million and net borrowings under the revolving loan with BFDS and the syndicated line of credit facility in the aggregate amount of \$29.2 million. Client funds obligations increased \$53.2 million during the six months ended June 30, 2010 compared to a decrease of \$146.1 million during the six months ended June 30, 2009. During the six months ended June 30, 2009, cash outflows from the repurchase of senior convertible debentures of \$121.8 million and share repurchase activities of \$4.9 million were partially offset by

Table of Contents

\$27.6 million of cash inflows from borrowings under the loan with BFDS and the syndicated line of credit facility.

*Common Stock Issuances and Repurchases*

The Company received proceeds of \$9.8 million and \$4.7 million from the issuance of common stock from the exercise of employee stock options during the six months ended June 30, 2010 and 2009, respectively.

On May 11, 2010, DST's Board of Directors authorized the repurchase of an additional 1.0 million shares under the existing share repurchase authorization plan, which allows for open market and private purchase of common stock through December 31, 2012. At June 30, 2010, there were approximately 1.0 million shares remaining to be repurchased under the Company's existing share repurchase authorization plan. The Company repurchased 2.3 million shares of DST common stock for \$91.1 million or approximately \$40.09 per share during the six months ended June 30, 2010. The Company repurchased 110,000 shares of DST common stock for \$3.1 million or approximately \$28.52 per share during the six months ended June 30, 2009.

Payments made for tax-withholding obligations arising from the exercise of options to purchase the Company's stock or from the vesting of restricted shares are included in common stock repurchased in the Condensed Consolidated Statement of Cash Flows. The amount of such share withholdings for option exercises and restricted stock vesting was \$17.6 million and \$1.8 million during the six months ended June 30, 2010 and 2009, respectively.

*Dividend declared*

On March 4, 2010, DST declared its first cash dividend since going public in 1995 and paid a \$0.30 per share dividend on April 8, 2010 to shareholders of record as of the close of business on March 17, 2010. The aggregate amount of the cash dividend was \$14.3 million.

*Off Balance Sheet Obligations*

As of June 30, 2010, the Company had no material off balance sheet arrangements.

*Financing Sources*

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

The Company has used the following primary sources of financing: its syndicated line of credit facility; convertible debentures; subsidiary line of credit facilities; secured promissory notes; loans from unconsolidated affiliates; accounts receivable securitization program; and secured borrowings. The Company has also utilized bridge loans as necessary to augment the above sources of debt financing. The Company had \$1,218.7 million and \$1,221.9 million of debt outstanding at June 30, 2010 and December 31, 2009, respectively, a decrease of \$3.2 million during 2010 compared to 2009. The 2010 decrease is principally from the repurchases of the Company's convertible senior debentures, partially offset by the adoption of new authoritative accounting guidance requiring proceeds from accounts receivable securitization transactions to be reflected as debt, which increased debt by \$125.0 million from December 31, 2009.



Table of Contents

The Company is obligated under notes and other indebtedness as follows (in millions):

	June 30, 2010	December 31, 2009
Accounts receivable securitization program	\$ 125.0	\$ 8.9
Secured promissory notes	6.0	8.8
Equipment credit facilities	9.0	111.6
Real estate credit agreement	110.1	
Convertible senior debentures		
Series A	84.1	151.8
Series B	165.5	171.3
Series C	178.5	257.0
Revolving credit facilities	430.4	416.3
Related party promissory note	90.0	75.0
Other indebtedness	20.1	21.2
	1,218.7	1,221.9
Less current portion of debt	313.7	658.1
Long-term debt	\$ 905.0	\$ 563.8

*Accounts Receivable Securitization Program*

On January 1, 2010, the Company adopted new authoritative accounting guidance related to transfers of financial assets. This guidance changed the accounting for securitizations of mortgages and other financial instruments and the consolidation requirements for qualifying special-purpose entities ( QSPE ). Besides removing the concept of a QSPE, this new accounting guidance: a) clarified the determination of whether a transferor and all the entities included in the transferor's financial statements being presented have surrendered control over transferred financial assets; b) defined the term participating interest to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale; c) required a transferor to recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer of financial assets accounted for as a sale; and d) enhanced disclosures to provide financial statement users with greater transparency about transfers of financial assets and a transferor's continuing involvement with transferred financial assets.

Prior to the adoption of this new authoritative accounting guidance on January 1, 2010, the periodic transfers by the SPE of undivided interests in accounts receivable to the third-party, multi-seller, asset-backed commercial paper conduit met the requirements for sale accounting treatment and were considered an off-balance sheet arrangement. After January 1, 2010, the periodic transfers of undivided interests in accounts receivable no longer qualify for sale accounting treatment in accordance with the new accounting guidance and are accounted for as secured borrowings. DST has continuing involvement with the transferred assets because it maintains servicing responsibilities for the accounts receivable assets included in the accounts receivable securitization program. Accounts receivable assets transferred from DST and certain of its domestic subsidiaries to its wholly-owned, bankruptcy remote special purpose subsidiary contain restrictions because they are not available to satisfy the creditors of any other person, including DST or any of its subsidiaries or affiliates.

At June 30, 2010, the outstanding amount of undivided interests in the receivables held by the conduit was \$125.0 million, unchanged from December 31, 2009. During the six months ended June 30, 2010, the Company's accounts receivable increased by \$125.0 million resulting in a cash outflow being reported in the operating section of the cash flow statement and the current portion of debt associated with the accounts receivable securitization program increased by \$125.0 million resulting in a cash inflow being reported in the financing section of the cash flow statement. During the six months ended June 30, 2010, total proceeds from the accounts receivable securitization program were approximately

Edgar Filing: DST SYSTEMS INC - Form 10-Q

\$415.0 million and total repayments were approximately \$290.0 million which comprises the net cash inflow in the financing section of the statement of cash flows. Costs

Table of Contents

associated with the accounts receivable securitization program were included in other income during 2009, but are included in interest expense effective January 1, 2010.

On May 20, 2010, the Company renewed the accounts receivable securitization program. In connection with the renewal, the maximum size of the program decreased from \$175 million to \$150 million and the expiration date for the conduit's purchase commitment was changed to May 19, 2011.

Aggregate transfers of undivided interests in the receivables from the SPE to the conduit were \$886.7 million and \$888.3 million for the six months ended June 30, 2010 and 2009, respectively.

*Equipment credit facilities*

The draw period under the Company's existing \$50 million equipment credit facility expired on June 30, 2010. The maturity date for each loan drawn under that facility is the earlier of approximately three years from the initial draw or August 1, 2013.

On June 30, 2010, the Company entered into a new \$50.0 million unsecured credit facility with the same vendor. Proceeds from loans made under the new credit facility can be used to make purchases of the vendor's eligible equipment, software or services. Loans under this credit facility must be made prior to December 31, 2012, the draw period termination date. The maturity date for each loan under this credit facility is the earlier of i) the last day of the thirty first (31st) calendar month following the loan date or ii) June 30, 2015. Interest rates applicable to the loans under this credit facility are generally based on the LIBOR rate plus an applicable margin of 1.5% to 2.5%. The applicable margin is based on a grid schedule that adjusts borrowing costs up or down based upon the Company's consolidated leverage ratio. No amounts were drawn under this facility at June 30, 2010.

*Convertible Senior Debentures*

During the three and six months ended June 30, 2010, the Company recorded a gain of \$0.7 million and \$0.1 million, respectively, associated with the repurchase of a portion of the Company's senior convertible debentures at a discount to carrying value. The Company repurchased \$67.7 million in principal amount of the original Series A senior convertible debentures, \$8.8 million in principal amount of the original Series B convertible debentures and \$78.5 million in principal of the original Series C senior convertible debentures during the six months ended June 30, 2010. During the three and six months ended June 30, 2009, the Company recorded a gain of \$2.1 million and \$5.8 million, respectively, associated with the repurchase of a portion of the Company's senior convertible debentures at a discount to carrying value.

*Revolving credit facilities*

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

On April 16, 2010, the Company entered into a new syndicated line of credit facility to replace its syndicated revolving line of credit facility that matured on July 1, 2010. The new credit agreement provides for a revolving unsecured credit facility in an aggregate principal amount of up to \$600 million. The interest rates applicable to loans under the new credit agreement are generally based on LIBOR, Federal Funds or prime rates plus applicable margins as defined in the agreement. The revolving credit facility contains grid schedules that adjust borrowing costs up or down based upon the Company's consolidated leverage ratio. The grid schedules may result in fluctuations in borrowing costs ranging from 1.75% to 2.375% over LIBOR and 0.75% to 1.375% over base rate as defined. Additionally, an annual facility fee of 0.25% to 0.625% is required on this revolving syndicated line of credit. The credit agreement contains customary restrictive covenants, as well as certain customary events of default. Among other provisions, the credit agreement limits consolidated indebtedness, liens, investments, subsidiary indebtedness, asset dispositions and restricted payments (including stock repurchases and cash dividends), and requires 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 new credit facility is July 1, 2013. On April 16, 2010, the date of the refinancing transaction, the administrative agent transferred \$443.4 million of the outstanding

Table of Contents

balance under the old credit facility to the new credit facility. The Company was in compliance with its debt covenants at June 30, 2010.

*Related party promissory note*

On June 25, 2010, the Company renewed its related party promissory note with Boston Financial Data Services, Inc. ( BFDS ). The agreement provides for unsecured revolving borrowings by the Company of up to \$100 million and matures on July 1, 2013. From time to time, BFDS may, subject to a ten day notice period, demand a prepayment of the loan by the Company in an amount not to exceed \$25 million in each instance. The interest rate applicable to the loan is based on LIBOR plus an applicable margin correlating to the applicable margin under the Company's \$600 million syndicated line of credit facility. The loan agreement incorporates by reference and requires the Company to comply with the affirmative and negative covenants contained in the Company's \$600 million syndicated line of credit facility.

*Company's Assessment of Short-term and Long-term Liquidity*

During the six months ended June 30, 2010, the Company entered into a new \$600 million revolving credit agreement and renewed its \$100 million revolving promissory note with a related party. Both of these revolving credit facilities mature on July 1, 2013. In addition, the Company renewed its accounts receivable securitization program, which matures on May 19, 2011, and decreased the maximum size of the program from \$175 million to \$150 million. The Company entered into a new \$50 million equipment credit facility with a vendor that can be used for equipment, software and service purchases from the vendor during the draw period which ends on December 31, 2012. The Company also repurchased approximately \$67.7 million in principal amount of the original Series A convertible senior debentures during the six months ended June 30, 2010 resulting in \$84.1 million outstanding at June 30, 2010. The Series A convertible senior debentures can be put to the Company at par for cash for a 10-day period beginning August 15, 2010. The Company believes it has sufficient resources to fund any potential puts of the Series A convertible senior debentures. Furthermore, the Company believes that its existing cash balances and other current assets, together with cash provided by operating activities and, as necessary, the Company's bank and revolving credit facilities, will suffice to meet the Company's operating and debt service requirements and other current liabilities for at least the next 12 months.

*Guarantees*

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 license 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.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

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:

Table of Contents

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 that 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.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

At June 30, 2010 and December 31, 2009, 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 accounting and reporting guidance on guarantees, including indirect guarantees of indebtedness of others.



Table of Contents

**OTHER**

**Comprehensive income (loss)**

The Company recorded comprehensive loss of \$31.5 million for the three months ended June 30, 2010 and comprehensive income of \$43.8 million for the six months ended June 30, 2010 compared to comprehensive income of \$216.9 million and \$241.4 million for the three and six months ended June 30, 2009, respectively. Comprehensive income includes net income of \$94.0 million and \$170.9 million for the three and six months ended June 30, 2010 compared to \$48.7 million and \$121.9 million for the three and six months ended June 30, 2009, and other comprehensive loss of \$125.5 million and \$127.1 million for the three and six months ended June 30, 2010 compared to other comprehensive income of \$168.2 million and \$119.5 million for the three and six months ended June 30, 2009. Other comprehensive income (loss) consists of unrealized gains (losses) on available-for-sale securities, net of deferred taxes, reclassifications for net gains and losses included in net income, unrealized gain (loss) on interest rate swaps, the Company's proportional share of unconsolidated affiliates interest rate swaps and foreign currency translation adjustments. The principal difference between net income and comprehensive net income is the net change in unrealized gains (losses) on available-for-sale securities.

**Other than temporary impairments**

At June 30, 2010, the Company's available-for-sale securities had gross unrealized holding losses of \$6.6 million. If it is determined that a reduction in a security's net realizable value is other than temporary, a realized loss will be recognized in the statement of operations and the cost basis of the security reduced to its estimated fair value. The Company does not believe that the gross unrealized losses at June 30, 2010 are other than temporary.

The Company recognized \$0.3 million and \$0.4 million of investment impairments for the three and six months ended June 30, 2010 compared to \$1.2 million and \$26.8 million for the three and six months ended June 30, 2009, which were other than temporary. The Company records lower of cost or market valuation adjustments on private equity fund investments and other cost method investments when impairment conditions are present. During the three and six months ended June 30, 2010, the Company recorded \$0.4 million and \$0.8 million, respectively, of impairments on private equity and other investments as compared to the three and six months ended June 30, 2009 when the Company recorded impairments of \$0.2 million and \$4.2 million, respectively. The impairments recorded related primarily to investments in the Financial Services Segment and the Investments and Other 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, net in the Condensed Consolidated Statement of Income.

**Seasonality**

Generally, the Company does not have significant seasonal fluctuations in its business operations. Processing and Output Solutions volumes for mutual fund customers are usually highest during the three months ended March 31 due primarily to processing year-end transactions and printing and mailing of year-end statements and tax forms during January. The Company has historically added operating equipment in the last half of the year in preparation for processing year-end transactions, which has the effect of increasing costs for the second half of the year. Revenues and operating results from individual license sales depend heavily on the timing and size of the contract.

**Authoritative Accounting Guidance**

*Variable Interest Entities*

On January 1, 2010, the Company adopted new authoritative accounting guidance related to variable interest entities. Among other items, this accounting guidance responds to concerns about the application of certain key provisions of the current accounting guidance for variable interest entities, including those regarding the

Table of Contents

transparency of the involvement with variable interest entities. The adoption of this new accounting guidance did not have a significant impact on the consolidated financial statements.

*Multiple-Element Revenue Arrangements*

In October 2009, the FASB issued new authoritative accounting guidance related to multiple element revenue arrangements. This update provides guidance on whether multiple elements (deliverables) exist, how the deliverables should be separated and how the consideration should be allocated. The new guidance established a hierarchy for determining the selling price of a deliverable. For DST, the new authoritative guidance is effective prospectively for revenue arrangements entered into or materially modified after January 1, 2011. Early adoption is permitted. The Company has not determined the impact this new authoritative accounting guidance may have on the consolidated financial statements.

*Certain Revenue Arrangements That Include Software Elements*

In October 2009, the FASB issued a new authoritative accounting guidance related to certain revenue arrangements that include software elements. This new guidance changes the accounting model for revenue arrangements that include both tangible products and software elements and also provides guidance on how consideration should be allocated in an arrangement that includes both tangible products and software. For DST, the new authoritative guidance is effective prospectively for revenue arrangements entered into or materially modified after January 1, 2011. Early adoption is permitted. The Company has not determined the impact this guidance may have on the consolidated financial statements.

*Earnings per Share Proposed Accounting Guidance*

In August 2008, the FASB issued a revised exposure draft, that would amend current earnings per share accounting guidance 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 final authoritative accounting guidance has yet to be issued. In April 2009, the FASB decided to pause the earnings per share project.

The proposed guidance, 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 guidance 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 the proposed guidance. Retrospective application would be required for all changes, 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 accounting guidance, 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 using the 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 approximately 8.5 million shares (less shares already included in diluted earnings per share, if any), the amount of shares that would be issued if all \$428.1 million of the senior convertible debentures at June 30, 2010 would be converted to equity. Under this if-converted method, diluted earnings per share would have been \$1.69 and \$0.84 (versus reported diluted

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

earnings per share of \$2.00 and \$0.97) for the three months ended June 30, 2010 and 2009, respectively, and \$3.02 and \$2.05 (versus reported diluted earnings per share of \$3.57 and \$2.44) for the six months ended June 30, 2010 and 2009, respectively. The revised 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 guidance.

Table of Contents

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 guidance 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 guidance when issued as final.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

In the operations of its businesses, the Company's financial results can be affected by changes in equity pricing, interest rates and currency exchange rates. Changes in interest rates and exchange rates have not materially impacted the consolidated financial position, results of operations or cash flows of the Company. Changes in equity values of the Company's investments have had a material effect on the Company's comprehensive income and financial position.

**Available-for-sale equity price risk**

The Company's investments in available-for-sale equity securities are subject to price risk. The fair value of the Company's available-for-sale investments as of June 30, 2010 was approximately \$704.6 million. The impact of a 10% change in fair value of these investments would be approximately \$43.1 million to comprehensive income. As discussed under Management's Discussion and Analysis of Financial Condition and Results of Operations Comprehensive Income (Loss) above, net unrealized gains and losses on the Company's investments in available-for-sale securities have had a material effect on the Company's comprehensive income (loss) and financial position.

**Interest rate risk**

The Company and certain of its joint ventures derive a certain amount of their service revenues from investment earnings related to cash balances maintained in bank accounts on which the Company is the agent for clients. The balances maintained in the bank accounts are subject to fluctuation. For the six months ended June 30, 2010, the Company and BFDS had average daily cash balances of approximately \$1.5 billion maintained in such accounts, of which approximately \$1.0 billion were maintained at BFDS. The Company estimates that a 50 basis point change in interest earnings rate would equal approximately \$2.4 million of net income (loss).

At June 30, 2010, the Company had \$1.2 billion of debt, of which \$654.4 million was subject to variable interest rates (Federal Funds rates, LIBOR rates, Prime rates). Included in this amount are program fees incurred on proceeds from the sale of receivables under the Company's accounts receivable securitization program, which are determined based on variable interest rates associated with commercial paper. As discussed above in comprehensive income (loss), the amount recorded related to the Company's proportional share of unconsolidated affiliates interest rate swap was a loss of \$2.6 million. The Company estimates that a 10% increase in interest rates would not be material to the Company's consolidated pretax earnings or to the fair value of its debt.

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

The effect of changes in interest rates on the Company's variable rate debt is somewhat neutralized by changes in interest rates attributable to balance earnings.

### **Foreign currency exchange rate risk**

The operation of the Company's subsidiaries in international markets results in exposure to movements in currency exchange rates. The principal currencies involved are the British pound, Canadian dollar, Australian dollar, Thai baht and Indian rupee. Currency exchange rate fluctuations have not historically materially affected the consolidated financial results of the Company. At June 30, 2010, the Company's international subsidiaries had approximately \$181.8 million in total assets and for the three and six months ended June 30, 2010, these international subsidiaries recorded approximately \$4.6 million and \$8.2 million in net income. The Company

Table of Contents

estimates that a 10% change in exchange rates could change total consolidated assets by approximately \$18.2 million. Furthermore, a 10% change in exchange rates based upon historical earnings in international operations could change consolidated reported net income by approximately \$0.8 million for the six months ended June 30, 2010.

The Company's international subsidiaries use the local currency as the functional currency. The Company translates its assets and liabilities at year-end exchange rates except for those accounts where historical rates are acceptable, and translates income and expense accounts at average rates during the year. While it is generally not the Company's practice to enter into derivative contracts, from time to time the Company and its subsidiaries do utilize forward foreign currency exchange contracts to minimize the impact of currency movements.

**Item 4. Controls and Procedures**

*Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures designed to ensure that information required to be disclosed in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, including without limitation, controls and procedures designed to ensure that information required to be disclosed in reports that it files under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on an evaluation of the Company's disclosure controls and procedures as of the end of the period covered by this report conducted by the Company's management, with the participation of the Chief Executive and Chief Financial Officer, the Chief Executive and Chief Financial Officer believe that these controls and procedures were effective as of June 30, 2010.

*Internal Control over Financial Reporting*

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13(a)-15 and 15(d)-15 under the Exchange Act) during the quarter ended June 30, 2010, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 4T. Controls and Procedures**

Not applicable.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company and its subsidiaries are involved in various legal proceedings arising in the normal course of their businesses. While the ultimate outcome of such legal proceedings cannot be predicted with certainty, management believes, after consultation with legal counsel, 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 or cash flows of the Company.

**Item 1A. Risk Factors**

**COMPANY-SPECIFIC TRENDS AND RISKS**

There are many risks and uncertainties that can affect our future business, financial performance or share price. Many of these are beyond our control. A description follows of some of the important factors that could have a material negative impact on our future business, operating results, financial condition or share price. This discussion includes a number of forward-looking statements. You should refer to the description of the



Table of Contents

qualifications and limitations on forward-looking statements in the first paragraph under Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations of our Form 10-K for the year ended December 31, 2009. Except for deleting the risk factor entitled Adverse conditions in the credit and financial markets could adversely affect our business, financial condition and results of operations, the risk factors have not changed materially from the date of our periodic report on Form 10-K for the year ended December 31, 2009.

Unless otherwise indicated or the context otherwise requires, reference in this section to we, ours, us or similar terms means the Company, together with its subsidiaries. The level of importance of each of the following trends and risks may vary from time to time, and the trends and risks are not listed in any specific order of importance. These risks, however, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**Trends or events affecting our clients or their industries could decrease the demand for our products and services.**

We derive our consolidated revenues from the delivery of products and services to clients in the mutual fund, brokerage, investment management, healthcare, telecommunications and utilities, cable TV, other financial service (i.e. insurance, banking, financial planning and mortgage) and other industries. A decline or lack of growth in demand for our products and services in any of the industries we serve could adversely affect our business and earnings. Demand for our products and services among companies in those industries could decline for many reasons. Consolidation or limited growth in an industry could reduce the number of our clients and potential clients.

Events that adversely affect our clients' businesses, rates of growth or numbers of customers they serve, including decreased demand for our customers' products and services, adverse conditions in our customers' markets or adverse economic conditions generally could decrease demand for our products and services and the number of transactions we process. We cannot always predict the needs of changing industries or whether potential customers will accept our products or services. Concentrating our resources based on trends or events that do not occur as we expected could negatively impact any of our various businesses.

**An increase in subaccounting services performed by brokerage firms could adversely impact our revenues.**

Our mutual fund clients may decide to allow a broker/dealer who has assisted with the purchase or sale of mutual fund shares to perform subaccounting services. A brokerage firm typically maintains an omnibus account with the fund's transfer agent that represents the aggregate number of shares of a mutual fund owned by the brokerage firm's customers. The omnibus account structure results in fewer mutual fund shareowner accounts on our systems, which adversely affects our revenues.

We offer subaccounting services to brokerage firms that perform mutual fund shareowner subaccounting. As the recordkeeping functions in connection with subaccounting are more limited than traditional shareowner accounting, the fees charged are generally lower on a per unit basis. Clients who determine to use the omnibus accounting structure of brokerage firms could allow the conversion of accounts currently on our traditional recordkeeping system to our subaccounting system, or to the subaccounting systems of other service providers, which could result in lower revenues.

**The demand for our products and services could decrease if we do not continually address our and our clients' technology and capacity requirements.**

Our clients use computer technology based products and services in the complex and rapidly changing markets in which they operate. We must substantially invest in technology and systems to meet customer demand for transaction processing and volume capacities. If we do not meet clients' technology and capacity demands in advance of our competitors or if the investments we make are not cost-effective or do not result in successful products or services, our businesses could be adversely affected.

Table of Contents

**Damage to our facilities or declining real estate values could impact our operations or financial condition.**

We own, lease and manage real estate as part of our business. The performance of our services also depends upon facilities that house central computer operations or operating centers or in which we process information, images, bills or statements. Declining property values in the markets in which we own investment properties may adversely affect our financial condition. Significant damage to any of our operating facilities could interrupt the operations at those facilities and interfere with our ability to serve customers.

**We may be unable to attract and retain capable technical personnel for our processing businesses or quality executives to manage the complex structure of our business.**

Our success depends on recruiting and retaining adept management and personnel with expertise in software and systems development and the types of computer hardware and software we utilize. Losing key personnel or not hiring qualified personnel could have a material adverse effect on our operations. Companies in our industry compete fiercely for qualified management and technical personnel. We cannot guarantee that we will be able to adequately compete for or keep qualified personnel. Lack of qualified management could increase the risk of unfavorable business strategies, especially in a complex business like ours with multiple segments and operating entities. Lack of qualified technical personnel could also affect our ability to develop the systems and services our clients demand.

**Our businesses are subject to substantial competition.**

We are subject to intense competition from other established service providers in all industries we serve. Some of our competitors are able to bundle service offerings and offer more appealing pricing structures. Some of our clients, or the clients they serve, may develop, have developed or are developing the in-house capacity to perform the transaction processing, recordkeeping, and output services they have paid us to perform. Some of our competitors and clients have greater financial and human resources and access to capital than we do.

Our failure to successfully compete in any of our operating segments could have a material adverse effect on our financial results. Competition could also affect the revenue mix of services we provide, resulting in decreased revenues in lines of business with higher profit margins.

**We and companies in which we own a significant interest are subject to government regulation. Any regulatory violations, changes or uncertainties could adversely affect our business.**

A number of our businesses are subject to U.S. or foreign regulatory oversight, as well as privacy, licensing, processing, recordkeeping, reporting and related obligations. Any violation of those obligations or related laws or regulations could expose us or those businesses to costly fines or sanctions or damage our reputation, which could adversely affect our business or financial performance. Governmental changes and uncertainties surrounding services we provide could increase our costs of business or diminish business, which could materially and adversely affect the Company's financial results.

**Our clients are subject to government regulation that could affect our business.**

Our clients are subject to extensive government regulation, including investment adviser, broker/dealer and privacy regulations applicable to services we provide to the financial industry, and insurance, privacy and other regulations applicable to services we provide to the healthcare industry. Any violation by our clients of applicable laws and regulations could diminish their business or financial condition and thus their demand for our products and services. Demand could also decrease if we do not continue to offer products and services that help our clients comply with regulations.

Table of Contents

**We operate internationally and are thus exposed to foreign political, economic and other conditions that could adversely affect our revenues from or support by foreign operations.**

Consolidated revenues from our subsidiaries in Asia, Australia, Canada, Europe and elsewhere outside the U.S. are an important element of our revenues. Inherent risks in our international business activities could decrease our international sales and have a material adverse effect on our overall financial condition, results of operations and cash flow. These risks include potentially unfavorable foreign economic conditions, political conditions or national priorities, foreign government regulation, potential expropriation of assets by foreign governments, the failure to bridge cultural differences, and limited or prohibited access to our foreign operations and the support they provide. We may also have difficulty repatriating profits or be adversely affected by exchange rate fluctuations in our international business.

**Various events may cause our financial results to fluctuate from quarter to quarter or year to year. The nature of these events might inhibit our ability to anticipate and act in advance to counter them.**

We cannot always control when and whether events occur, that could cause varying financial results. Unfavorable results may occur that we did not anticipate or take advance action to address. The various reasons our quarterly and annual results may fluctuate include unanticipated economic conditions, and costs for starting up significant client operations, for hiring staff, and for developing products. Our results may also vary as a result of pricing pressures, increased cost of supplies, timing of license fees, the evolving and unpredictable markets in which our products and services are sold, changes in accounting principles, and competitors' new products or services.

**Investment decisions with respect to cash balances, market returns or losses on those investments, and limits on insurance applicable to cash balances held in bank and brokerage accounts, including as agent on behalf of our clients, could expose us to losses of such cash balances and adversely affect revenues attributable to cash balance deposit investments.**

As part of our transaction processing and other services, we maintain and manage large bank and investment accounts containing client funds which we hold as agent as well as operational funds. Our revenues include investment earnings related to client fund cash balances. Our choices in selecting investments, or market conditions that affect the rate of return on or the availability of investments, could have an adverse effect on the level of such revenues. The amounts held in our operational and client deposit accounts could exceed the limits of government insurance programs of organizations such as the Federal Deposit Insurance Corporation and the Securities Investors Protection Corporation.

**Our revenues and profit margins could decrease if clients cancel contracts, fail to renew contracts, renegotiate contracts or use our services at less than anticipated rates.**

Client contract terminations, non-renewals, renegotiations or under-utilization of our services could decrease our revenues and profit margins. We derive revenue by selling products and services under long-term contracts. We cannot unilaterally extend the terms of these contracts when they expire. Some of these contracts contain termination for convenience clauses, which enable clients to cancel the agreements by providing written notice to us. Any failure to extend these contracts under their current terms, or any early termination of these contracts by customers, could adversely affect our business.

**Claims against us, including claims for the lost market value of securities and class action claims, could cause significant liability and damage our reputation and business prospects.**

Our proprietary applications and related services involve the processing of financial transactions for our clients and their customers. The dollar amount of transactions processed is vastly higher than the revenues derived from providing these services. We may be subject to claims, including class actions, for reimbursements, losses or damages arising from any transaction processing or operational error, or from process mismanagement, that causes, among other potential issues, processing delays, disclosure of protected information, miscalculations,

Table of Contents

failure to follow a clients' instructions, failure of third parties to recognize our role as our clients' agent, or mishandling of pass-through disbursements or other processes. Because of the sensitive nature of the financial and healthcare transactions we process, our liability and alleged damages may significantly exceed the fees we receive for performing the service at issue. Litigation can include class action claims based, among other theories, upon various regulatory requirements and consumer protection and privacy laws that class action plaintiffs may attempt to use to assert private rights of action. Any of these claims and related settlements or judgments could affect our profitability, damage our reputation, decrease demand for our services, or cause us to make costly operating changes.

**We are substantially dependent on our intellectual property rights, and a claim for infringement or a requirement to indemnify a client for infringement could adversely affect us.**

We have made substantial investments in software and other intellectual property on which our business is highly dependent. Any loss of our intellectual property rights, or any significant claim of infringement or indemnity for violation of the intellectual property rights of others, could have a material adverse effect on our financial condition, results of operations and cash flow. We rely on patent, trade secret and copyright laws, nondisclosure agreements, and other contractual and internal security measures to protect our proprietary technology. We cannot guarantee these measures will be effective. Our products and services rely on technology developed by others, including open source software, and we have no control over possible infringement of someone else's intellectual property rights by the provider of this technology. The owner of the rights could seek damages from us rather than or in addition to the persons who provide the technology to us. We could be subject at any time to intellectual property infringement claims that are costly to evaluate and defend. Our clients may also face infringement claims, allege that such claims relate to our products and services, and seek indemnification from us.

**Failure to protect the confidential information of our clients could hurt our business.**

We often maintain trade secrets and proprietary information, including sensitive financial and personal health information of our clients' customers, electronically. A material breach of our security systems and procedures could lead to significant claims for liability, cause our customers to reconsider using our services and products, damage our reputation, or otherwise have a material adverse effect on us. We maintain systems and procedures to protect against unauthorized access to electronic information and computer viruses, but we cannot guarantee these systems and procedures will always protect us. Rapid advances in technology may prevent us from anticipating all potential security threats, and the limits of technology and skills or the prohibitive cost of more advanced security solutions might prevent us from addressing these threats.

**We do not control certain businesses in which we have significant ownership.**

We invest in joint ventures and other unconsolidated affiliates as part of our business strategy, and part of our net income is derived from our pro rata share of the earnings of those businesses. Despite owning significant equity interests in those companies and having directors on their boards, we do not control their operations, strategies or financial decisions. The other owners may have economic, business or legal interests or goals that are inconsistent with our goals or the goals of the businesses we co-own. Our pro rata share of any losses due to unfavorable performance of those companies could negatively impact our financial statements.

**We own interests in companies under agreements that may inhibit our ability to sell our interests and the other owners may ask us to increase our investment.**

We own interests in Boston Financial Data Services, International Financial Data Services Limited Partnership, International Financial Data Services Limited, and various real estate joint ventures. Our interests in these companies are subject to buy/sell arrangements, which may restrict our ability to sell our interests when we believe it is prudent to do so. These arrangements may also allow us to purchase the other owners' interests to prevent someone else from acquiring them and we cannot control the timing of occasions to do so. The businesses or other owners may encourage us to increase our investment in or make contributions to the businesses at an inopportune time.



Table of Contents

**The financial results of our reinsurance subsidiary could be adversely affected if actual loss experience exceeds estimated loss experience.**

Our subsidiary, Vermont Western Assurance, Inc., which we refer to as Vermont Western, reinsures a portion of the risk in connection with replacing lost stock certificates for registered shareholders of unrelated companies. Vermont Western utilizes underwriting procedures and actuarial advisors to assess risk and establish reserves against loss. Vermont Western does not control clients' loss experience. Vermont Western could inaccurately assess risk at any time and actual loss experience could exceed estimates. Vermont Western's results, if unfavorable, could have a material adverse effect on our financial condition, operating results or cash flow.

**We hold equity investments in companies that operate in various industries, and the value of those investments could decrease.**

We hold significant investments in available-for-sale equity securities of other companies or other financial interests that are subject to fluctuations in market prices. A significant decline in the value of our equity investments could have a material adverse effect on our financial condition or results of operations. We may not always be able to sell those investments at higher prices than we paid for them or than the value of the consideration used to acquire them.

**We hold significant investments in illiquid private equity funds.**

We are a limited partner in various private equity funds and have significant future capital commitments related to certain private equity fund investments. These investments are illiquid. Generally, private equity fund securities are non-transferable or are subject to long holding periods, and withdrawals from the private equity firm partnerships are typically not permitted. Even when transfer restrictions do not apply, there is generally no public market for the securities. Therefore, we may not be able to sell the securities at a time when the Company desires to do so.

**Various plans, agreements, laws and organizational documents may make more difficult or prevent a change in control.**

Provisions in our Certificate of Incorporation, Bylaws, certain plans and agreements, and applicable laws could make it more difficult for a party to make a tender offer for our shares or complete a takeover, which is not approved by our Board of Directors. The provisions include:

- super-majority stockholder approval required for certain actions
- staggered terms for directors

## Edgar Filing: DST SYSTEMS INC - Form 10-Q

- specific procedures for stockholders to nominate new directors
- cumulative voting in election of directors
- the Board's authority to issue and set the terms of preferred stock
- a stockholders' rights plan giving stockholders' rights to purchase preferred stock if certain changes in our ownership occur
- various rights of debenture holders, joint venture co-owners, lenders and certain customers and executives in the event of a change in control
- public reporting of ownership and of changes in ownership by stockholders with at least a 5% interest in us

Table of Contents

- legal restrictions on business combinations with certain stockholders

**Because of contractual commitments, a change in control could affect our operating results and weaken our management retention and incentive tools.**

A change in control of the Company would trigger various rights and obligations in service agreements with our customers, in agreements governing our joint ventures, and in incentive award and employment agreements with our management. A change in control could also allow some clients to terminate their agreements with us or to obtain rights to use our processing software. We are parties to joint venture agreements that allow other co-owners to buy our equity interests if we undergo a change in control. A change in control or a termination of employment without cause or their resignation for good reason (each as defined in applicable agreements) after a change in control could accelerate certain restricted stock and other awards we have granted to our management employees. This award vesting may decrease an employee's incentive to continue employment with us. Certain executive officers have agreements with us that require us to continue to employ them for three years after a change in control or to pay certain amounts if we terminate their employment without cause or they resign for good reason following a change in control. The executives might not be incented to achieve results for the new owners of our business, and the cost of keeping the executives on the payroll might deter potential new owners from acquiring us or hinder new owners from hiring replacement management.

**Our equity incentive and stockholders' rights plans could have a dilutive effect on our common stock.**

Our directors, officers and certain managers have received restricted stock units and options to purchase our common stock as part of their compensation. These equity grants could have a dilutive effect on our common stock. A change of control would trigger the right of stockholders under our stockholders' rights plan to purchase 1/1000th shares of our preferred stock for each share of our common stock, which could be dilutive in value to common stockholders who do not exercise those rights.

**Conversion or settlement of our debentures could have a dilutive effect on our common stock or affect our liquidity.**

The Company has issued convertible senior debentures. Issuing common stock to settle conversions could be dilutive to the price of our common stock, and settlement of debentures for cash could affect our financial condition, operating results and cash flow. The debentures are convertible into shares of common stock under specified circumstances, which we refer to as Conversion Triggers. We cannot accurately predict when certain Conversion Triggers outside of our control may occur. To satisfy a conversion notice subsequent to a Conversion Trigger, we must deliver our common stock unless we properly notify the holder that we will settle with cash or a combination of cash and shares of common stock. A conversion notice settled with shares will cause additional dilution to existing common shareholders, while a conversion notice settled in cash may require the Company to access credit markets or sell its investments.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****Stock repurchases**

The following table sets forth information with respect to shares of Company common stock purchased by the Company during the three months ended June 30, 2010.

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs</b>
April 1 - April 30	111,501(1)	\$ 42.08	110,300	54,010(2)
May 1 - May 31	64,067(1)	\$ 42.29		1,054,010(2)
June 1 - June 30	40,824(1)	\$ 38.91	40,000	1,014,010(2)
<b>Total</b>	<b>216,392</b>	<b>\$ 41.54</b>	<b>150,300</b>	<b>1,014,010</b>

(1) For the three months ended June 30, 2010, the Company purchased, in accordance with the 2005 Equity Incentive Plan (formerly the 1995 Stock Option and Performance Award Plan), 66,092 shares of its common stock for participant income tax withholding in conjunction with stock option exercises or from the vesting of restricted shares, as requested by the participants. These purchases were not made under the publicly announced repurchase plans or programs, but were allowed by the rules of the Compensation Committee of the DST Board of Directors. Of these shares, 1,201 shares were purchased in April 2010, 64,067 shares were purchased in May 2010 and 824 shares were purchased in June 2010.

(2) On May 11, 2010, DST's Board of Directors authorized the repurchase of an additional 1.0 million shares under the existing share repurchase authorization plan, which allows for the repurchase of common stock in open market and private transactions through December 31, 2012. The Company may enter into one or more plans with its brokers or banks for pre-authorized purchases within defined limits pursuant to Rule 10b5-1 to effect all or a portion of such share repurchases.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. (Removed and Reserved)**

**Item 5. Other Information**

**(a) Disclosure of Unreported 8-K Information**

None.

**(b) Material Changes to Director Nominee Procedures**

On May 11, 2010, DST's Board of Directors approved amendments to our Amended and Restated Bylaws (the Bylaws) which revise, clarify and update the advance notice requirements for stockholders to nominate directors for election to the Board, or to bring other business before the stockholders.

The Bylaws became effective immediately upon the adoption of such resolutions by our Board of Directors on May 11, 2010. The foregoing summary is qualified in its entirety by reference to the full amended and restated Bylaws, a copy of which are attached as Exhibit 3.2 to the Company's Current Report on Form 8-K filed on May 17, 2010 (Commission File No. 1-14036), are hereby incorporated by reference as Exhibit 3.1.

Table of Contents

**Item 6. Exhibits**

(a) Exhibits:

- 2.1 Share Purchase and Sale Agreement, dated as of June 30, 2010, among Innovative Output Solutions Limited and various sellers, including but not limited to Mark Thomas Felstead, Susan Ann Felstead, and Andrew Young, of the issued share capital of dsicmm Group Limited. Pursuant to a request for confidential treatment, portions of this Exhibit have been redacted and have been provided separately to the Securities and Exchange Commission.
- 3.1 The Amended and Restated Bylaws of DST Systems, Inc., which are attached as Exhibit 3.2 to the Company's Current Report on Form 8-K filed on May 17, 2010 (Commission File No. 1-14036), are hereby incorporated by reference as Exhibit 3.1.
- 10.1 Credit Agreement, dated as of April 16, 2010, among DST Systems, Inc., Bank of America N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, and other lenders party thereto which is attached as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 20, 2010 (Commission File No. 1-14036), is hereby incorporated by reference as Exhibit 10.1.
- 10.2 The Third Amendment to the agreement listed as Exhibit 10.20.1 to the Company's Annual Report on Form 10-K for the period ended December 31, 2009 (Commission File No. 1-14036) ( "Receivables Purchase Agreement" ).
- 10.3 Amendment Number 4 to the Receivables Purchase Agreement dated as of May 20, 2010, which is attached as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 25, 2010 (Commission File No. 1-14036), is hereby incorporated by reference as Exhibit 10.3.
- 31.1 Certification of the Chief Executive Officer of Registrant
- 31.2 Certification of the Chief Financial Officer of Registrant
- 32 Certification Pursuant to 18 U.S.C. Section 1350 of Chief Executive Officer of Registrant and Chief Financial Officer of Registrant
- 101 The following financial information from DST's Quarterly Report on Form 10-Q for the period ended June 30, 2010, filed with the SEC on August 6, 2010, formatted in Extensible Business Reporting Language ( "XBRL" ): (i) the Condensed Consolidated Statement of Income for the three and six months ended June 30, 2010 and 2009, (ii) the Condensed Consolidated Balance Sheet at June 30, 2010 and December 31, 2009, (iii) the Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2010 and 2009, and (iv) Notes to Condensed Consolidated Financial Statements (tagged as blocks of text).

**SIGNATURE**

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

August 6, 2010

DST Systems, Inc.

/s/ Kenneth V. Hager

Kenneth V. Hager  
Vice President, Chief Financial Officer and  
Treasurer

