

DST SYSTEMS INC
Form 10-Q
August 04, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2006

or

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)

43-1581814

(I.R.S. Employer
Identification No.)

333 West 11th Street, Kansas City, Missouri

(Address of principal executive offices)

64105

(Zip Code)

(816) 435-1000

(Registrant's telephone number, including area code)

No Changes

(Former name, former address and former fiscal year, if changed since last report)

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

Yes No

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

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Large accelerated filer x

Accelerated filer o

Non-accelerated filer o

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

Number of shares outstanding of the Company's common stock as of June 30, 2006:

Common Stock \$0.01 par value 69,511,542

**DST Systems, Inc.
Form 10-Q
June 30, 2006
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The brand, service or product names or marks referred to in this Report are trademarks or service marks, registered or otherwise, of DST Systems, Inc. or its subsidiaries or affiliates or of vendors to the Company.

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Form 10-Q
June 30, 2006

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, 2005.

The results of operations for the three and six months ended June 30, 2006, are not necessarily indicative of the results to be expected for the full year 2006.

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DST Systems, Inc.
Condensed Consolidated Balance Sheet
(dollars in millions, except per share amounts)
(unaudited)

	June 30, 2006	December 31, 2005
ASSETS		
Current assets		
Cash and cash equivalents	\$ 72.8	\$ 80.2
Transfer agency investments	88.6	93.3
Accounts receivable	370.0	386.2
Deferred income taxes	36.9	32.9
Other assets	55.1	48.9
Assets of businesses held for sale		118.9
	623.4	760.4
Investments	1,719.2	1,405.2
Properties	506.9	492.4
Goodwill	75.6	75.1
Intangibles	18.2	18.9
Other assets	69.8	90.8
Assets of business held for sale		186.7
Total assets	\$ 3,013.1	\$ 3,029.5
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Debt due within one year	\$ 62.0	\$ 863.1
Transfer agency deposits	88.6	93.3
Accounts payable	92.3	97.6
Accrued compensation and benefits	74.0	90.2
Deferred revenues and gains	63.4	69.4
Other liabilities	165.7	160.3
Income taxes payable	116.6	137.7
Liabilities of businesses held for sale		110.7
	662.6	1,622.3
Long-term debt	1,332.0	541.4
Deferred income taxes	384.1	318.0
Other liabilities	57.5	52.1
	2,436.2	2,533.8
Commitments and contingencies (Note 9)		
Stockholders' equity		
Common stock, \$0.01 par; 400 million shares authorized, 95.3 million shares issued	1.0	1.0
Additional paid-in capital	117.8	209.8
Retained earnings	1,299.2	1,162.0
Unearned compensation		(106.8)
Treasury stock (25.8 million and 23.6 million shares, respectively), at cost	(1,281.8)	(1,148.2)
Accumulated other comprehensive income	440.7	377.9
Total stockholders' equity	576.9	495.7
Total liabilities and stockholders' equity	\$ 3,013.1	\$ 3,029.5

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

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Operating revenues	\$ 380.5	\$ 469.2	\$ 763.2	\$ 906.3
Out-of-pocket reimbursements	190.0	201.1	383.3	392.3
Total revenues	570.5	670.3	1,146.5	1,298.6
Costs and expenses	469.8	549.8	947.1	1,065.5
Depreciation and amortization	30.9	38.4	60.2	74.2
Income from operations	69.8	82.1	139.2	158.9
Interest expense	(16.3)	(18.2)	(45.8)	(34.8)
Other income, net	5.0	82.3	29.5	90.0
Gains on sale of businesses		120.4	52.8	120.4
Equity in earnings of unconsolidated affiliates	18.3	20.0	34.4	27.9
Income before income taxes	76.8	286.6	210.1	362.4
Income taxes	21.3	116.3	72.9	142.9
Net income	\$ 55.5	\$ 170.3	\$ 137.2	\$ 219.5
Average common shares outstanding	67.1	78.6	67.5	78.5
Diluted shares outstanding	73.0	80.9	73.2	80.9
Basic earnings per share	\$ 0.83	\$ 2.17	\$ 2.03	\$ 2.79
Diluted earnings per share	\$ 0.76	\$ 2.11	\$ 1.87	\$ 2.71

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

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

	For the Six Months Ended June 30,	
	2006	2005
Cash flows operating activities:		
Net income	\$ 137.2	\$ 219.5
Depreciation and amortization	60.2	74.2
Equity in earnings of unconsolidated affiliates	(34.4)	(27.9)
Net realized gain on investments	(13.1)	(74.6)
Gains on sale of businesses and properties	(52.8)	(117.3)
Amortization of unearned compensation on restricted stock	12.3	13.1
Amortization of debt issuance costs	12.9	2.6
Deferred income taxes	23.6	(95.3)
Cash dividend from unconsolidated affiliates	25.2	
Changes in accounts receivable	16.8	69.0
Changes in other assets	3.4	(63.2)
Changes in transfer agency investments	4.8	13.3
Changes in transfer agency deposits	(4.8)	(13.3)
Changes in accounts payable and accrued liabilities	(1.7)	39.7
Changes in income taxes payable	(15.6)	207.8
Changes in deferred revenues and gains	(6.1)	5.9
Changes in accrued compensation and benefits	(11.1)	(8.7)
Other, net	7.3	(12.6)
Total adjustments to net income	26.9	12.7
Net	164.1	232.2
Cash flows investing activities:		
Capital expenditures	(65.7)	(73.6)
Proceeds from sale of investments	103.0	13.5
Investments in securities	(43.2)	(17.5)
Investments in and advances to unconsolidated affiliates	(8.2)	(3.0)
Proceeds from exchange of CSC common stock		224.6
Proceeds from sale of Equiserve		216.0
Other, net	(0.8)	11.5
Net	(14.9)	371.5
Cash flows financing activities:		
Proceeds from issuance of common stock	38.6	15.2
Principal payments on long-term debt	(26.6)	(54.7)
Net increase (decrease) in revolving credit facilities	8.1	(158.7)
Repayment of promissory note		(107.4)
Debt refinancing costs		(1.7)
Common stock repurchased	(183.1)	(3.5)
Excess tax benefits from share based compensation	6.4	
Net	(156.6)	(310.8)
Net increase (decrease) in cash and cash equivalents	(7.4)	292.9
Cash and cash equivalents at beginning of period	80.2	96.6
Cash and cash equivalents at end of period	\$ 72.8	\$ 389.5

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

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DST Systems, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Summary of Accounting Policies

The Condensed Consolidated Financial Statements of DST Systems, Inc. (*DST* or the *Company*) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (*GAAP*) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to enable a reasonable understanding of the information presented. The Condensed Consolidated Balance Sheet as of December 31, 2005 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, 2005.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal interim closing procedures) necessary to present fairly the financial position of the Company and its subsidiaries at June 30, 2006, and the results of operations for the three and six months ended June 30, 2006 and 2005, and cash flows for the six months ended June 30, 2006 and 2005.

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

The results of operations for the three and six months ended June 30, 2006, are not necessarily indicative of the results to be expected for the full year 2006.

2. Merger of lock\line with Asurion

On January 1, 2006, the Company completed the transaction to merge lock\line into a wholly-owned subsidiary of Asurion, a privately held company with principal operations in Nashville, Tennessee.

The merger was structured as a tax free reorganization, and resulted in the Company acquiring a 37.4% ownership interest in Asurion. The Company received no cash proceeds in connection with the merger. Effective January 1, 2006, the Company began recording 37.4% of Asurion's net income as equity in earnings of unconsolidated affiliates. For financial accounting purposes, the Company has treated the merger as both a sale of lock\line and a corresponding purchase of a 37.4% interest in Asurion. For financial accounting purposes, the sale portion of the transaction resulted in a net pre-tax gain of \$52.8 million which has been included in gains on sale of businesses in DST's consolidated statement of income during the first quarter 2006. The pre-tax gain has been calculated using an estimated fair market value for lock\line of \$287 million and has been reduced by a required gain deferral of \$31.6 million that results from the Company's 37.4% ownership in the merged entity. Approximately \$12.5 million of the deferred gain will be amortized primarily over a 15 year life, while the residual will be deferred indefinitely. For financial accounting purposes, the purchase portion of the acquired interest in Asurion exceeded DST's pro-rata portion of Asurion's stockholders' equity by \$174.8 million. As a result, the Company has performed a preliminary allocation of the excess purchase price and has currently allocated approximately \$44.6 million to certain identifiable intangibles (net of deferred taxes) that will be amortized primarily over a 15 year life. The remaining excess purchase price has been allocated to goodwill and will not be subject to amortization, but rather on-going impairment tests. The Company estimates that for 2006, the deferred gain amortization will increase equity in earnings of Asurion by approximately \$1.0 million while the amortization of identifiable intangibles will reduce equity in earnings of Asurion by approximately \$3.8 million.

Asurion accounted for the merger as a purchase of lock\line. Asurion has performed a purchase price allocation for lock\line using an estimated fair market value of \$287 million. The purchase price exceeded the net tangible assets of lock\line by approximately \$260 million, of which Asurion has preliminarily allocated approximately \$100 million to certain identifiable intangibles that will be amortized primarily over a 15 year life. The residual has been allocated to goodwill, which is included in the Company's investment in Asurion, and will not be subject to amortization, but rather on-going impairment tests. In addition to lock\line, Asurion has acquired two additional businesses in 2006 which has resulted in additional intangible assets that will be amortized. The Company estimates that the 2006 after-tax impact of Asurion amortizing the identifiable intangibles (lock\line and other acquisitions) will be approximately \$7.4 million, of which DST's 37.4% pro-rata portion would result in a \$2.8 million reduction in equity in earnings of Asurion due to the amortization.

The calculation of DST's equity in earnings of Asurion for the three and six months ended June 30, 2006 is as follows:

	Three months ended June 30, 2006 (000 s)	Six months ended June 30, 2006 (000 s)	
Asurion net income before amortization of identified intangibles	\$ 23,485	\$ 47,415	
Identified intangible amortization, after tax	(2,012)	(3,077)	
Asurion net income (unaudited)	21,473	44,338	
DST's ownership percentage	37.4	% 37.4	%
DST's pro-rata share of Asurion's earnings	8,031	16,582	
Amortization of DST's deferred gain	245	490	
Amortization of identified intangibles	(973)	(1,926)	
DST's equity in Asurion's earnings	\$ 7,303	\$ 15,146	

For diluted earnings per share purposes, DST's equity in earnings of Asurion is calculated using a 35.5% pro-rata share based on Asurion's fully diluted shares outstanding.

lock\line related operating revenues for the three and six months ended June 30, 2005 and the year ended December 31, 2005 were \$39.3 million, \$74.7 million and \$164.8 million, respectively. Because of the significant continuing involvement as an equity method investment of the Company, the merger of lock\line does not qualify as a discontinued operation.

Asurion provides services related to warranty management, device protection, roadside assistance and enterprise managed mobility solutions for technology firms in the U.S., Canada and Asia. Asurion had approximately 4,500 employees at June 30, 2006.

At December 31, 2005, the assets and liabilities of lock\line have been categorized as assets and liabilities held for sale in the consolidated balance sheet.

On July 13, 2006, DST received a \$254 million cash dividend from Asurion. The payment was part of a debt-financed distribution made by Asurion to all of its shareholders. Asurion also made dividend-equivalent bonus

payments to its stock option holders, and the compensation expense allocable to DST's interest in Asurion is estimated to reduce DST's net income by approximately \$8.0 million in the third quarter of 2006. Under the equity method of accounting, the dividend will not be treated as income to DST, and the carrying value of DST's investment in Asurion will be reduced by the amount of the dividend.

3. Share-Based Compensation

The Company has a share-based compensation plan covering its employees and a share-based compensation plan covering its non-employee directors and has outstanding share awards (primarily in the form of stock options and restricted stock) under each of these plans. Both of these share-based compensation plans have been approved by the Company's Board of Directors and shareholders. The DST Systems, Inc. 2005 Equity Incentive Plan (the Employee Plan) and the DST Systems, Inc. 2005 Non-Employee Directors Award Plan (the Directors Plan) became effective on May 10, 2005. The term of both the Employee Plan and the Directors Plan is from May 10, 2005 through May 9, 2015.

The Employee Plan amends, restates and renames the DST Systems, Inc. 1995 Stock Option and Performance Award Plan (1995 Plan). The number of shares of common stock reserved for delivery under the Employee Plan is the sum of (a) 4.0 million shares, plus (b) 201,714 shares, the number of shares remaining under the 1995 Plan (originally 30 million shares available) as of May 10, 2005 (not subject to outstanding Awards under the 1995 Plan and not delivered out of the Shares reserved there under), plus (c) shares that become available under the 1995 Plan after May 10, 2005 pursuant to forfeiture, termination, lapse or satisfaction of an award in cash or property other than shares of common stock, application as payment for an award, or, except with respect to restricted stock, to satisfy tax withholding, plus (d) any shares of common stock required to satisfy substitute awards. As of June 30, 2006, approximately 5.3 million shares were available under the Employee Plan. The Employee Plan provides for the availability of shares of the Company's common stock for the grant of awards to employees, prospective employees and consultants to the Company or an affiliate. Awards under the Employee Plan may take the form of shares, dividend equivalents, options, stock appreciation rights, limited stock appreciation rights, performance units, restricted stock, restricted stock units, deferred stock, annual incentive awards, service awards and substitute awards (each as defined in the plan).

The Directors Plan replaced the component of the 1995 Plan that provided for equity awards to directors who are not employees of DST or any affiliate. Subject to adjustment, as provided in the Directors Plan, the number of shares of common stock reserved for delivery under this plan is the sum of (a) 300,000 shares plus (b) any shares of common stock required to satisfy substitute awards, as defined in the Directors Plan. As of June 30, 2006, approximately 288,000 shares were available under the Directors Plan. Awards under the Directors Plan may take the form of shares, dividend equivalents, options, restricted stock, restricted stock units, deferred stock and substitute awards (each as defined in the plan).

Prior to January 1, 2006, the Company accounted for stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees and related Interpretations. Accordingly, no compensation expense was recognized for fixed option plans because the exercise prices of employee stock options equaled or exceeded the market prices of the underlying stock on the dates of grant. However, share-based compensation has been included in pro forma disclosures in the financial statement notes in prior periods as required under SFAS 123, Accounting for Stock-Based Compensation. For restricted stock awards granted prior to January 1, 2006, the Company expensed the grant date fair value of these awards using the straight-line method over the service period.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards 123R, Share-Based Payment (SFAS 123R), using the modified prospective application transition method. Among other items, SFAS 123R eliminates the use of APB 25 and the intrinsic value method of accounting, and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements.

Under the modified prospective application method, the historical financial statements of the Company have not been adjusted. Instead, SFAS 123R has been applied to new awards granted by the Company after January 1, 2006 and

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any portion of awards that were not fully vested on January 1, 2006. At January 1, 2006, the Company had unvested stock option awards with remaining unvested grant date fair value of approximately \$800,000. These stock option awards will be substantially vested at December 31, 2006 and, accordingly, the remaining unvested grant date fair value will be recorded in costs and expenses evenly throughout 2006. Upon adoption of SFAS 123R, the Company discontinued its historical accounting practice of recognizing forfeitures when they occurred and now estimates compensation costs related to awards that are not expected to vest. In measuring compensation costs for outstanding restricted stock awards, the Company determined that the adjustment to record estimated forfeitures as of January 1, 2006 was \$1.4 million. This amount has been included as a reduction to costs and expenses during the three months ended March 31, 2006.

The following table illustrates the effect on net income and earnings per share, for the three and six months ended June 30, 2005, if the Company had applied the fair value recognition provisions of SFAS 123 to share-based employee compensation related to all awards (in millions, except per share amounts):

		For the Three Months Ended June 30, 2005	For the Six Months Ended June 30, 2005
Net income:	As reported	\$ 170.3	\$ 219.5
Stock-based employee compensation cost, net of related tax effects, included in the determination of net income as reported		4.4	8.5
Stock-based employee compensation cost, net of related tax effects, that would have been included in the determination of net income if the fair value based method had been applied to all awards		(5.2) (10.4
Net income	Pro forma	\$ 169.5	\$ 217.6
Basic earnings per share:	As reported	\$ 2.17	\$ 2.79
	Pro forma	\$ 2.16	\$ 2.78
Diluted earnings per share:	As reported	\$ 2.11	\$ 2.71
	Pro forma	\$ 2.12	\$ 2.73

The Company did not issue any stock option awards during the six months ended June 30, 2006 or the year ended December 31, 2005. The fair value of historical option grants, which generally had a ten year contractual life, was estimated on the date of grant using the Black-Scholes option pricing model. Prior to the adoption of SFAS 123R, the Company presented the benefit of all tax deductions resulting from the exercise of stock options and restricted stock awards as operating cash flows in the Consolidated Statement of Cash Flows. SFAS 123R requires the benefits of tax deductions in excess of grant-date fair value be reported as a financing cash flow, rather than as an operating cash flow. Excess tax benefits of \$6.4 million were classified as a financing inflow during the six months ended June 30, 2006. Cash proceeds from options exercised for the six months ended June 30, 2006 and 2005 were \$38.6 million and \$15.2 million, respectively. The Company generally issues shares out of treasury to satisfy stock option exercises.

Summary stock option activity is presented in the table below (shares in millions):

	For the Six Months Ended June 30, 2006	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in millions)
	Shares			
Outstanding at January 1	10.6	\$ 39.89		
Granted				
Exercised	(1.1	\$ 34.81		\$ 28.3
Forfeited or Expired				
Outstanding at June 30	9.5	\$ 40.39	5.0	\$ 177.0
Exercisable at June 30	9.4	\$ 40.36	5.0	\$ 175.0

On October 29, 2004, the Compensation Committee of the Board of Directors of the Company voted to grant as of November 10, 2004 approximately 2.8 million shares of restricted common stock of the Company to officers and certain other participants. Subject to early lapsing and forfeiture provisions, the restrictions on shares granted to participants lapse on November 10, 2009 and January 31, 2010. The restricted stock grants cover the five-year period of 2005 through 2009 and are intended to be the only restricted stock grants for such periods other than for new hires or promotions and for special employee recognition purposes. The restrictions on shares granted after November 2004 also lapse on November 10, 2009. Grants of restricted stock are valued at the date of grant and expensed using the straight-line method over the service period. Unvested shares of restricted stock may be forfeited upon termination of employment with the Company depending on the circumstances of the termination. Except for restrictions placed on the transferability of the restricted stock, holders of restricted stock have full stockholders rights during the term of restriction, including voting rights and the right to receive cash dividends, if any.

Summary restricted stock activity is presented in the table below (shares in millions):

	For the Six Months Ended June 30, 2006	Weighted Average Grant Date Fair Value
	Shares	
Non-vested at January 1	2.7	\$ 47.23
Granted		
Vested	(0.1)	\$ 46.89
Forfeited	(0.1)	\$ 47.78
Non-vested at June 30	2.5	\$ 47.43

The fair value of vested restricted stock awards during the six months ended June 30, 2006 was \$5.0 million. At June 30, 2006, the Company had \$77.9 million of total unrecognized compensation expense related to restricted shares, net of estimated forfeitures. The impact of amortized compensation expense for the three and six months ended June 30, 2006 was \$6.0 million and \$12.3 million, respectively, net of the Company's accrual for estimated forfeitures. This amount includes \$1.7 million from accelerated vesting of restricted stock awarded to lockline employees resulting from the merger with Asurion. The Company estimates that the amortized compensation expense attributable to the grants will be approximately \$11.4 million for the remainder of 2006, \$22.9 million for each of the years 2007 and 2008, \$20.2 million for 2009 and \$500,000 for 2010. In accordance with SFAS 123R, unearned compensation on January 1, 2006 was combined into additional paid-in capital upon adoption of this standard.

4. Investments

Investments are as follows (in millions):

	2006 Ownership Percentage	Carrying Value June 30, 2006	December 31, 2005
Available-for-sale securities:			
State Street Corporation	3	% \$ 657.0	\$ 709.2
Computershare Ltd.	5	% 172.5	147.3
Euronet Worldwide	5	% 72.3	52.4
Other available-for-sale securities		205.2	179.8
		1,107.0	1,088.7
Unconsolidated affiliates:			
Asurion Corporation	37	% 270.5	
Boston Financial Data Services	50	% 107.2	118.3
International Financial Data Services, U.K.	50	% 42.3	38.4
International Financial Data Services, Canada	50	% 13.7	8.0
Argus Health Systems	50	% 12.1	9.1
Unconsolidated real estate affiliates		110.9	93.6
Other unconsolidated affiliates		12.0	12.3
		568.7	279.7
Other:			
Trading securities		36.7	29.7
Held-to-maturity		6.8	7.8
		43.5	37.5
Total investments		\$ 1,719.2	\$ 1,405.9

The table above includes \$700,000 of investments classified as Assets of businesses held for sale in the consolidated balance sheet as of December 31, 2005. During the three months ended March 31, 2006, the Company sold approximately 1.5 million shares of State Street Corporation (State Street) which resulted in gains on sales of securities of \$15.9 million and cash proceeds of \$89.9 million. The Company continues to hold approximately 11.3 million shares of State Street Corporation and has no current intention to further reduce its holdings.

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

	June 30, 2006	December 31, 2005
Book cost basis	\$ 412.3	\$ 468.4
Gross unrealized gains	696.8	621.3
Gross unrealized losses	(2.1)	(1.0)
Market value	\$ 1,107.0	\$ 1,088.7

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The Company has a cash management service for full service mutual fund transfer agency clients, whereby end of day available client bank balances are invested overnight by and in the name of the Company into credit-quality money market funds. All invested balances are returned to the full service mutual fund transfer agency client accounts the following business day. The Company had \$88.6 million and \$93.3 million of transfer agency investments and deposits at June 30, 2006 and December 31, 2005, respectively.

The following table summarizes the fair value and gross unrealized losses of the Company's investments by the length of time that the securities have been in a continuous loss position, as of June 30, 2006 (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	\$ 34.6	\$ 2.1	\$	\$	\$ 34.6	\$ 2.1

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

The Company recognized \$900,000 of investment impairments for the three and six months ended June 30, 2006 and \$2.7 million and \$3.1 million for the three and six months ended June 30, 2005, which the Company believed were other than temporary. The impairments recorded during the three and six months ended June 30, 2006 and 2005 related to available for sale investments in the Investments and Other Segment and other investments held by the Financial Services Segment. A decline in a security's net realizable value that is other than temporary is treated as a loss based on quoted or derived market value and is reflected in the Other Income, net line in the statement of income.

Included in other income, net, during the three months ended June 30, 2006 is a loss, in the amount of \$2.9 million, principally related to the decline in value of a non-operating Chapter 11 bankruptcy claim.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Asurion Corporation	\$ 7.3	\$	\$ 15.1	\$
Boston Financial Data Services, Inc.	7.3	15.6	13.9	19.6
International Financial Data Services, U.K.	2.4	2.2	3.6	4.6
International Financial Data Services, Canada	0.1	1.4	0.3	3.2
Argus Health Systems	2.0	0.1	3.0	0.3
Other	(0.8)	0.7	(1.5)	0.2
	\$ 18.3	\$ 20.0	\$ 34.4	\$ 27.9

The components of DST's equity in earnings of Asurion for the three and six months ended June 30, 2006 is included in Note 2 of these Condensed Consolidated Financial Statements.

5. Intangible Assets and Goodwill

Intangible Assets

The following table summarizes intangible assets (in millions):

	June 30, 2006 Gross Carrying Amount	Accumulated Amortization	December 31, 2005 Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets:				
Customer relationships	\$ 20.7	\$ 3.5	\$ 126.3	\$ 22.9
Other	2.0	1.0	2.1	1.0
Total	\$ 22.7	\$ 4.5	\$ 128.4	\$ 23.9

The table above includes \$85.6 million of net intangible assets classified as Assets of business held for sale in the consolidated balance sheet as of December 31, 2005.

Amortization of intangible assets for the three and six months ended June 30, 2006 was approximately \$700,000 and \$1.3 million, respectively. Amortization of intangible assets for the three and six months ended June 30, 2005 was approximately \$2.9 million and \$4.8 million, respectively. Annual amortization amounts for intangible assets recorded as of June 30, 2006 are estimated at \$2.2 million for each of 2006 and 2007, \$2.1 million for 2008, \$2.0 million for each of 2009 and 2010, and \$1.7 million for 2011.

Goodwill

The following table summarizes the changes in the carrying amount of goodwill for the six months ended June 30, 2006, by segment (in millions):

	December 31, 2005	Acquisitions	Disposals	Other	June 30, 2006
Financial Services	\$ 152.8	\$	\$ (86.9)) \$ 0.5	\$ 66.4
Output Solutions	9.2				9.2
Total	\$ 162.0	\$	\$ (86.9)) \$ 0.5	\$ 75.6

The table above includes \$86.9 million of goodwill classified as Assets of business held for sale in the consolidated balance sheet as of December 31, 2005.

6. Debt

Syndicated Line of Credit Amendment

The Company amended its revolving \$600 million syndicated line of credit facility during the three months ended March 31, 2006. The amendment (i) subject to certain conditions, allows the Company to request an increase of up to \$600 million in the aggregate revolving commitment, and (ii) clarifies that the Company is allowed to use cash and/or

the Company's stock to settle both the principal and accrued interest portion of the Company's Series A and B convertible senior debentures (upon conversion or otherwise) and use the Company's stock to settle any conversion premium payable upon any conversion of the Company's Series A and B convertible senior debentures.

BFDS Promissory Note

The Company entered into a promissory note with Boston Financial Data Services, Inc. (BFDS) on March 1, 2006. The agreement provides for unsecured revolving borrowings by the Company of up to \$50 million and matures on July 1, 2010. 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 the British Bankers Association LIBOR rate 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. The amount outstanding under this loan agreement was \$45.0 million at June 30, 2006. For the three and six months ended June 30, 2006, the Company recorded interest expense related to this loan of \$400,000 and \$500,000, respectively.

Senior Convertible Debentures

Holders of the Company's \$840 million senior convertible debentures were eligible to convert these bonds during the three months ended March 31, 2006 as a result of DST's common stock trading above 120% of the applicable conversion price (\$49.08) for at least 20 trading days during the period of 30 consecutive trading days ended December 30, 2005. Actual conversions through June 30, 2006 have been less than \$100,000 and cash was used to settle the principal portion of these conversions. Because 100% of the outstanding debentures could have been converted during the three months ended March 31, 2006, and in accordance with GAAP, the Company amortized the remaining net book value of its debenture issuance costs (included in other non-current assets at December 31, 2005), in the amount of \$12.7 million, during the three months ended March 31, 2006. This non-cash charge has been included in interest expense. The right to convert these bonds has not been effective since April 1, 2006 due to the conversion feature hurdle not being met. As a result, the Company has classified the entire amount of the debentures of \$839.9 million as a non-current liability at June 30, 2006. Conversion rights, and ultimate classification as a current or non-current liability, for subsequent quarters will be a function of future DST stock prices.

Equipment Promissory Note

During the three months ended March 31, 2006, DST purchased \$10.7 million of computer equipment with a promissory note. Principal and interest are payable monthly at a fixed interest rate of approximately 4.5% per year. The note matures on February 1, 2009. The note is secured by the equipment.

7. Income Taxes

In general, the Company provides income taxes during interim periods based on its best estimate of the full year's effective tax rate. Certain items, however, are given discrete period treatment and, as a result, the tax effects of such items are reported in full in the relevant interim period. The Company's effective tax rate was 27.7% and 34.7% for the three and six months ended June 30, 2006, respectively, compared to 40.6% and 39.4% for the three and six months ended June 30, 2005, respectively. The effective tax rates for three and six months ended June 30, 2006 were lower compared to the same periods in 2005 due to higher effective tax rates related to the gain from the DST Health Solutions exchange transaction on April 29, 2005 and the gain from the sale of EquiServe on June 17, 2005. In addition, the effective tax rates for the three and six months ended June 30, 2006 include a benefit from a settlement and refund with the IRS related to research and experimentation credits, described below, which resulted in a lower effective tax rate during 2006. Excluding the effects of discrete period items, the Company estimates its recurring effective tax rate for the remainder of 2006 will be 34.9%. The full year 2006 effective tax rate can be affected as a result of variances among the estimates and amounts of full year sources of taxable income (e.g. domestic

consolidated, joint venture and/or international), the realization of tax credits (e.g. historic rehabilitation, research and experimentation and state incentive), adjustments which may arise from the resolution of tax matters under review and the Company's assessment of its liability for uncertain tax positions.

As discussed in Note 8 to the Company's Consolidated Financial Statements included in its 2005 Annual Report on Form 10-K, the Company filed federal income tax refund claims for research and experimentation credits for the tax years 1988 through 1995. The IRS examined and denied the claims for 1988 through 1992, but the Company appealed the examiner's findings. During the three months ended June 30, 2006, the Company reached a settlement with the IRS for claims from 1988 through 1992 and the settlement agreement was then applied to claims from 1993 through 1995. A federal income tax refund was received during the three months ended June 30, 2006 related to this settlement. In addition, a settlement was reached with respect to the Company's refund claims for research and experimentation credits for the years 1996 through 2001.

A portion of the federal income tax refund received during the three months ended June 30, 2006, in the amount of \$1.3 million, was required to be reported as interest income and has been included in other income, net, in the Consolidated Statement of Income. The income tax effect of this IRS settlement and federal income tax refund during the three months ended June 30, 2006 resulted in an income tax benefit of approximately \$4.4 million. Despite the settlement, the IRS continues to challenge the amount and availability of research and experimentation credits attributable to the Company's operations after 2001. Income tax expense includes no research and experimentation credit benefits applicable to post 2001 operations.

8. Stockholders' Equity

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Net income	\$ 55.5	\$ 170.3	\$ 137.2	\$ 219.5
Dilutive securities at unconsolidated affiliates	(0.3)		(0.5)	
Net income for dilutive computation	\$ 55.2	\$ 170.3	\$ 136.7	\$ 219.5
Average common shares outstanding (excluding restricted stock)	67.1	78.6	67.5	78.5
Incremental shares from assumed conversions of stock options and vesting of stock based compensation	5.9	2.3	5.7	2.4
Diluted potential common shares	73.0	80.9	73.2	80.9
Basic earnings per share	\$ 0.83	\$ 2.17	\$ 2.03	\$ 2.79
Diluted earnings per share	\$ 0.76	\$ 2.11	\$ 1.87	\$ 2.71

The Company had approximately 69.5 million and 81.8 million shares outstanding at June 30, 2006 and 2005, respectively. For financial reporting purposes, however, unvested restricted shares in the amount of 2.5 million and 3.0 million at June 30, 2006 and 2005, respectively, are excluded from the determination of average common shares outstanding used in the calculation of basic earnings per share in the above table. Shares from options to purchase common stock that were excluded from the diluted earnings per share calculation because they were anti-dilutive totaled 800,000 and 3.3 million for the three months ended June 30, 2006 and 2005, respectively, and 800,000 and 2.6 million for the six months ended June 30, 2006 and 2005, respectively. The Company has issued convertible senior debentures that if converted in the future would have a potentially dilutive effect on the Company's stock. The Series A debentures are convertible into 11.0 million shares of common stock and the Series B debentures are convertible

into 6.1 million shares of common stock, subject to adjustment. The Company intends to settle any conversions with cash for the principal and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amounts. Related to the debentures, the calculation of diluted earnings per share would begin to include an incremental amount of shares assumed to be issued for the conversion spread if the Company's stock price exceeds \$49.08 per share. For the three and six months ended June 30, 2006, there was additional dilution of approximately 2.9 million shares and 2.8 million shares, respectively, related to the Company's average daily share price exceeding \$49.08 per share. There was no impact during the three and six months ended June 30, 2005 because the Company's average daily stock price during these periods did not exceed \$49.08 per share.

Stock repurchases

The Company repurchased approximately 364,200 shares of DST common stock for \$21.9 million or approximately \$60.00 per share during the three months ended June 30, 2006. For the six months ended June 30, 2006, the Company had repurchased approximately 2.9 million shares of DST common stock at an average cost of \$57.63 per share. Cash proceeds from the State Street stock sale and from stock option exercises and cash flow from operations were used to repurchase these shares. At June 30, 2006, 2.4 million shares remained under the existing share repurchase authorization plan. On August 1, 2006, DST's Board of Directors authorized an additional 6.0 million shares under the existing share repurchase authorization plan. The plan allows, but does not require, the repurchase of common stock in open market and private transactions through July 31, 2008. 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.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Net income	\$ 55.5	\$ 170.3	\$ 137.2	\$ 219.5
Other comprehensive income (loss):				
Unrealized gains (losses) on investments:				
Unrealized holding gains (losses) arising during the period	(18.7)	39.0	88.6	(96.5)
Proportional share of unconsolidated affiliate interest rate swap	4.3	(9.9)	10.4	(8.2)
Less reclassification adjustments for net gains included in net income		(76.8)	(16.1)	(77.9)
Foreign currency translation adjustments	11.5	(11.5)	11.8	(14.1)
Deferred income taxes	5.7	18.3	(31.9)	71.0
Other comprehensive income (loss)	2.8	(40.9)	62.8	(125.7)
Comprehensive income	\$ 58.3	\$ 129.4	\$ 200.0	\$ 93.8

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 flow of the Company.

As a result of recent court decisions, customers of the Company's 50% joint venture, International Financial Data Services, U.K. Limited (IFDS U.K.), may seek refunds of past value added tax (VAT) payments charged by IFDS U.K. Protective refund claims have been filed by IFDS U.K. for customers having potential claims for past VAT paid. IFDS U.K. plans to make disbursements to its clients based upon the net amount received from the refund claims. However, the amounts recoverable and payable to customers are uncertain. IFDS U.K. currently estimates that the resolution of this matter will not result in a significant financial impact to the Company.

The Company has entered into an agreement to guarantee 50% of a construction loan of a 50% owned joint venture. The construction loan becomes due and the Company's guarantee thereof expires in June 2008 and allows for borrowings up to \$2.6 million. At June 30, 2006, total borrowings against the loan were \$100,000.

The Company has entered into an agreement to guarantee 50% of a \$10.0 million line of credit for a 50% owned real estate joint venture. The line of credit becomes due and the Company's guarantee thereof expires on December 16, 2007. At June 30, 2006, total borrowings against the line of credit were \$7.0 million.

The Company entered into an agreement to guarantee 10% of any amounts between \$10.0 million and \$20.0 million, and 20% of any amounts thereafter, related to a \$48.2 million construction loan to a 50% owned real estate joint venture. The \$48.2 million loan matures on the earlier of the completion of the project or December 31, 2007. At June 30, 2006, total borrowings on the loan were \$24.1 million, resulting in a guarantee of \$1.8 million by the Company.

The Company and a wholly owned subsidiary of the Company have entered into an agreement to guarantee \$1.0 million (which, in the event a certain debt service coverage ratio requirement is not met, will increase to \$2.0 million) plus any enforcement costs related to a \$32.0 million mortgage loan to a 33% owned real estate joint venture. The \$32.0 million loan matures on July 1, 2010. At June 30, 2006, total borrowings on the loan were \$28.4 million and the Company's guarantee totaled \$1.0 million.

The Company is a 50% partner in a limited purpose real estate joint venture. The real estate joint venture is developing approximately 1.1 million square feet of office space to be leased to the U.S. government. The project is estimated to cost approximately \$362 million and has been financed with \$315.4 million of non-recourse insured bonds (issued June 2004) with the remainder in the form of equal equity contributions from the Company and its real estate joint venture partner. At June 30, 2006, the Company and its joint venture partner had each contributed half of the equity of \$60.4 million. The Company and its joint venture partner have committed up to \$31.8 million of equity investments in the aggregate in the event of delays in construction or lease commencement. The remaining equity contributions up to \$31.8 million have been secured through \$31.8 million of letters of credit that will begin expiring in 2007 through 2008. The Company is responsible for \$15.9 million of the letters of credit at June 30, 2006. At June 30, 2006, there were no outstanding borrowings against the letters of credit.

The Company and State Street have each guaranteed 50% of a lease obligation of IFDS U.K., which requires IFDS U.K. to make annual rent payments of approximately \$3.5 million through 2017, for its use of a commercial office building. The commercial office building is owned by a wholly owned affiliate of International Financial Data Services, (Canada) Limited (IFDS Canada) and is financed with a \$19.5 million mortgage loan from a bank. The loan has a floating interest rate based upon LIBOR and fully amortizes over the 15 year term. To fix the rate of borrowing costs, the IFDS Canada affiliate entered into a 15-year interest rate hedge agreement with the same bank. The interest rate hedge, which has an initial notional amount value of approximately \$19.5 million and scheduled reductions that coincide with the scheduled principal payments for the mortgage loan, was entered into for the purpose of fixing the borrowing costs of the mortgage at approximately 6.3%. The Company and State Street have each guaranteed 50% of the amounts of the interest rate hedge obligations. Upon default, the Company would be required to pay 50% of the total amount to close out of the hedge, which is approximately \$200,000.

The Company's 50% owned joint ventures are generally governed by shareholder or partnership agreements. The agreements generally entitle the Company to elect one-half of the directors to the board in the case of corporations and to have 50% voting/managing interest in the case of partnerships.

The agreements generally provide that the Company or the other party has the option to establish a price payable in cash, or a promise to pay cash, for all of the other's ownership in the joint venture and to submit an offer, in writing, to the other party to sell to the other party all of its ownership interests in the joint venture or to purchase all ownership interests owned by the other party at such offering price. The party receiving the offer generally has a specified period of time to either accept the offer to purchase, or to elect to purchase the offering party's interest at the offering price. The Company cannot estimate the potential aggregate offering price that it could be required to receive or elect to pay in the event this option becomes operable; however, the amount could be material.

Guarantees

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

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

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

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

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

The Company has entered into agreements with certain third parties, including banks and escrow agents, 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.

At June 30, 2006 and December 31, 2005, the Company had not accrued any liability on the aforementioned guarantees or indemnifications as they relate to future performance criteria or indirect indebtedness of others in accordance with FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*.

10. Recently Issued Accounting Standards

Accounting for Uncertainty in Income Taxes

In June 2006, the FASB issued FASB Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes* - an interpretation of FASB Statement No. 109. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company will be required to adopt this interpretation in the first quarter of 2007. Management is currently evaluating the requirements of FIN 48 and has not yet determined the impact on the consolidated financial statements.

Earnings Per Share

On September 30, 2005, the Financial Accounting Standards Board (the FASB) issued an exposure draft on a proposed accounting standard that would amend SFAS 128, *Earnings per Share*, to clarify guidance for mandatorily convertible instruments, the treasury stock method, contingently issuable shares, and contracts that may be settled in cash or shares.

The proposed amendment, which is designed for convergence with international accounting standards, would require the use of the if-converted method from the date of issuance of the convertible debentures. The proposed amendment would remove the ability of a company to support the presumption that the convertible securities will be satisfied in cash and not converted into shares of common stock. Accordingly, the Company's stated intention to settle conversions of its convertible debentures with cash for the principal and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amounts would no longer be accepted under SFAS 128, if amended as proposed. The final statement is expected to be issued later this year. Retrospective application would be required for all changes to SFAS 128, except that retrospective application would be prohibited for contracts that were either settled in cash prior to adoption or modified prior to adoption to require cash settlement. For DST, adoption of this statement, as proposed, will require retroactive restatement of the Company's diluted earnings per share calculations subsequent to the issuance of the convertible debentures. In

calculating diluted earnings per share under the revised SFAS 128 if converted method included in the exposure draft, the Company would need to increase net income for the interest expense associated with the convertible debentures, net of tax, and increase the incremental shares assumed to be issued upon conversion by 17.1 million shares (less shares already included in diluted earnings per share), the amount of shares that would be issued if all \$840 million of convertible debentures would be converted to equity. Under this if converted method, diluted earnings per share would have been \$0.70 and \$1.80 for the three months ended June 30, 2006 and 2005 (versus reported diluted earnings per share of \$0.76 and \$2.11), respectively, and \$1.78 and \$2.36 for the six months ended June 30, 2006 and 2005 (versus reported diluted earnings per share of \$1.87 and \$2.71), respectively. The above pro-forma information presents only the effect on diluted earnings per share of the if converted method included in the exposure draft, but does not include any other computational changes (i.e., treasury stock method considerations) discussed in the exposure draft. DST is still evaluating the remaining aspects of this proposed accounting standard.

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

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

11. Segment Information

The Company's operating business units offer sophisticated information processing and software services and products. The Company has elected to organize and report on these business units as two operating Segments (Financial Services and Output Solutions). In addition, investments in equity securities and certain financial interests and the Company's real estate subsidiaries and affiliates have been aggregated into an Investments and Other Segment. Prior to July 1, 2005, the Company had an additional operating segment (Customer Management) which was essentially comprised of the Innovis Entities. The Customer Management Segment provided customer management, billing and marketing solutions to the video / broadband/cable/satellite TV industry. The Innovis Entities were sold on July 1, 2005.

As more fully described in Note 3 Significant Business Transactions in the Company's Consolidated Financial Statements included in its 2005 Annual Report on Form 10-K, there were certain changes in the composition of the Financial Services Segment during the year ended December 31, 2005. DST Health Solutions became a subsidiary of DST on April 29, 2005 through an exchange transaction with Computer Sciences Corporation. On June 17, 2005, the Company sold its wholly owned subsidiary, EquiServe, Inc. to Computershare Ltd. As discussed in Note 2 to the Condensed Consolidated Financial Statements included in this report, on January 1, 2006, the Company merged its wholly-owned subsidiary, lockline, into a wholly-owned subsidiary of Asurion for an approximate 37.4% equity interest in Asurion.

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

	June 30, 2006	December 31, 2005
Financial Services	\$ 2,381.2	\$ 2,471.5
Output Solutions	378.1	379.4
Investments and Other	1,959.1	1,946.2
Eliminations	(1,705.3)	(1,767.6)
	\$ 3,013.1	\$ 3,029.5

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

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

	Three Months Ended June 30, 2006					Consolidated Total
	Financial Services	Output Solutions	Customer Management	Investments/Other	Eliminations	
Operating revenues	\$ 244.0	\$ 132.8	\$	\$ 3.7	\$	\$ 380.5
Intersegment operating revenues	1.2			11.9	(13.1)	
Out-of-pocket reimbursements	15.4	174.6		0.1	(0.1)	190.0
Total revenues	260.6	307.4		15.7	(13.2)	570.5
Costs and expenses	174.6	298.2		10.2	(13.2)	469.8
Depreciation and amortization	19.6	8.5		2.8		30.9
Income from operations	66.4	0.7		2.7		69.8
Other income, net	2.0			3.0		5.0
Gains on sale of businesses						
Equity in earnings (loss) of unconsolidated affiliates	18.8			(0.5)		18.3
Earnings before interest and income taxes	\$ 87.2	\$ 0.7	\$	\$ 5.2	\$	\$ 93.1

	Three Months Ended June 30, 2005					Consolidated Total
	Financial Services	Output Solutions	Customer Management	Investments/Other	Eliminations	
Operating revenues	\$ 310.8	\$ 104.5	\$ 50.3	\$ 3.6	\$	\$ 469.2
Intersegment operating revenues	2.1	14.7		14.0	(30.8)	
Out-of-pocket reimbursements	55.5	151.8	13.2	0.1	(19.5)	201.1
Total revenues	368.4	271.0	63.5	17.7	(50.3)	670.3
Costs and expenses	284.3	257.9	51.7	6.2	(50.3)	549.8
Depreciation and amortization	26.1	6.6	1.8	3.9		38.4
Income from operations	58.0	6.5	10.0	7.6		82.1
Other income, net	2.0	0.1		80.2		82.3
Gains on sale of businesses	120.4					120.4
Equity in earnings of unconsolidated affiliates	19.2			0.8		20.0
Earnings before interest and income taxes	\$ 199.6	\$ 6.6	\$ 10.0	\$ 88.6	\$	\$ 304.8

Earnings before interest and income taxes in the segment reporting information above less interest expense of \$16.3 million and \$18.2 million for the three months ended June 30, 2006 and 2005, respectively, is equal to the Company's income before income taxes on a consolidated basis for the corresponding periods.

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	Six Months Ended June 30, 2006					Consolidated
	Financial Services	Output Solutions	Customer Management	Investments/ Other	Eliminations	Total
Operating revenues	\$ 486.2	\$ 268.6	\$	\$ 8.4	\$	\$ 763.2
Intersegment operating revenues	2.4			22.6	(25.0)	
Out-of-pocket reimbursements	31.7	352.0		0.2	(0.6)	383.3
Total revenues	520.3	620.6		31.2	(25.6)	1,146.5
Costs and expenses	352.5	600.1		20.1	(25.6)	947.1
Depreciation and amortization	38.9	15.6		5.7		60.2
Income from operations	128.9	4.9		5.4		139.2
Other income, net	5.8			23.7		29.5
Gains on sale of businesses	52.8					52.8
Equity in earnings (loss) of unconsolidated affiliates	35.8			(1.4)		34.4
Earnings before interest and income taxes	\$ 223.3	\$ 4.9	\$	\$ 27.7	\$	\$ 255.9

	Six Months Ended June 30, 2005					Consolidated
	Financial Services	Output Solutions	Customer Management	Investments/ Other	Eliminations	Total
Operating revenues	\$ 588.3					