PEROT SYSTEMS CORP
Form 10-K/A
August 03, 2004

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A
Amendment No. 1

[X] **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For The Fiscal Year Ended December 31, 2003

[ ] **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 0-22495

PEROT SYSTEMS CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware *(State of Incorporation)*	**75-2230700** *(I.R.S. Employer Identification No.)*
2300 WEST PLANO PARKWAY **PLANO, TEXAS** *(Address of Principal Executive Offices)*	**75075** *(Zip Code)*

(Registrant s Telephone Number)
(972) 577-0000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Class A Common Stock Par Value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
Preferred Stock Purchase Rights

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

As of June 30, 2004, the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant, based upon the closing sales price for the registrant s common stock as reported on the New York Stock Exchange, was approximately $1,046,987,076 (calculated by excluding shares owned beneficially by directors and officers).

Number of shares of registrant s common stock outstanding as of July 30, 2004: 114,970,403

DOCUMENTS INCORPORATED BY REFERENCE

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K/A: certain information required in Part III of this Form 10-K/A is incorporated from the registrant s Proxy Statement for its 2004 Annual Meeting of Stockholders.

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EXPLANATORY NOTE

We are filing this Amendment to our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2003 to revise certain disclosures in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003, which was originally filed with the Securities and Exchange Commission on March 15, 2004. Primarily, we revised disclosures to:

Expand, clarify, or update the description of our business and the associated risk factors in Item 1, Business ;

Expand or clarify disclosures about our financial condition, results of operations, and critical accounting policies in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations ;

Expand or clarify disclosures about our accounting policies in Note 1 to the Consolidated Financial Statements in Item 8, Financial Statements and Supplementary Data ; and

Expand disclosures to clarify the calculation methodology and components of the loss we recorded in terminating a business relationship during 2003 in Note 11 to the Consolidated Financial Statements in Item 8, Financial Statements and Supplementary Data.

This Form 10-K/A replaces the original Form 10-K in its entirety. All information contained in this Form 10-K/A is subject to updating and supplementing as provided in our periodic reports filed with the SEC.

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FORM 10-K

For the Year Ended December 31, 2003

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PART I

This report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, forecasts, expects, plans, anticipates, believes, estimates, predicts, potential, see, target, continue or the negative of such terms and other comparable terminology. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider various factors, including the risks outlined below under the caption Risk Factors. These risk factors describe reasons why our actual results may differ materially from any forward-looking statement. We do not undertake to update any forward-looking statement.

Item 1. *Business*

Overview

Perot Systems Corporation is a worldwide provider of information technology (commonly referred to as IT) services and business solutions to a broad range of customers. We offer our customers integrated solutions designed around their specific business objectives, chosen from a breadth of services, including technology outsourcing, business process outsourcing, development and integration of systems and applications, and business and technology consulting services.

With this approach, our customers benefit from integrated service offerings that help synchronize their strategy, systems, and infrastructure. As a result, we help our customers achieve their business objectives, whether those objectives are to accelerate growth, streamline operations, or enhance customer service capabilities.

Our customers may contract with us for any one or more of our services, which fall into the following categories:

- IT outsourcing services
- Business process services
- Consulting services

IT Outsourcing Services

IT outsourcing services includes multi-year contracts in which we assume operational responsibility for various aspects of our customers businesses, including IT outsourcing (such as data center management, desktop solutions, and messaging services), application services, infrastructure management, program management, and security. We typically hire a significant portion of the customers staff that has supported these functions. We then apply our expertise and operating methodologies to increase the efficiency of the operations, which usually results in increased operational quality at a lower cost. Our IT outsourcing contracts are priced using a variety of mechanisms, including level-of-effort, direct costs plus a fee (which may be either a fixed amount or a percentage of direct costs incurred), fixed-price, unit price, and risk/reward. Depending on a customer s business requirements and the pricing structure of the contract, the cash flows from a contract can vary significantly during a contract s term. With fixed-price contracts or when an upfront payment is required to purchase assets, an IT outsourcing contract will typically produce less cash flow at the beginning of the contract with significantly more cash flow generated as efficiencies are realized later in the term. With a cost plus contract, the cash flows tend to be relatively consistent over the term of the contract.

Business Process Services

Business process services includes services such as call center management, health and dental claims processing, energy management, payment and settlement management, security, and collection of receivables, which we offer on a stand-alone basis. We classify our Business Process Services in three categories: transaction processing services, back-office services, and professional services related to non-technical functions.

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Consulting Services

Consulting services includes services such as application development and maintenance, system design and implementation services, application systems migration and testing, and management consulting and IT strategy services, which we offer to customers typically on a short-term basis. We market these services through two primary channels our standalone Consulting segment and the four vertical industry groups of our IT Solutions segment as additional project work for our customers with whom we have a long-term IT outsourcing contract. The consulting services provided through our Consulting segment relate primarily to the implementation of prepackaged software applications, offshore application development and maintenance, and offshore systems migration and testing, primarily under short-term contracts related to specific projects. The consulting services provided to customers within our IT Solutions segment typically consist of customized, industry-specific business solutions provided by associates with industry expertise. All consulting services are typically viewed as discretionary services by our customers, with the level of business activity depending on many factors, including economic conditions and specific customer needs.

Our Contracts

Our contracts utilize a wide variety of pricing mechanisms, used to meet customer business requirements. In determining how to price a contract, we consider the delivery, credit and pricing risk of a business relationship. For the year ended December 31, 2003:

Approximately 33% of our revenue is from fixed price contracts where our customers pay us a set amount for contracted services. For some of these fixed price contracts, the price will be set so that the customer realizes an immediate savings in relation to their current expense for an operation we are assuming. On contracts of this nature, our profitability generally increases over the term of the contract as we become more efficient. The timeframe it takes for us to realize these efficiencies can range from a few months to a few years, depending on the complexity of the operation. We have experienced a substantial increase in our fixed price contract revenue during the past three years.

Approximately 30% of our revenue is from cost plus contracts where our billings are based in part on the amount of expense we incur in providing services to a customer.

Approximately 26% of our revenue is from time and materials contracts where our billings are based on time measurements such as hours, days or months and an agreed upon rate. In some cases, the rate the customer pays for a unit of time can vary over the term of a contract, which may result in the customer realizing immediate savings at the beginning of a contract.

Approximately 11% of our revenue is from per-unit pricing where we bill our customers based upon the volume of technology or business units used at the unit rate specified. In some contracts, the per-unit prices may vary over the term of the contract, which may result in the customer realizing immediate savings at the beginning of a contract.

We also utilize other pricing mechanisms, including license fees and risk/reward relationships where we participate in the benefit associated with delivering a certain outcome. Revenue from these other pricing mechanisms totaled less than one percent of our revenue.

We offer our services under three primary lines of business IT Solutions, Government Services and Consulting. We consider these three lines of business to be reportable segments and include financial information and disclosures about these reportable segments in our consolidated financial statements. You can find this financial information in Note 13, Segment and Certain Geographic Data, of the Notes to Consolidated Financial Statements below. We routinely evaluate the historical performance of and growth prospects for various areas of our business, including our lines of business, vertical industry groups, and service offerings. Based on a quantitative and qualitative analysis of varying factors, we may increase or decrease the amount of ongoing investment in each of these business areas, make acquisitions that strengthen our market position, or divest, exit, or downsize aspects of a business area. During the past four years, we have used our acquisition program to strengthen our business in the healthcare market, consulting market (primarily in India), and to expand into the government market. At the same time, we have divested, or exited, certain service offerings and joint ventures that did not meet our criteria for continued investment.

IT Solutions

IT Solutions, our largest line of business, provides services to our customers primarily under long-term contracts in strategic relationships. The primary services that we provide to the majority of our customers include the following:

IT outsourcing includes data center management, web hosting and internet access, desktop solutions, messaging services, and video, voice, and data services.

Application services includes application assessment and evaluation, hardware and architecture consulting, systems integration, custom application development, system testing, application management and maintenance, business intelligence, and web-based services.

Infrastructure management includes process and change management, hardware maintenance and monitoring, network management, including VPN services, and service desk capabilities.

Program management includes project assessments, project management, transition and contingency planning.

Security includes physical security, network security, and risk management.

Business process services includes call center management, health and dental claims processing, energy management, payment and settlement management, security, and collection of receivables.

Consulting includes strategic consulting, technology consulting, and enterprise solutions and applications.

Within IT Solutions, we face the market through our four vertical industry groups Healthcare, Financial Services, Industrial Services and Strategic Markets. Supporting these vertical industry groups is our Global Infrastructure Services group, the delivery organization for our technology outsourcing services and our network and system operations services.

Healthcare

Our Healthcare group, which represented 45% of our total revenue for 2003 and 55% of revenue for the IT Solutions line of business, provides technology and business process services in four industry markets:

Providers including integrated health systems, free standing hospitals, and physician practices;

Payers including national insurers, Blue Cross and Blue Shield plans, and regional managed care organizations;

Life Sciences including research-based pharmaceutical and contract research companies; and

Healthcare Supply Chain including medical/surgical suppliers and distributors.

The additional services that we provide in the Healthcare group that cross all markets include Health Insurance Portability and Accountability Act compliance and remediation consulting, and full and unbundled IT outsourcing. In addition, our Healthcare group provides numerous services and solutions tailored to each market.

For customers in the provider market, we offer revenue cycle solutions, clinical solutions, health information management, Digital Access, and ERP solution. Combined, these services are targeted to improve quality outcomes and patient safety, increase cash, and improve hospital efficiency and cost control.

For our payer customers, we offer our Digital Health Plan application suite, which provides an integrated set of Web-based self-service applications. In addition, we provide claims processing outsourcing and act as an application

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service provider for payer enterprise applications. We also offer DIAMOND® 950, which manages more than 8 million members in a variety of payer risk settings. In addition, we provide a range of business and IT strategy, tactical consulting and software development services to companies in this market. Combined, these services are targeted to increase back office efficiency, and improve consumer satisfaction.

For life science customers, we offer management consulting, and IT strategic planning and outsourcing services.

For customers in the healthcare supply chain market, we offer technology outsourcing services.

Financial Services

Our Financial Services group, which represented 19% of our total revenue for 2003, focuses on providing technology solutions to customers in the financial markets, banking and insurance sectors. The technology solutions we provide include application development and management services on both an on-shore and offshore basis, computer and processing systems services, desktop services, outsourcing and applications services management.

The majority of our revenue for this group comes from our contract with UBS AG, which accounted for 85% of the revenue for our Financial Services group in 2003. Under our agreement with UBS, we provide IT services to UBS Investment Bank, the investment banking division of UBS, as well as other business units of UBS. For UBS, our services consist primarily of technology infrastructure-related services such as outsourcing, customer support, and market data services.

Industrial Services

Our Industrial Services group, which represented 8% of our total revenue for 2003, focuses on providing business process and technology services primarily for customers in the engineering and construction and automotive markets.

For the engineering and construction market, we provide solutions that help engineering firms as well as commercial and residential construction firms lower overhead cost, manage project risk, and increase return on assets. We provide these benefits to our customers primarily by applying our expertise in information technology and business processes to all aspects of their business, including the consolidation and integration of technology operations and the implementation of new technology to increase efficiency of their IT infrastructure.

For the automotive market, we provide services primarily to automotive manufacturers and suppliers to these manufacturers. Our services include business and technology solutions that improve the efficiencies of critical processes, including product design, supply chain execution, warranty systems, collaborative commerce, and manufacturing plant floor processes.

We also offer services to a limited customer base in other markets, including the consumer packaged goods market. These services include supply chain management and cost reduction, order processing management and support and customer relationship management.

Strategic Markets

Our Strategic Markets group, which represented 9% of our total revenue for 2003, focuses on the maintenance and future development of a selected set of vertical industry markets. By utilizing a single delivery and operations unit that supports the entire group, we are able to optimize our delivery capability and concentrate our resources on building industry expertise and scale.

The majority of our revenue in the Strategic Markets group comes from customers in the travel and transportation industries, including hotel, food service, vehicle rental, and cargo companies. We also serve a limited number of customers in the communications and energy industries. Our solutions for these markets are focused on solving business critical issues with technology solutions, including IT outsourcing, business process services and application management.

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Global Infrastructure Services

Our Global Infrastructure Services group is responsible for defining the technology strategies for our IT Solutions customers and us. This group identifies new technology offerings and innovations that deliver value to our customers. It manages, updates and maintains our technology infrastructure including networks, data centers, help desks, mainframes, servers, storage, and workspace computing. It also provides senior technology consultants to assist our customers with more complex technology transformations. It manages, resolves and documents problems in our customers computing environments. The group also provides comprehensive monitoring, planning, and safeguarding of information technology systems against intrusion by monitoring system and network status, collecting and analyzing data regarding system and network performance, and applying appropriate corrective action. All of these activities are either performed at customer facilities or delivered through centralized data processing centers that we maintain.

Government Services

We formed Perot Systems Government Services in July of 2002 through the acquisition of ADI Technology Corporation and then expanded it in February 2003 through the acquisition of Soza & Company, Ltd. This line of business provides consulting and technology-based business process solutions for the Department of Defense, law enforcement agencies, and other governmental agencies.

We provide engineering and technical services predominantly to organizations with stringent quality, safety, technical, engineering and regulatory requirements. Our services include the direct support of engineering, safety, quality assurance, logistics, environmental solutions, financial management and program management for the United States Navy ships and nuclear-powered submarines.

We provide management consulting services, information technology and infrastructure support, application design and development, government financial services, business process outsourcing, and outreach, media and communications services to federal agencies such as the U.S. Department of Agriculture, U.S. Coast Guard, U.S. Department of Justice, National Institutes of Health, Environmental Protection Agency, national intelligence agencies and U.S. Department of Energy among others.

Our service offerings include business process management; enterprise solutions, environmental consulting, financial services, information technology, infrastructure management, management consulting, marine engineering, and ship maintenance and technology consulting.

Despite the fact that a number of government projects for which we serve as a contractor or subcontractor are planned as multi-year projects, the U.S. government normally funds these projects on an annual or more frequent basis. Generally, the government has the right to change the scope of, or terminate, these projects at its convenience. The termination or a major reduction in the scope of a major government project could have a material adverse effect on our results of operations and financial condition. Approximately 99% of the revenue from the Government Services segment in 2003 is from contracts with the U.S. government.

U.S. government entities audit our contract costs, including allocated indirect costs, or conduct inquiries and investigations of our business practices with respect to our government contracts. If the government finds that we improperly charged any costs to a contract, the costs are not reimbursable or, if already reimbursed, the cost must be refunded to the government. If the government discovers improper or illegal activities in the course of audits or investigations, the contractor may be subject to various civil and criminal penalties and administrative sanctions, which may include termination of contracts, forfeiture of profits, suspension of payments, fines and suspensions or debarment from doing business with the U.S. government. These government remedies could have a material adverse effect on our results of operations and financial condition.

Consulting

Our Consulting line of business includes Perot Systems TSI B.V., Perot Systems Solutions Consulting, our Global Software Services group, and a group of management consultants. This line of business provides our customers high-value and repeatable services related to business and technical expertise and the design and implementation of business and software solutions, primarily under short-term contracts related to specific projects.

Perot Systems TSI

On December 19, 2003, we acquired our joint venture partner s interest in HCL Perot Systems and changed its name to Perot Systems TSI B.V. Perot Systems TSI is an IT services firm specializing in application development and maintenance, including the development and maintenance of custom and packaged application software for customers, and application systems migration and testing, which includes the migration of applications from legacy environments to current technology, as well as performing quality assurance functions on custom applications. UBS is Perot Systems TSI s largest customer.

Perot Systems Solutions Consulting

Perot Systems Solutions Consulting provides services ranging from strategy through full implementation of software solutions. These solutions include enterprise resource planning, supply chain management, eBusiness, customer relationship management and related process and technology solutions. We partner with leading packaged software providers including SAP, PeopleSoft, and Oracle. Our focus is on execution and customer satisfaction, which we accomplish with small, well-integrated teams that work more collaboratively with the customer team.

Global Software Services

Our Global Software Services group optimizes the application services delivery options for our customers by utilizing the proper mix of delivery resources, architectures, methodologies, and repeatable processes. We support the entire life cycle of software services. Our service offerings include application architecture; package application selection and implementation; design, development, implementation, and maintenance of applications; as well as systems integration services. These services are delivered through a combination of teams that leverage our expertise in project management and software development, primarily through The Technical Resource Connection delivery unit.

Perot Systems Associates

The markets for IT personnel and business integration professionals are intensely competitive. A key part of our business strategy is the hiring, training and retaining of highly motivated personnel with strong character and leadership traits. We believe that employing associates with such traits is and will continue to be - an integral factor in differentiating us from our competitors in the IT industry. In seeking such associates, we screen candidates for employment through a rigorous interview process. In addition to competitive salaries, we distribute cash bonuses that are paid promptly to reward excellent performance, and we have an annual incentive plan based on our performance in relation to our business and financial targets. We also seek to align the interests of our associates with those of our stockholders by compensating outstanding performance with stock option awards, which we believe fosters loyalty and commitment to our goals.

As of December 31, 2003, we employed approximately 13,500 associates. A limited number of these associates located in the United States are currently employed under an agreement with a collective bargaining unit. In European countries, our associates are generally members of work councils and have worker representatives. We believe that our relations with our associates are good.

UBS Agreements

In January 1996, we entered into a series of agreements to form a strategic relationship with Swiss Bank Corporation, one of the predecessors of UBS AG. This relationship involves a master operating agreement, a long-term information technology services agreement and a master project agreement. Our agreements with UBS also provided for the sale to UBS of our stock and options. We provide a substantial majority of the services for UBS under the agreements described below. Perot Systems TSI has entered into several contractual relationships with UBS, which are not discussed below. Our risk factor relating to the expiration of our outsourcing agreement with UBS on page 10 of this Annual Report contains material information about our relationship with UBS.

Master Operating Agreement

The Amended & Restated Master Operating Agreement, dated as of January 1, 1997, as amended on September 15, 2000, between us and UBS, contains the standard terms and conditions that apply to all agreements (except for the agreements between Perot Systems TSI and UBS) pursuant to which we provide operational management services and related information technology services to UBS and its affiliates. We have one IT Services agreement subject to the Master Operating Agreement under which we provide services to UBS Warburg, the investment banking division of UBS, and other business units of UBS. The Master Operating Agreement has an indefinite term; however, it may be terminated by either party after December 31, 2008 upon sixty days notice and prior to that date by mutual consent of the parties. In addition, upon certain changes in circumstance, which impact our revenue by an increase or decrease of fifty percent or more under our IT Services Agreement, the Master Operating Agreement requires good faith renegotiations of the terms of our relationship with UBS. We may terminate the Master Operating Agreement and our IT Services Agreement for cause, nonpayment by UBS, insolvency or bankruptcy of UBS, or certain cross-defaults (which may occur upon termination of another agreement between us and UBS). UBS may terminate the Master Operating Agreement and our IT Services Agreement for cause, our insolvency or bankruptcy, a change in control of us, our failure to continue to generally provide IT services, upon certain significant events and acquisitions of UBS, our noncompliance with UBS s security procedures, certain cross-defaults (which may occur upon termination of another agreement between us and UBS, except for agreements between TSI and UBS), and upon certain recoveries by UBS and its affiliates for our gross negligence or willful misconduct for which we do not agree to increase the contractual limit on our liability to UBS and its affiliates. Compensation, pricing, and costs are addressed in our IT Services Agreement.

IT Services Agreement

We provide services to UBS Warburg and other UBS business units under the IT Services Agreement, which is formally known as the Second Amended and Restated Agreement for EPI Operational Management Services dated June 28, 1998, and as amended as of September 15, 2000. The IT Services Agreement requires that UBS obtain from us UBS Warburg s requirements for the operational management of its technology resources (including mainframes, desktops, and voice and data networks), excluding hardware and proprietary software applications development and general network services. The term of the IT Services Agreement is 11 years, which began January 1, 1996. Our charges for services provided under the IT Services Agreement are generally based on reimbursement of all costs, other than corporate overhead, we incur in the performance of services for UBS Warburg. In addition, we receive an annual fee, as adjusted each year for inflation, and we are subject to bonuses and penalties of up to 13% of such fee based on our performance. The IT Services Agreement provides that UBS will determine any bonus or penalty based on a good faith assessment of our performance as measured using many objective and subjective criteria, including service quality, product delivery, business user satisfaction, cost effectiveness, and corporate level support.

We earned approximately 16.6%, 18.7% and 24.1% of our revenue in connection with services performed on behalf of UBS and its affiliates for 2003, 2002, and 2001, respectively. During these three years the amount of annual gross profit that we have earned from UBS and its affiliates has ranged from $44.2 million to $50.2 million.

Project Services Agreement

Pursuant to the Master Project Agreement dated January 1, 1996, which establishes the standard terms and conditions of projects between UBS and us, we undertake specific projects for UBS. This Project Services Agreement commenced on January 1, 1996 and may be terminated only by mutual agreement between UBS and us until January 1, 2021, when either party by giving sixty days notice may unilaterally terminate the Project Services Agreement. Each separate project under the Project Services Agreement requires a separate project agreement to be executed and may contain a separate pricing methodology based on time and materials, fixed units or a fixed price, and may include a bonus mechanism based on cost savings, performance, deliverables achievement, or any other agreed mechanism. The default pricing mechanism is based on our costs plus 26.5% with a possible bonus of up to 50%.

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Equity Interests

Under the Amended and Restated PSC Stock Option and Purchase Agreement, we sold UBS 100,000 shares of our Class B Common Stock for $3.65 a share and 7,234,320 options to purchase shares of Class B Common Stock for $1.125 an option. Shares of the Class B Common Stock are convertible, on a share for share basis, into our Class A Common Stock for the purpose of sales to non-affiliates of UBS. UBS can exercise these options at any time for $3.65 a share, subject to United States bank regulatory limits on UBS s shareholdings. UBS exercised options to purchase 700,008, 3,391,680, 850,000 and 834,320 shares of Class B Common Stock in 2003, 2002, 1999 and 1998, respectively. In addition to other limits, UBS and its employees may not own a number of shares of Class B Common Stock in excess of 10% of the number of shares of outstanding Common Stock. Once the underlying shares of Class B Common Stock vest, the corresponding UBS options are void unless UBS exercises those options within five years of such vesting. This five-year period is tolled at any time when bank regulatory limits prohibit UBS from acquiring the shares.

Beginning on January 1, 1997, the shares of our Class B Common Stock subject to the UBS Options vested at a rate of 63,906 shares per month until January 1, 2002. The remaining shares vest at a rate of 58,334 per month until the IT Services Agreement terminates. Upon termination of the IT Services Agreement, we have the right to buy back any previously acquired unvested shares of our Class B Common Stock for the original purchase price of $3.65 per share. The UBS Options with respect to unvested shares of our Class B Common Stock would become void upon such a termination.

UBS cannot transfer these options. Subject to exceptions relating to transfers to UBS affiliates and transfers in connection with widely dispersed offerings or transactions that comply with Rule 144 under the Securities Act of 1933, as amended, UBS must first offer its shares to us before transferring any shares of our Class B Common Stock. UBS converted 1,050,012 shares of Class B Common Stock to shares of Class A Common Stock in 2003. Since the beginning of the agreement, UBS has converted 2,834,332 shares of Class B Common Stock to shares of Class A Common Stock.

Competition

We operate in extremely competitive markets, and the technology required to meet our customers needs changes. In all of our segments we frequently compete with companies that have greater financial resources; more technical, sales, and marketing capacity; and larger customer bases than we do. Because many of the factors on which we compete, as discussed below, are outside of our control, we cannot be sure that we will be successful in the markets in which we compete. If we fail to compete successfully against our competitors, our business, financial condition, and results of operations will be materially and adversely affected.

IT Solutions

Our IT Solutions segment competes with a number of different information technology service providers depending upon the region, country, and/or market we are addressing. Some of our more frequent competitors include: Accenture Ltd., Affiliated Computer Services, Inc., Cap Gemini Ernst & Young, CGI Group, Inc., Computer Sciences Corporation, Electronic Data Systems Corporation, Hewlett Packard Company, IBM Global Services (a division of International Business Machines Corporation), McKesson Corporation, and Siemens Business Services, Inc. As we enter new markets, we expect to encounter additional competitors. Our IT Solutions segment competes on the basis of a number of factors, including the attractiveness and breadth of the business strategy and services that we offer, pricing, technological innovation, quality of service, ability to invest in or acquire assets of potential customers, and our scale in certain industries. In addition, we frequently compete with our customers own internal information technology capability, which may constitute a fixed cost for our customer. This may increase pricing pressure on us.

Government Services

Our Government Services segment competes with a number of different information technology service providers depending upon the federal agency or department as well as the market we are addressing. Some of our more frequent competitors include: Accenture Ltd., Affiliated Computer Services, Inc., Anteon International Corporation,

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BearingPoint, Inc., Booz-Allen and Hamilton, CACI International, Inc., Cap Gemini Ernst & Young, Computer Sciences Corporation, Electronic Data Systems Corporation, General Dynamics, Lockheed Martin Corporation, Northrop Grumman Corporation, Science Applications International Corporation, SRA International, and Unisys Corporation. We compete on the basis of a number of factors, including the attractiveness and breadth of the business strategy and professional services that we offer, pricing, technological innovation and quality of service. We must frequently compete in federal and defense programs with declining budgets, which creates pressure to lower our prices.

Consulting

Our Consulting segment competes with a number of different consulting practices including large consulting firms such as Accenture Ltd., BearingPoint, Inc., Cap Gemini Ernst & Young, Cognizant Technology Solutions Corporation, Computer Sciences Corporation, and Wipro Limited; smaller consulting firms with industry expertise in areas such as healthcare or financial services, and the consulting divisions of large systems integrators and IT services providers. We compete on many factors, including price, industry expertise, our process methodologies and intellectual property, and our past successes in executing assignments. The market for consulting services is affected by an oversupply of consulting talent, both domestically and offshore, which results in downward price pressure for our services. Emerging offshore development capacity in countries such as India and China is also increasing the degree of competition for our consulting services generally and for our software development services in particular.

Financial Information About Foreign and Domestic Operations

See Note 13, Segment and Certain Geographic Data, to the Consolidated Financial Statements included elsewhere in this report.

Intellectual Property

While we attempt to retain intellectual property rights arising from customer engagements, our customers often have the contractual right to such intellectual property. We rely on a combination of nondisclosure and other contractual arrangements and trade secret, copyright, and trademark laws to protect our proprietary rights and the proprietary rights of third parties from whom we license intellectual property. We enter into confidentiality agreements with our associates and limit distribution of proprietary information. There can be no assurance that the steps we take in this regard will be adequate to deter misappropriation of proprietary information or that we will be able to detect unauthorized use and take appropriate steps to enforce our intellectual property rights.

We license the right to use the names Perot Systems and Perot in our current and future businesses, products, or services from the Perot Systems Family Corporation and Ross Perot, our Chairman. The license is a non-exclusive, royalty-free, worldwide, non-transferable license. We may also sublicense our rights to the Perot name to some of our affiliates. Under the license agreement, either party may, in its sole discretion, terminate the license at any time, with or without cause and without penalty, by giving the other party written notice of such termination. Upon termination by either party, we must discontinue all use of the Perot name within one year following notice of termination. The termination of this license agreement could materially and adversely affect our business, financial condition, and results of operations. Except for the license of our name, we do not believe that any particular copyright, trademark, or group of copyrights and trademarks is of material importance to our business taken as a whole.

Risk Factors

An investment in our Class A common stock involves a high degree of risk. You should carefully consider the following risk factors in evaluating an investment in our common stock. The risks described below are not the only *ones that we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the following risks actually occurs, our business, financial condition, or results of operations could be materially and adversely affected. In such case, the trading price of our Class A common stock could decline, and you may lose all or part of your investment. You should also refer to the other information set forth in this report, including our Consolidated Financial Statements and the related notes.*

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Our outsourcing agreement with UBS, the largest of our UBS agreements, ends in January 2007, which we expect to result in the loss of a substantial majority of revenue and profits from our UBS relationship

Our largest customer is UBS. During 2003, our UBS relationship generated $242.0 million, or 16.6% of our revenue, which is a decline of $7.8 million from 2002 revenue of $249.8 million.

Our business with UBS is governed by two primary agreements that define the services that we provide and the terms under which those services are provided.

The outsourcing agreement with UBS that covers the substantial majority of our business with UBS entitles us to recover our costs plus a fixed fee, with a bonus or penalty that can cause this annual fee to vary up and down by as much as 13%, depending on our level of performance as determined by UBS. We also provide additional project services to UBS. As a result, the revenue and gross profit that we derive from our UBS relationship depends on our performance and on the level of services we provide to UBS. The annual amount of gross profit that we have earned from UBS has ranged from $44.2 million to $50.2 million during the three years ended December 31, 2003.

We separately provide offshore services to UBS through our subsidiary, Perot Systems TSI. Prior to our acquisition of Perot Systems TSI and its subsequent consolidation on December 31, 2003, we did not consolidate the financial results of Perot Systems TSI. UBS is also Perot Systems TSI s largest customer.

The outsourcing agreement under which we provide most of our services to UBS expires on January 1, 2007, which is expected to result in the loss of a substantial majority of the revenues and profits from UBS. The impact of the expiration of the outsourcing agreement on our profits will be based in part on our ability to reduce our costs. We expect that the expiration of the outsourcing agreement likely will have a disproportionately large effect on our profitability compared to the effect on our revenues.

Revenue and profit from our contract with UBS may substantially vary between periods because it depends on the amount and quality of the services we provide

Revenue that we derive from our UBS relationship depends upon the level of services we perform, which may vary from period to period depending on UBS s requirements. In addition, the agreement with UBS that covers most of our business with UBS entitles us to recover our costs plus an annual fee, with a bonus or penalty that can cause this annual fee to vary up or down by as much as 13%, depending on our level of performance as determined by UBS. Determination of whether our performance merits a bonus or a penalty depends on many objective and subjective factors, including service quality, product delivery, customer satisfaction, cost effectiveness, and corporate level support. To the extent that UBS determines to diminish our annual fee in any given year, our profitability will be adversely affected.

We may bear the risk of cost overruns under custom software development contracts, and, as a result, cost overruns could adversely affect our profitability

We develop custom software applications for some of our customers. The effort and cost associated with the completion of a software development project is difficult to estimate and, in some cases, may significantly exceed the estimate made at the time we begin the project. We provide most of our software development projects under level-of-effort contracts, usually based on time and materials or direct costs plus a fee. Under those arrangements, we are able to bill our customer based on the actual cost of completing the software development project, even if the ultimate cost of the project exceeds our initial estimates. However, if the ultimate cost exceeds our initial estimate by a significant amount, we may have difficulty collecting the full amount that we are due under the contract, depending upon many factors, including the reasons for the increase in cost, our communication with the customer throughout the project and the customer s satisfaction with the developed software. As a result, we could incur losses with respect to software development projects even when they are priced on a level-of-effort basis. For example, during the three months ended June 30, 2003, we exited an under-performing contract that included a software development project in which the actual development costs were expected to exceed the estimated costs as stated in the contract. While the contract provided for us to collect most of the excess of the actual cost over the estimate in the contract, we expected to incur a loss on the software development project beginning in 2002. In the first quarter

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of 2003, we recorded approximately $19.5 million of expense related to the excess of the actual cost over the estimate in the contract (approximately $12.1 million, net of the applicable income tax benefit), which was included in the cumulative effect of change in accounting principle relating to our adoption of EITF 00-21. In the second quarter of 2003, we and our client were unable to reach agreement on the timing and form of payment for the excess, and we recorded an additional $17.7 million of expense in direct cost of services related to this software development project. If we provide a software development project under a fixed-price contract, we bear all the risk that the ultimate cost of the project will exceed the price to be charged to the customer.

We are currently not aware of any situation that is likely to result in material, non-recoverable cost overruns; however, we are not able to predict the probability of future material non-recoverable cost overruns. Accordingly, there is a risk that we will have material non-recoverable cost overruns in the future.

Our five largest customers account for a substantial portion of our revenue and profits, and the loss of any of these customers could result in decreased revenues and profits

Our five largest customers accounted for approximately 41.2% of our revenue for 2003 and approximately 46.4% of our revenue in 2002. UBS was the only customer that accounted for more than 10% of our revenue for 2003 and 2002. After UBS our next four largest customers accounted for approximately 24.6% of our revenue in 2003 and 27.7% of our revenue in 2002. Our primary relationship with each of our five largest customers consists of a long-term outsource revenue contract with a term extending at least through 2006. If we were to lose one of these major customers, our revenues would generally be materially decreased and our profits would be less. Generally, we may lose a customer as a result of a merger or acquisition, contract expiration, the selection of another provider of information technology services, business failure or bankruptcy, or our performance. These contracts typically require us to maintain specified performance levels with respect to the services that we deliver to our customer, with the result that if we fail to perform at the specified levels, we may be required to pay or credit the customer with amounts specified in the contract. In the event of significant failures to deliver the services at the specified levels, a number of these contracts provide that the customer has the right to terminate the agreement. In addition, some of these contracts provide the customer the right to terminate the contract at the customer s convenience. The customer s right to terminate for convenience typically requires the customer to pay us fees to cover costs that we have incurred but not recovered and an amount that results in the recovery of a portion of profit we had expected to earn over the term of the contract. We may not retain long-term relationships or secure renewals of short-term relationships with our major customers in the future.

We are currently evaluating ways that we can provide our second largest customer with increased cost efficiencies. As part of this process, we are evaluating potential increases and decreases to the scope of services we provide, ways to reduce costs, and may look to restructure payment terms. Although we cannot currently predict the impact of any change in our relationship, the actions we are contemplating could lead to reduced near-term cash flow and earnings, with some or all of this potentially being recovered in future years.

If entities we acquire fail to perform in accordance with our expectations or if their liabilities exceed our expectations, our profits per share could be diminished and our financial results could be adversely affected

In connection with any acquisition we make, there may be liabilities that we fail to discover or that we inadequately assess. To the extent that the acquired entity failed to fulfill any of its contractual obligations, we may be financially responsible for these failures or otherwise be adversely affected. In addition, acquired entities may not perform according to the forecasts that we used to determine the price paid for the acquisition. If the acquired entity fails to achieve these forecasts, our financial condition and operating results may be adversely affected.

Our software development products may cost more than we initially project, encounter delays, or fail to perform well in the market, which could decrease our profits

Our business has risks associated with the development of software products. There is the risk that capitalized costs of development may not be fully recovered if the market for our products or the ability of our products to capture a portion of the market differs materially from our estimates. In addition, there is the risk that the cost of product development differs materially from our estimates or a delay in product introduction may reduce the portion of the market captured by our product.

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Our financial results are materially affected by a number of economic and business factors

Our financial results are materially affected by a number of factors, including broad economic conditions, the amount and type of technology spending that our customers undertake, and the business strategies and financial condition of our customers and the industries we serve, which could result in increases or decreases in the amount of services that we provide to our customers and the pricing of such services. Our ability to identify and effectively respond to these factors is important to our future financial and growth position. Each of our three major lines of business has distinct economic factors, business trends, and risks that could have a materially adverse affect on our results of operations and financial condition.

If we are unable to successfully integrate acquired entities, our profits may be less and our operations more costly or less efficient

We have completed several acquisitions in recent years and we will continue to analyze and consider potential acquisition candidates. Acquisitions involve significant risks, including the following:

- companies we acquire may have a lower quality of internal controls and reporting standards, which could cause us to incur expenses to increase the effectiveness and quality of the acquired company s internal controls and reporting standards;

- we may have difficulty integrating the systems and operations of acquired businesses, which may increase anticipated expenses relating to integrating our business with the acquired company s business and delay or reduce full benefits that we anticipate from the acquisition;

- integration of an acquired business may divert our attention from normal daily operations of the business, which may adversely affect our management, financial condition, and profits; and

- we may not be able to retain key employees of the acquired business, which may delay or reduce the full benefits that we anticipate from the acquisition and increase costs anticipated to integrate and manage the acquired company.

Our contracts generally contain provisions that could allow customers to terminate the contracts, decreasing our revenue and profits and potentially damaging our business reputation

Our contracts with customers generally permit termination in the event our performance is not consistent with service levels specified in those contracts. The ability of our customers to terminate contracts creates an uncertain revenue and profit stream. If customers are not satisfied with our level of performance, our reputation in the industry may suffer, which may also adversely affect our ability to market our services to other customers.

Some contracts contain fixed-price provisions or penalties that could result in decreased profits

Some of our contracts contain pricing provisions that require the payment of a set fee by the customer for our services regardless of the costs we incur in performing these services, or provide for penalties in the event we fail to achieve certain contract standards. In such situations, we are exposed to the risk that we will incur significant unforeseen costs or such penalties in performing the contract.

Fluctuations in currency exchange rates may adversely affect the profitability of our foreign operations

Fluctuations in currency exchange rates may adversely affect the profitability of our foreign operations. For instance, with respect to most of our Indian operations, our customers pay us in their local currency (typically Euros or U.S.

Dollars), but our costs are primarily incurred in Indian Rupees. Therefore, if the Rupee increases in strength against these local currencies, our profits from our Indian operations would be adversely affected. To attempt to mitigate the effects of foreign currency fluctuations, we sometimes use forward exchange contracts and other hedging techniques. However, we do not currently have such hedges in place with respect to most of our contracts that are being performed in India.

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Our international operations expose our assets to increased risks and could result in business loss or in more expensive or less efficient operations

We have operations in many countries around the world. In addition to the risks related to fluctuations in currency exchange rates discussed in the immediately preceding risk factor and the additional risk associated with doing business in India discussed in the immediately following risk factor, risks that affect these international operations include:

- complicated licensing and work permit requirements may hinder our ability to operate in some jurisdictions;
- our intellectual property rights may not be well protected in some jurisdictions;
- our operations may be vulnerable to terrorist actions or harmed by government responses;
- governments may restrict our ability to convert currencies; and
- additional expenses and risks inherent in conducting operations in geographically distant locations, with customers speaking different languages and having different cultural approaches to the conduct of business.

We have a significant business presence in India, and risks associated with doing business there could decrease our revenue and profits

In December 2003, we, through a wholly owned subsidiary, completed the acquisition from HCL Technologies Limited, a corporation formed in India, of all of their interest in HCL Perot Systems B.V., a joint venture entity formed by us and HCL in 1996, for approximately $99.4 million (including acquisition costs and net of $12.1 million of cash acquired). Subsequently, we changed the name to Perot Systems TSI B.V. In addition to the risks regarding fluctuations in currency exchange rates and regarding international operations discussed in the two immediately preceding risk factors, the following risks associated with doing business in India could decrease our revenue and profits:

- governments could enact legislation that restricts the provision of services from offshore locations;
- difficulty in staffing and managing operations in India;
- difficulties in collecting accounts receivable;
- developments between the nations of India and Pakistan regarding the threat of war;
- potential wage increases in India which could prevent us from maintaining our competitive advantage; and
- cost increases if the Government of India reduces or withholds tax benefits and other incentives provided to us.

Our government contracts contain early termination and reimbursement provisions that may adversely affect our revenue and profits

Perot Systems Government Services provides services as a contractor and subcontractor on various projects with U.S. government entities. Despite the fact that a number of government projects for which we serve as a contractor or subcontractor are planned as multi-year projects, the U.S. government normally funds these projects on an annual or more frequent basis. Generally, the government has the right to change the scope of, or terminate, these projects at its convenience. The termination or a major reduction in the scope of a major government project could have a material adverse effect on our results of operations and financial condition. Approximately 99% of the revenue from the

Government Services segment in 2003 is from contracts with the U.S. government.

U.S. government entities audit our contract costs, including allocated indirect costs, or conduct inquiries and investigations of our business practices with respect to our government contracts. If the government finds that we improperly charged any costs to a contract, the costs are not reimbursable or, if already reimbursed, the cost must be refunded to the government. If the government discovers improper or illegal activities in the course of audits or investigations, the contractor may be subject to various civil and criminal penalties and administrative sanctions, which may include termination of contracts, forfeiture of profits, suspension of payments, fines and suspensions or debarment from doing business with the U.S. government. These government remedies could have a material adverse effect on our results of operations and financial condition.

If customers reduce spending that is currently above contractual minimums, our revenues and profits could diminish

Some of our outsourcing customers request services in excess of the minimum level of services required by the contract. These services are often in the form of project work and are discretionary to our customers. Our customers ability to continue discretionary project spending may depend on a number of factors including, but not limited to, their financial condition, and industry and strategic direction. Spending above contractual minimums by customers could end with limited notice and result in lower revenue and earnings.

If we fail to compete successfully in the highly competitive markets in which we operate, our business, financial condition, and results of operations will be materially and adversely affected

As described in more detail in the bullet points below, we operate in extremely competitive markets, and the technology required to meet our customers needs changes. In all of our segments we frequently compete with companies that have greater financial resources; more technical, sales, and marketing capacity; and larger customer bases than we do. Because many of the factors on which we compete, as discussed below, are outside of our control, we cannot be sure that we will be successful in the markets in which we compete. If we fail to compete successfully against our competitors, our business, financial condition, and results of operations will be materially and adversely affected.

IT Solutions. Our IT Solutions segment competes with a number of different information technology service providers depending upon the region, country, and/or market we are addressing. Some of our more frequent competitors include: Accenture Ltd., Affiliated Computer Services, Inc., Cap Gemini Ernst & Young, CGI Group, Inc., Computer Sciences Corporation, Electronic Data Systems Corporation, Hewlett Packard Company, IBM Global Services (a division of International Business Machines Corporation), McKesson Corporation, and Siemens Business Services, Inc. As we enter new markets, we expect to encounter additional competitors. Our IT Solutions segment competes on the basis of a number of factors, including the attractiveness and breadth of the business strategy and services that we offer, pricing, technological innovation, quality of service, ability to invest in or acquire assets of potential customers and our scale in certain industries. In addition, we frequently compete with our customers own internal information technology capability, which may constitute a fixed cost for our customer. This may increase pricing pressure on us.

Government Services. Our Government Services segment competes with a number of different information technology service providers depending upon the federal agency or department as well as the market we are addressing. Some of our more frequent competitors include: Accenture Ltd., Affiliated Computer Services, Inc., Anteon International Corporation, BearingPoint, Inc., Booz-Allen and Hamilton, CACI International, Inc., Cap Gemini Ernst & Young, Computer Sciences Corporation, Electronic Data Systems Corporation, General Dynamics, Lockheed Martin Corporation, Northrop Grumman Corporation, Science Applications International Corporation, SRA International, and Unisys Corporation. We compete on the basis of a number of factors, including the attractiveness and breadth of the business strategy and professional services that we offer, pricing, technological innovation and quality of service. We must frequently compete in federal and defense programs with declining budgets, which creates pressure to lower our prices.

Consulting. Our Consulting segment competes with a number of different consulting practices including large consulting firms such as Accenture Ltd., BearingPoint, Inc., Cap Gemini Ernst & Young, Cognizant Technology Solutions Corporation, Computer Sciences Corporation, and Wipro Limited; smaller consulting firms with industry expertise in areas such as healthcare or financial services, and the consulting divisions of large systems integrators and information technology service providers. We compete on many factors, including price, industry expertise, our process methodologies and intellectual property, and our past successes in executing assignments. The market for consulting services is affected by an oversupply of consulting talent, both domestically and offshore, which results in downward price pressure for our services. Emerging offshore development capacity in countries such as India and China is also increasing the degree of competition for our consulting services generally and for our software development services in particular.

Increasingly complex regulatory environments may increase our costs

Our customers are subject to complex and constantly changing regulatory environments. These regulatory environments change and in ways that cannot be predicted. For example, our financial services clients are subject to domestic and foreign privacy and electronic record handling rules and regulations, and our clients in the health care industry have been made subject to increasingly complex and pervasive privacy laws and regulations. These regulations may increase our potential liabilities if our services contribute to a failure by our clients to comply with the regulatory regime and may increase the cost to comply as regulatory requirements increase or change.

Our quarterly operating results may vary

We expect our revenue and operating results to vary from quarter to quarter. Such variations are likely to be caused by many factors that are, to some extent, outside our control, including:

- mix and timing of customer projects;
- completing customer projects;
- hiring, integrating, and utilizing associates;
- timing of new contracts;
- issuance of common shares and options to associates; and
- costs to exit certain activities.

Accordingly, we believe that quarter-to-quarter comparisons of operating results for preceding quarters are not necessarily meaningful. You should not rely on the results of one quarter as an indication of our future performance.

Loss of key personnel could adversely affect our ability to attract and retain business

Our success depends in part on the skills, experience, and performance of some key members of our management, including our Chairman, Ross Perot, and our President and Chief Executive Officer, Ross Perot, Jr. The loss of any key member of our management may materially and adversely affect our ability to attract or retain business with the effect of adversely affecting our business, financial condition, and results of operations.

Changes in technology could adversely affect our competitiveness, revenue, and profit

The markets for our information technology services change rapidly because of technological innovation, new product introductions, changes in customer requirements, declining prices, and evolving industry standards, among other factors. New products and new technology often render existing information services or technology infrastructure obsolete, excessively costly, or otherwise unmarketable. As a result, our success depends on our ability to timely innovate and integrate new technologies into our service offerings. We cannot guarantee that we will be successful at adopting and integrating new technologies into our service offerings in a timely manner.

Ross Perot has substantial control over any major corporate action

Ross Perot, our Chairman, is the managing general partner of HWGA, Ltd., a partnership that owned 31,705,000 shares of our Class A common stock as of December 31, 2003. Mr. Perot also beneficially owns 54,100 shares of our Class A common stock. Accordingly, Mr. Perot, primarily through HWGA, Ltd., controls approximately 28% of our outstanding voting common stock. As a result, Mr. Perot, through HWGA, Ltd., effectively has the power to block corporate actions such as an amendment to our Certificate of Incorporation, a change of control or the sale of all or substantially all of our assets. In addition, Mr. Perot may significantly influence the election of directors and any other action requiring stockholder approval. The other general partner of HWGA, Ltd. is Ross Perot, Jr., our President and Chief Executive Officer, who has the authority to manage the partnership and direct the voting or sale of the shares of our Class A common stock held by HWGA, Ltd. if Mr. Perot is no longer the managing general partner.

We could lose rights to our company name, which may adversely affect our ability to market our services

We do not own the right to our company name. In 1988, we entered into a license agreement with Ross Perot, our Chairman, and the Perot Systems Family Corporation that allows us to use the name Perot and Perot Systems in our business on a royalty-free basis. Mr. Perot and the Perot Systems Family Corporation may terminate this agreement at any time and for any reason. Beginning one year following such a termination, we would not be allowed to use the names Perot or Perot Systems in our business. Mr. Perot s or the Perot Systems Family Corporation s termination of our license agreement could materially and adversely affect our ability to attract and retain customers, which could have a material adverse affect on our business, financial condition, and results of operations.

Failure to recruit, train, and retain technically skilled personnel could increase costs or limit growth

We must continue to hire and train technically skilled people in order to perform services under our existing contracts and new contracts into which we will enter. The people capable of filling these positions have historically been in great demand, and recruiting and training such personnel requires substantial resources. We may be required to pay an increasing amount to hire and retain a technically skilled workforce. In addition, during periods in which demand for technically skilled resources is great, our business may experience significant turnover. These factors could create variations and uncertainties in our compensation expense and efficiencies that could directly affect our profits. If we fail to recruit, train, and retain sufficient numbers of these technically skilled people, our business, financial condition, and results of operations may be materially and adversely affected.

Alleged or actual infringement of intellectual property rights could result in substantial additional costs

Our suppliers, customers, competitors and others may have or obtain patents and other proprietary rights that cover technology we employ. We are not, and cannot be, aware of all patents or other intellectual property rights of which our services may pose a risk of infringement. Others asserting rights against us could force us to defend ourselves or our customers against alleged infringement of intellectual property rights. We could incur substantial costs to prosecute or defend any intellectual property litigation and we could be forced to do one or more of the following:

- cease selling or using products or services that incorporate the disputed technology;
- obtain from the holder of the infringed intellectual property right a license to sell or use the relevant technology; or
- redesign those services or products that incorporate such technology.

Provisions of our certificate of incorporation, bylaws, stockholders rights plan and Delaware law could deter takeover attempts

Our Board of Directors may issue up to 5,000,000 shares of preferred stock and may determine the price, rights, preferences, privileges, and restrictions, including voting and conversion rights, of these shares of preferred stock without any further vote or action by our stockholders. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may make it more difficult for a third party to acquire a majority of our outstanding voting stock.

In addition, we have adopted a stockholders rights plan. Under this plan, after the occurrence of specified events that may result in a change of control, our stockholders will be able to buy stock from us or our successor at half the then current market price. These rights will not extend, however, to persons participating in takeover attempts without the consent of our Board of Directors or that our Board of Directors determines to be adverse to the interests of the stockholders. Accordingly, this plan could deter takeover attempts.

Some provisions of our Certificate of Incorporation and Bylaws and of Delaware General Corporation Law could also delay, prevent, or make more difficult a merger, tender offer, or proxy contest involving our company. Among other things, these provisions:

- require a 66 2/3% vote of the stockholders to amend our Certificate of Incorporation or approve any merger or sale, lease, or exchange of all or substantially all of our property and assets;
- require an 80% vote for stockholders to amend our Bylaws;
- require advance notice for stockholder proposals and director nominations to be considered at a vote of a meeting of stockholders;
- permit only our Chairman, President, or a majority of our Board of Directors to call stockholder meetings, unless our Board of Directors otherwise approves;
- prohibit actions by stockholders without a meeting, unless our Board of Directors otherwise approves; and
- limit transactions between our company and persons that acquire significant amounts of stock without approval of our Board of Directors.

Our Website and Availability of SEC Reports and Corporate Governance Documents

Our Internet address is www.perotsystems.com and the investor relations section of our web site is located at www.perotsystems.com/investors. We make available free of charge, on or through the investor relations section of our web site, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Also, posted on our corporate responsibility section of our website (located at www.perotsystems.com/responsibility.htm), and available in print upon request of any shareholder to our Investor Relations Department, are our charters for our Audit Committee, Compensation Committee and Nominating and Governance Committee, as well as our Standards & Ethical Principles and our Corporate Governance Guidelines (which include our Director Qualification Guidelines and Director Independence Standards). Within the time period required by the SEC and the New York Stock Exchange, we will post on our website any amendment to the Standards & Ethical Principles and any waiver applicable to our executive officers or directors.

Item 2. ***Properties***

As of December 31, 2003, we had offices in approximately 90 locations in the United States and seven countries outside the United States. Our office space and other facilities cover approximately 2,200,000 square feet. The majority of our buildings are leased, including a lease with a variable interest entity for our corporate headquarters located in Plano, Texas, which includes office space and our data center operations. Our IT Solutions segment uses the corporate headquarters facility and data center. The Government and Consulting segments do not make any significant use of the facility.

As discussed below in Accounting Standards Issued, in January 2003, the Financial Accounting Standards Board issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities. Upon adoption of FIN 46 on

December 31, 2003, we consolidated the variable interest entity, which resulted in us recording the land and buildings of our Plano facility, as well as the related long-term debt, on our consolidated balance sheets. Our leases have expiration dates ranging from 2004 to 2013. Upon expiration of our leases, we do not anticipate any significant difficulty in obtaining renewals or alternative space.

In addition to these properties, we also occupy office space at customer locations throughout the world. We generally occupy this space under the terms of the agreement with the particular customer. We believe that our

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current facilities are suitable and adequate for our business.

We have commitments related to data processing facilities, office space, and computer equipment under non-cancelable operating leases and fixed maintenance agreements for remaining periods ranging from one to twelve years. We have disclosed future minimum commitments under these agreements as of December 31, 2003, in Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 14, Commitments and Contingencies, to the Consolidated Financial Statements which are included elsewhere in this report.

Item 3. *Legal Proceedings*

We are, from time to time, involved in various litigation matters arising in the ordinary course of our business. We believe that the outcome of these litigation matters, either individually or taken as a whole, will not have a material adverse effect on our consolidated financial condition, results of operations or cash flows.

IPO Allocation Securities Litigation

In July and August 2001, we, as well as some of our current and former officers and the investment banks that underwrote our initial public offering, were named as defendants in two purported class action lawsuits. These lawsuits, Seth Abrams v. Perot Systems Corp. et al. and Adrian Chin v. Perot Systems, Inc. et al., were filed in the United States District Court for the Southern District of New York. The suits allege violations of Rule 10b-5, promulgated under the Securities Exchange Act of 1934, and Sections 11, 12(a)(2) and 15 of the Securities Act of 1933. Approximately 300 issuers and 40 investment banks have been sued in similar cases. The suits against the issuers and underwriters have been consolidated for pretrial purposes in the IPO Allocation Securities Litigation. The lawsuit involving us focuses on alleged improper practices by the investment banks in connection with our initial public offering in February 1999. The plaintiffs allege that the investment banks, in exchange for allocating public offering shares to their customers, received undisclosed commissions from their customers on the purchase of securities and required their customers to purchase additional shares in aftermarket trading. The lawsuit also alleges that we should have disclosed in our public offering prospectus the alleged practices of the investment banks, whether or not we were aware that the practices were occurring. We believe the claims against us are without merit, and we will vigorously defend ourselves in this case.

During 2002, the current and former officers and directors of Perot Systems Corporation that were individually named in the lawsuits referred to above were dismissed from the cases. In exchange for the dismissal, the individual defendants entered agreements with the plaintiffs that toll the running of the statute of limitations and permit the plaintiffs to refile claims against them in the future. In February 2003, in response to the defendant s motion to dismiss, the court dismissed the plaintiffs Rule 10b-5 claims against us, but did not dismiss the remaining claims.

We have accepted a settlement proposal presented to all issuer defendants. Pursuant to the proposed settlement, plaintiffs would dismiss and release all claims against us and our current and former officers and directors, in exchange for an assurance by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases that the plaintiffs will achieve a minimum recovery (including amounts recovered from the underwriters), and for the assignment or surrender of certain claims we may have against the underwriters. We would not be required to make any cash payment with respect to the settlement. The proposed settlement requires approval of an unspecified percentage of issuers. The proposed settlement would also require court approval, which cannot be assured. In the event that the settlement is not completed, we will continue to vigorously defend ourselves in this case.

Litigation Relating to the California Energy Market

In June 2002, we were named as a defendant in a purported class action lawsuit that alleges that we conspired with energy traders to manipulate the California energy market. This lawsuit, Art Madrid v. Perot Systems Corporation et al., was filed in the Superior Court of California, County of San Diego. The case is currently pending in the Superior Court for the County of Sacramento. In September 2003, we filed a demurrer to the complaint and an alternative motion to strike all claims for monetary relief. In January 2004, the court granted our demurrer and did not grant the plaintiffs leave to amend their complaint. The plaintiffs, however, have the right to appeal.

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In June, July and August 2002, Perot Systems, Ross Perot and Ross Perot, Jr., were named as defendants in eight purported class action lawsuits that allege violations of Rule 10b-5, and, in some of the cases, common law fraud. These suits allege that our filings with the Securities and Exchange Commission contained material misstatements or omissions of material facts with respect to our activities related to the California energy market. All of these eight cases have been consolidated in the Northern District of Texas, Dallas Division in the case of Vincent Milano vs. Perot Systems Corporation. The plaintiffs in this case filed a consolidated amended complaint in July 2003. The plaintiffs are seeking unspecified monetary damages, interest, attorneys fees and costs. In October 2003, we moved to dismiss the amended complaint with prejudice. The plaintiffs have filed an opposition to our motion.

In 1997 and 1998, pursuant to a consulting contract with the California Independent Systems Operator, we assisted in implementing the operating systems for California s newly deregulated wholesale electricity markets. The consolidated amended complaint in these federal court securities class actions alleges that the statements in our public filings and statements were fraudulently misleading, because we did not disclose to investors that (1) we allegedly advocated improper bidding practices to our customers in the California wholesale electricity markets and (2) in October 1997, the California ISO sent a letter to us accusing us of wrongfully using confidential information in our 1997-1998 marketing efforts. We believe that the claims against us are without merit and will vigorously defend ourselves in these cases.

Item 4. ***Submission of Matters to a Vote of Security Holders***

We did not submit any matters to a vote of our security holders during the fourth quarter of the fiscal year ended December 31, 2003.

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PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities***

Our Class A Common Stock is traded on the New York Stock Exchange (the NYSE) under the symbol PER. The table below shows the range of reported per share sales prices for each quarterly period within the two most recent fiscal years.

	High	Low
2002		
First Quarter.	$20.75	$16.08
Second Quarter	20.20	10.45
Third Quarter.	12.63	9.01
Fourth Quarter	11.80	8.21
2003		
First Quarter.	$11.63	$ 8.99
Second Quarter	12.23	9.85
Third Quarter.	11.87	9.67
Fourth Quarter	14.45	10.04

The last reported sale price of the Class A Common Stock on the NYSE on February 27, 2004 was $13.82 per share. As of February 27, 2004, the approximate number of record holders of Class A Common Stock was 3,081. All of our Class B Common Stock is held by UBS.

We have never paid cash dividends on shares of our Class A Common Stock and have no current intention of paying such dividends in the future.

The following table gives information about our Class A Common Stock that may be issued under our equity compensation plans as of December 31, 2003. See Note 10, Stock Awards and Options, to the Consolidated Financial Statements included herein for information regarding the material features of these plans.

Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))

	(a)	(b)	(c)
Equity compensation plans approved by security holders	8,172,864(1)	$ 13.27	42,846,559(2)
Equity compensation plans not approved by security holders	24,733,891	$ 14.12	472,000(3)
Total	32,906,755	$ 13.99	43,318,559

(1) Excludes 206,925 shares of restricted stock that were granted during 2003 under the 2001 Long-Term Incentive Plan.

(2) Includes 25,274,434 shares under the 2001 Long-Term Incentive Plan and 17,572,125 shares under the 1999 Employee Stock Purchase Plan.

(3) Includes 472,000 shares under the 1996 Non-Employee Director Stock Option/Restricted Stock Plan and no shares for the 1991 Stock Option Plan and the Advisor Stock Option/Restricted Stock Incentive Plan.

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Item 6. *Selected Financial Data*

The following selected consolidated financial data as of and for the years ended December 31, 2003, 2002, 2001, 2000, and 1999 have been derived from our audited Consolidated Financial Statements. This information should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and the related Notes to Consolidated Financial Statements, which are included herein.

	Year Ended December 31,				
	2003	2002	2001	2000	1999
	(In millions, except per share data)				
Operating Data(1):					
Revenue	$1,460.8	$1,332.1	$1,204.7	$1,105.9	$1,151.6
Direct cost of services	1,193.6	1,020.8	949.7	851.6	875.8
Gross profit	267.2	311.3	255.0	254.3	275.8
Selling, general and administrative expenses(2)	187.8	195.6	256.6	220.0	169.2
Operating income (loss)	79.4	115.7	(1.6)	34.3	106.6
Interest income, net	2.6	3.9	8.9	16.6	10.9
Equity in earnings (loss) of unconsolidated affiliates	(1.9)	4.7	8.4	(4.3)	9.0
Other income (expense), net	2.3	(2.1)	(1.9)	45.1	(0.7)
Income before taxes	82.4	122.2	13.8	91.7	125.8
Provision for income taxes	30.5	43.9	16.5	36.2	50.3
Income (loss) before cumulative effect of changes in accounting principles	51.9	78.3	(2.7)	55.5	75.5
Cumulative effect of changes in accounting principles, net of tax	(49.4)				
Net income (loss)	$ 2.5	$ 78.3	$ (2.7)	$ 55.5	$ 75.5
Basic earnings (loss) per common share:					
Income (loss) before cumulative effect of changes in accounting principles	$ 0.47	$ 0.74	$ (0.03)	$ 0.58	$ 0.85
	(0.45)				

Cumulative effect of changes in accounting principles, net of tax					
Net income (loss)	$ 0.02	$ 0.74	$ (0.03)	$ 0.58	$ 0.85
Weighted average common shares outstanding	110.6	106.3	99.4	96.2	88.4
Diluted earnings (loss) per common share:					
Income (loss) before cumulative effect of changes in accounting principles	$ 0.45	$ 0.68	$ (0.03)	$ 0.49	$ 0.67
Cumulative effect of changes in accounting principles, net of tax	(0.43)				
Net income (loss)	$ 0.02	$ 0.68	$ (0.03)	$ 0.49	$ 0.67
Weighted average diluted common shares outstanding(3)	115.3	115.4	99.4	113.5	113.2
Balance Sheet Data (at Period End):					
Cash and cash equivalents	$ 123.8	$ 212.9	$ 259.2	$ 239.7	$ 294.6
Total assets	1,010.6	842.3	757.6	673.2	613.9
Long-term debt	75.5			0.4	0.6
Stockholders equity	712.8	676.6	530.8	501.1	390.7
Other Data:					
Capital expenditures	$ 28.4	$ 36.9	$ 30.7	$ 30.7	$ 25.2

(1) Our results of operations include the effects of business acquisitions made in 2003, 2002, 2001 and 2000 as discussed in Note 4 to the Consolidated Financial Statements included herein. In addition, see Management s Discussion and Analysis of Financial Condition and Results of Operations and Notes 1, 2, 6, and 19 to the Consolidated Financial Statements included herein for discussions of significant charges and cumulative effect of changes in accounting principles recorded during 2003, 2002, 2001 and 2000.

(2) Includes a $22.1 million compensation charge related to an acquisition for 2000.

(3) All options to purchase shares of our common stock were excluded from the calculation of weighted average diluted common shares outstanding for 2001 because the impact was antidilutive given the reported net loss for the period.

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Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with the Consolidated Financial Statements and related Notes to the Consolidated Financial Statements, which are included herein.

Overview of Our Company

We are a worldwide provider of information technology (commonly referred to as IT) services and business solutions to a broad range of customers. We offer our customers integrated solutions designed around their specific business objectives, chosen from a breadth of services, including technology outsourcing, business process outsourcing, development and integration of systems and applications, and business and technology consulting services.

With this approach, our customers benefit from integrated service offerings that help synchronize their strategy, systems, and infrastructure. As a result, we help our customers achieve their business objectives, whether those objectives are to accelerate growth, streamline operations, or enhance customer service capabilities.

Our customers may contract with us for any one or more of our services, which fall into the following categories:

IT Outsourcing Services - includes multi-year contracts in which we assume operational responsibility for various aspects of our customers businesses, including application systems, technology infrastructure, and some back office functions. We typically hire a significant portion of the customers staff that has supported these functions. We then apply our expertise and operating methodologies to increase the efficiency of the operations, which usually results in increased operational quality at a lower cost. Our IT outsourcing contracts are priced using a variety of mechanisms, including level-of-effort, direct costs plus a fee (which may be either a fixed amount or a percentage of direct costs incurred), fixed-price, unit price, and risk/reward. Depending on a customer s business requirements and the pricing structure of the contract, the cash flows from a contract can vary significantly during a contract s term. With fixed-price contracts or when an upfront payment is required to purchase assets, an IT outsourcing contract will typically produce less cash flow at the beginning of the contract with significantly more cash flow generated as efficiencies are realized later in the term. With a cost plus contract, the cash flows tend to be relatively consistent over the term of the contract.

Business Process Services - includes services such as claims processing, revenue cycle management, travel agent commission settlement, and engineering services, which we offer on a stand-alone basis. We classify our Business Process Services in three categories: transaction processing services, back-office services, and professional services related to non-technical functions.

Consulting Services - includes services such as application development and maintenance, system design and implementation services, application systems migration and testing, and management consulting and IT strategy services, which we offer to customers typically on a short-term basis.

We offer our services under three primary lines of business IT Solutions, Government Services and Consulting. We consider these three lines of business to be reportable segments and include financial information and disclosures about these reportable segments in our consolidated financial statements. You can find this financial information in Note 13, Segment and Certain Geographic Data, of the Notes to Consolidated Financial Statements below. We routinely evaluate the historical performance of and growth prospects for various areas of our business, including our lines of business, vertical industry groups, and service offerings. Based on a quantitative and qualitative analysis of varying factors, we may increase or decrease the amount of ongoing investment in each of these business areas, make acquisitions that strengthen our market position, or divest, exit, or downsize aspects of a business area. During the past four years, we have used our acquisition program to strengthen our business in the healthcare and consulting markets and expand into the government market. At the same time, we have divested, or exited, certain service offerings and joint ventures that did not meet our criteria for continued investment.

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Results of Operations

Change in Accounting Principle for Revenue Arrangements with Multiple Deliverables

As discussed below in Critical Accounting Policies under the heading Revenue Recognition, we changed our method of accounting for revenue from arrangements with multiple deliverables for both existing and prospective customers. Our adoption of EITF 00-21 effective January 1, 2003, resulted in an expense for the cumulative effect of a change in accounting principle of $69.3 million ($43.0 million, net of the applicable income tax benefit), or $0.37 per diluted share. This adjustment resulted primarily from the reversal of unbilled revenues associated with our long-term fixed price contracts that include construction services, as each such contract had been accounted for as a single unit of accounting using the percentage-of-completion method. This adjustment also includes approximately $19.5 million (approximately $12.1 million, net of the applicable income tax benefit), or $0.11 per diluted share, to recognize an estimated loss on a construction service included in a contract that we expected to be profitable in the aggregate over its term and that was accounted for as a single unit of accounting using the percentage-of-completion method, as discussed below under Exiting of a Customer Contract.

To illustrate the impact of the adoption of EITF 00-21 on our financial results for 2002 and 2001, we have shown in the table below the pro forma revenue, gross profit, gross margin and net income (loss) as if EITF 00-21 had been applied during the years ended December 31, 2002 and 2001 (amounts in millions):

	Year Ended December 31, 2002			Year Ended December 31, 2001		
	Reported	Impact from EITF 00-21	Pro Forma Amounts	Reported	Impact from EITF 00-21	Pro Forma Amounts
Revenue	$ 1,332.1	$ (34.4)	$ 1,297.7	$ 1,204.7	$ (16.9)	$ 1,187.8
Gross profit	311.3	(45.0)	266.3	255.0	(16.9)	238.1
Gross margin	23.4%		20.5%	21.2%		20.0%
Net income (loss)	78.3	(27.9)	50.4	(2.7)	(10.4)	(13.1)

The impact of EITF 00-21 on the years ended December 31, 2002 and 2001, as reflected above, applied only to the IT Solutions segment and to domestic contracts.

Exiting of a Customer Contract

In 2001, we entered into a long-term fixed-price IT outsourcing contract with a customer that included various non-construction services and a construction service, which was an application development project. In 2002, we began to expect that the actual cost to complete the application development project would exceed the cost estimate included in the contract with the customer. The contract provided for us to collect most of the excess of the actual cost over the cost estimate in the contract, but we expected the project to generate a loss because we did not expect to collect all of the excess of the actual cost over the cost estimate in the contract. However, we did not recognize a loss on the contract at that time. As discussed below under Revenue Recognition in our Critical Accounting Policies discussion, prior to the adoption of EITF 00-21 we recorded revenue and profit on those fixed-price contracts which included both construction and non-construction services using the percentage-of-completion method of accounting. Therefore, because we expected that the contract would be profitable in the aggregate over its term, we did not recognize a loss on this contract in 2002.

As part of our adoption of EITF 00-21 in the first quarter of 2003, we were required to separate the deliverables in the contract into multiple units of accounting and recognized a net estimated loss on the application development project totaling approximately $19.5 million (approximately $12.1 million, net of the applicable income tax benefit), or $0.11 per diluted share, which was recorded as part of the cumulative effect of a change in accounting principle. The $19.5 million loss on the application development project is composed of two adjustments:

- the reversal of $8.9 million of revenue and profit that was recognized prior to January 1, 2003, to adjust to the amount that would have been recorded if we had applied the percentage-of-completion method to this project separately; and

- the recording of a future estimated loss of $10.6 million, which was calculated as the difference between the estimated amount that we expected to collect from the customer and the estimated costs to complete the application development project.

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If EITF 00-21 had been in effect during 2001 and 2002, the $19.5 million net estimated loss on the application development project would have had the following net impact on revenue, direct cost of services and gross profit for the years ended December 31, 2002 and 2001 (in millions):

	December 31, 2002	December 31, 2001
Revenue	$ (9.8)	$ 0.9
Direct cost of services	10.6	
Gross profit	$ (20.4)	$ 0.9

In the second quarter of 2003, we were unable to reach agreement with the customer on the timing and form of payment for the excess of the actual cost over the cost estimate in the contract. As a result, we exited this contract and recorded an additional $17.7 million of expense in direct cost of services in the second quarter of 2003, which consists of the following:

The impairment of assets related to this contract totaling $20.7 million, including the impairment of $14.7 million of long-term accrued revenue;

The accrual of estimated costs to exit this contract of $3.8 million; and

Partially offsetting the above expenses was the reversal of $6.8 million in accrued liabilities that had been recognized for future losses that we expected to incur to complete the application development project.

We completed the services necessary to transition certain functions back to the client during the fourth quarter of 2003.

Comparison of 2003 to 2002

Revenue

Revenue for 2003 increased by $128.7 million, or 9.7%, to $1,460.8 million from revenue of $1,332.1 million for 2002. As noted above, we adopted EITF 00-21 effective January 1, 2003, which adjusted revenue recognized on existing contracts based on the new criteria of EITF 00-21 regarding whether an arrangement involving multiple deliverables contains more than one unit of accounting and how arrangement consideration should be measured and allocated to the separate units of accounting in an arrangement. The effect from this change in accounting is reflected above in the presentation of pro forma amounts for revenue, gross profit, gross margin and net income (loss) for the years ended December 31, 2002 and 2001.

Revenue for 2003 increased by $163.1 million, or 12.6%, compared to pro forma 2002 revenue of $1,297.7 million. This increase in revenue is due to increases in revenue from the IT Solutions and Government Services segments, partially offset by a decrease in revenue from the Consulting segment.

Revenue from the IT Solutions segment decreased $32.8 million, or 2.7%, to $1,199.4 in 2003 from $1,232.2 million in 2002 and increased $1.6 million, or 0.1%, from pro forma revenue of $1,197.8 million in 2002. This net increase as compared to pro forma revenue for 2002 was primarily attributable to the following items:

$66.6 million increase in revenue from contracts signed during 2003. The services that we are providing to these new customers are primarily the same services that we provide to the majority of our other long-term outsourcing customers. These services include both business process services, such as claims processing, and technology-related services, such as IT infrastructure management, application development and maintenance, and business process re-engineering. For a few of these new customers, we are also providing proprietary software application services, including the implementation and customization of our Diamond® health benefits administration suite of software. These new customer contracts were won primarily in competitive situations with the majority of this revenue growth coming from new contracts with customers in the healthcare industry. The strength in healthcare new sales revenue comes from two primary factors:

- ¡ Our solutions for the healthcare market were developed over several years and are highly customized to the specific business needs of the market. We identified certain aspects of the healthcare market as core to our long-term service offerings several years ago when the market for technology and business process outsourcing was immature. As a result, we have an established presence and brand, which we have strengthened during the past several years through internal investment in software and solutions and through acquisitions.

- ¡ There is a degree of change within the healthcare industry today as health systems look to transform their clinical and administrative back-office operations, payer organizations work to develop new consumer-based health models, and as the rate of medical cost inflation continues to be high. These business factors, as well as increased outsourcing activity within the markets we serve, have resulted in stronger new sales revenue.

Our other commercial vertical units in IT Solutions have less scale and have been operating in these markets during a time when many of these industries have been experiencing economic pressures coupled with a mature market for technology outsourcing. Consequently, we have not experienced the same level of demand in these markets as we have in the healthcare industry.

$5.0 million net decrease from existing accounts, short-term offerings, and project work that is provided to customers within our long-term account base. Within our long-term client contracts we typically perform services above our base level of services. Given the discretionary nature of these additional services, the amount of these services that we provide to our customers may fluctuate from period to period depending on many factors, including economic conditions and specific client needs;

$52.2 million decrease in revenue as a result of exiting certain business relationships and under-performing delivery units during 2002, primarily in the financial services and strategic markets industries. Of this decrease in revenue, $14.6 million related to fees we received in 2002 in connection with the termination of services provided through two joint ventures. One of these joint ventures was with a European telecommunications company and the other was with a European financial institution. Both of these joint ventures were terminated at the convenience of the customers, resulting in the payments to us of $14.6 million in termination fees. The remaining revenue decrease is due primarily to reduced revenue from those two joint ventures as they were terminated in 2002; and

$7.8 million decrease from UBS to $242.0 million in 2003 from $249.8 million in 2002. This decrease is primarily attributable to cost savings efforts initiated by us and UBS. The outsourcing agreement with UBS that covers the majority of our business with UBS entitles us to recover our costs plus a fixed fee, with a bonus or penalty that can cause this annual fee to vary up and down by as much as 13%, depending on our level of performance as determined by UBS. We also provide additional project services to UBS. As a result, the revenue and gross profit that we derive from our UBS relationship depends on our performance and on the level of services we provide to UBS. The annual amount of gross profit that we have earned from UBS has ranged from $44.2 million to $50.2 million during the three years ended December 31, 2003.

Revenue from the Government Services segment increased $166.9 million, or 436.9%, to $205.1 million for 2003 from $38.2 million for 2002. This increase is primarily attributable to the acquisition of Soza & Company, Ltd. (Soza) in February 2003, which contributed $121.2 million of revenue in 2003. The remainder of the increase is attributable to ADI Technology Corporation, which we acquired in July 2002. ADI contributed $36.4 million of additional revenue in 2003 as we recognized a full year of ADI revenue in our financial statements, and $9.3 million of existing program expansion within the Department of Homeland Security, the Department of Defense, and the civilian agencies of the federal government.

Revenue from the Consulting segment decreased 8.3% to $56.1 million in 2003 from $61.2 million in 2002 due to a combination of business volume and pricing reductions. Both of these measures directly impact our revenue and are indicators of the value we bring to customers, as well as the competitive environment for our services. In addition, since our direct costs are relatively fixed from period-to-period, changes in utilization and billing rates can affect our profitability. For 2003, utilization decreased by 7%, while the average billing rate declined by 6%. The reduction to

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utilization came primarily as a result of reduced activity and resulting variation in demand within the consulting markets we serve. Our services tend to be tied to the level of systems investment, which varies with the rate of technology change and general economic conditions. During the past few years, weakened economic conditions have resulted in inconsistent demand for technology investment. Additionally, our billing rates have been impacted by increased competition from lower cost resources including small independent contractors. In response to the trends of increased price competition, we invested in offshore capabilities through the acquisition of TSI in December of 2003. We plan to continue to optimize the resource mixture of onshore, offshore and subcontractor labor, which will allow us to respond to increased price competition while minimizing the impact of any price reductions on the profitability of our domestic technology consulting operations.

Domestic revenue grew by 17.2% in 2003 to $1,263.5 million from $1,078.3 million in 2002, and increased as a percent of total revenue to 86.5% from 80.9% in the prior year. Domestic revenue grew by 21.0% in 2003 from pro forma 2002 domestic revenue of $1,043.9 million, and increased as a percent of total revenue to 86.5% from 80.4% of total pro forma 2002 revenue. This increase is primarily the result of domestic growth within the IT Solutions segment and from our Government Services segment. Domestic revenue growth for our IT Solutions segment came primarily from the healthcare industry, where we experienced a strong demand as described above. In addition, as discussed above we have acquired two companies in the government services market since July 2002, which has significantly increased our domestic revenue.

Non-domestic revenue, consisting of European and Asian operations, decreased by 22.3% in 2003 to $197.3 million from $253.8 million in 2002 and decreased to 13.5% of total 2003 revenue from 19.1% of 2002 total revenue and 19.6% of 2002 pro forma revenue. The largest components of our European operations are in the United Kingdom and Switzerland. In the United Kingdom, revenue for 2003 decreased to $107.4 million from $119.9 million for 2002. In Switzerland, revenue for 2003 decreased to $28.1 million from $34.6 million for 2002. Asian operations generated revenue of $25.9 million in 2003 compared to $22.9 million in 2002. The majority of the revenue decrease from 2002 in European operations is due to a revenue decline from UBS and a decrease of $41.3 million in revenue from the two joint ventures that were terminated in 2002. In addition, our service offerings for the European market are largely based on providing systems integration and application management services, which are typically tied to economic conditions. During the past few years, we have seen a weak demand for technology investment in the various European countries in which we currently operate, primarily because of the general economic condition in Europe. As a result of all of these factors, we have experienced revenue declines outside of the United States over the last several years.

Gross Margin

Gross margin for 2003 was 18.3% of revenue, which is lower than the gross margin for 2002 of 23.4% and the pro forma gross margin for 2002 of 20.5%. The following items are important in understanding the decrease in gross margin as compared to the pro forma gross margin for 2002:

In 2002, we recorded revenue of $14.6 million and direct cost of services of $0.9 million, resulting in gross profit of $13.7 million, associated with the termination of services provided through two joint ventures.

In 2002, we received a $3.0 million payment from a customer in bankruptcy reorganization that was previously believed to be unrecoverable.

As discussed above in Exiting of a Customer Contract, the pro forma gross profit for 2002 includes a reduction of $20.4 million associated with the adoption of EITF 00-21 for a contract we exited ($9.8 million as a reduction of revenue and $10.6 million as an increase in direct cost of services).

As discussed above in Exiting of a Customer Contract, in the second quarter of 2003, we recorded $17.7 million of expense in direct cost of services associated with the exiting of this contract.

In 2003, we recorded additional expense for associate year-end bonuses as compared to 2002, which reduced gross profit by $6.2 million.

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As discussed below in Purchase Commitments, in 2003 we recorded $5.6 million of expense associated with unfulfilled minimum purchase commitments.

In 2003, we also experienced a year over year decline in gross margin primarily due to lower up-front profitability on new contracts signed during 2003 and lower profitability from short-term consulting activities, which were partially offset by higher margins from 2003 acquisitions and improvements in long-term commercial account profitability, including an increase in profitability for certain fixed price contracts.

Selling, General and Administrative Expenses

SG&A for 2003 decreased 4.0% to $187.8 million from $195.6 million in 2002. SG&A for 2003 was 12.9% of revenue, which is lower than SG&A for 2002 of 15.1% of pro forma revenue. In our analysis of SG&A for both 2003 and 2002, we identified the following items that are important in understanding this change:

During 2002, we recorded $11.1 million of expense in SG&A relating to severance and other costs to exit certain activities and $8.7 million of expense associated with our response to investigations of the California energy crisis.

During 2003, we recorded a reduction of expense of $7.3 million resulting from revising our estimate of liabilities associated with actions in prior years to streamline our operations, which included a favorable resolution of an employment dispute.

Other Statement of Operations Items

Interest income, net, decreased by 33.3% to $2.6 million in 2003 from $3.9 million in 2002 due to a decrease in the average cash balance in 2003 as compared to 2002 and an overall decrease in interest rates.

Equity in earnings (loss) of unconsolidated affiliates, which primarily represents our share of the earnings of HCL Perot Systems B.V. (HPS), an information technology services joint venture based in India, was a $1.9 million loss in 2003 as compared to $4.7 million of earnings in 2002. This change from 2002 is primarily related to the following:

In 2003, HPS recorded approximately $9.3 million of expense, related primarily to stock option compensation expense. In 2003, the ownership structure of the HPS joint venture was modified in connection with the negotiations between us and HCL Technologies regarding our potential purchase of HCL s equity ownership in HPS or the potential sale to HCL of our equity ownership of HPS, as it was agreed that various stock option agreements to purchase shares of HPS stock would be modified to provide for the option holders to be paid in cash the intrinsic value of the options on the transaction date. These options did not contain such a provision prior to the transaction date.

In 2002, HPS recorded expense to impair the goodwill related to an acquisition, which reduced our equity in earnings by approximately $1.6 million, and recorded $1.9 million of expense related to a contingent liability.

On December 19, 2003, we acquired HCL Technologies shares in HPS, and changed the name of HPS to Perot Systems TSI B.V. Because of the late December 2003 closing of this acquisition, the post-acquisition results of operations of Perot Systems TSI were not material to our consolidated results of operations for 2003. As a result, we continued to account for Perot Systems TSI s results of operations using the equity method of accounting through December 31, 2003, and the balance of our investment in TSI at December 31, 2003, was $29.5 million. We consolidated the assets and liabilities of TSI as of December 31, 2003.

Other income (expense), net, was $2.3 million of income in 2003 as compared to $2.1 million of expense in 2002. During 2003, we recorded non-investment interest income of $1.2 million and a $0.9 million gain related to the sale of marketable equity securities. During 2002, we recorded a $1.0 million loss when we divested our equity investment in BillingZone, a start-up joint venture.

Our effective tax rate for income before the cumulative effect of changes in accounting principles for 2003 was

37.0%. Income tax expense for 2003 was reduced by $1.6 million primarily due to the impact of our non-U.S. operations. Our effective tax rate for 2002 was 35.9%. Income tax expense for 2002 included a $2.7 million benefit from the reduction of a valuation allowance against certain foreign deferred tax assets as well as $1.1 million of other tax benefits.

Comparison of 2002 to 2001

Revenue

Revenue for 2002 increased $127.4 million, or 10.6%, to $1,332.1 million from revenue of $1,204.7 million for 2001. As noted above, on January 1, 2003, we adopted EITF 00-21 and changed our method of accounting for revenue from agreements with multiple deliverables for both existing and prospective customer contracts. The effect from this change in accounting is reflected above in the presentation of pro forma amounts for revenue, gross profit, gross margin and net income (loss) for the years ended December 31, 2002 and 2001.

Pro forma revenue for 2002 increased by $109.9 million, or 9.3%, compared to pro forma 2001 revenue of $1,187.8 million. This increase in revenue was due to increases in revenue from the IT Solutions and Government Services segments, partially offset by a decrease in revenue from the Consulting segment.

Revenue from the IT Solutions segment increased 8.1% to $1,232.2 million in 2002 from $1,139.7 million in 2001. Pro forma revenue from the IT Solutions segment increased $75.0 million, or 6.7%, to $1,197.8 million in 2002 from pro forma revenue of $1,122.8 million in 2001. This increase was primarily attributable to:

- $63.1 million of additional revenue from acquisitions consummated in 2002 and 2001 in the healthcare market, including the acquisitions of Advanced Receivables Strategy, Inc. in July 2001 and Claim Services Resource Group, Inc. in January 2002. ARS contributed $38.4 million of this increase in revenue, as we recognized a full year of ARS revenue in our financial statements in 2002, and CSRG contributed $24.7 million of this increase in revenue;

- $51.8 million of revenue from contracts signed during 2002 with new and existing customers in which the scope of services to be provided was expanded. For these contracts, we are primarily providing our customers technology-related services, including IT infrastructure management, application development and maintenance, and business process re-engineering. The selection criteria for outsourcing contracts typically include the alignment of our operational plan and the customer s business needs, the price for the services to be delivered, the skills of the team that will be leading the relationship, and the level of industry expertise exhibited. The contracts underlying this revenue increase came primarily from markets where we have established expertise and service offerings, and they are primarily in the healthcare market;

- $40.8 million of revenue from other existing accounts, primarily in the healthcare industry and primarily related to a full year of revenue in 2002 on a new contract that was signed in the middle of 2001; and

- $14.6 million of revenue in 2002 relating to fees paid in connection with the termination of services provided through two joint ventures. One of these joint ventures was with a European telecommunications company and the other was with a European financial institution. Both of these joint ventures were terminated after the service contracts with these customers were terminated at the convenience of the customers, resulting in the payment to us of $14.6 million in termination fees.

These increases in revenue were partially offset by:

$54.6 million decrease as a result of exiting certain business relationships and under-performing delivery units and closing geographic project sales efforts in 2001, and

$40.7 million decrease in revenue from UBS. Revenue from UBS decreased to $249.8 million in 2002 from $290.5 million in 2001 due primarily to lower spending by UBS on infrastructure and discretionary project services as a result of cost savings initiatives implemented by us and UBS.

In July 2002, we acquired ADI Technology Corporation and formed our Government Services segment. Revenue from this segment was $38.2 million for 2002.

Revenue from the Consulting segment decreased 3.2% to $61.2 million in 2002 from $63.2 million in 2001 due to continued weak demand for custom application development services, partially offset by growth in systems integration and package implementation services.

Domestic revenue grew by 21.0% in 2002 to $1,078.3 million from $891.0 million in 2001, and increased as a percent of total revenue to 80.9% from 74.0% in the prior year. Pro forma 2002 domestic revenue grew by 19.4% in 2002 to $1,043.9 million from pro forma 2001 domestic revenue of $874.1 million, and increased as a percent of total pro forma revenue to 80.4% from 73.6% of total 2001 pro forma revenue. This increase is primarily the result of new contract signings and acquisitions in 2002 and 2001.

Non-domestic revenue, consisting of European and Asian operations, decreased by 19.1% in 2002 to $253.8 million from $313.7 million in 2001 and decreased as a percent of total revenue to 19.1% from 26.0% over the same period. Non-domestic revenue for 2002 was 19.6% of pro forma revenue, which is lower than non-domestic revenue for 2001 of 26.4% of pro forma revenue. The largest components of European operations were the United Kingdom and Switzerland. In the United Kingdom, revenue for 2002 decreased to $119.9 million from $152.1 million for 2001. In Switzerland, revenue for 2002 decreased to $34.6 million from $43.7 million for 2001. Asian operations generated revenue of $22.9 million in 2002 compared to $24.7 million in 2001, respectively. These revenue decreases from 2001 are due to a revenue decline from UBS, as well a decrease in the number of customers in these geographic areas.

Gross Margin

Direct costs of services increased in 2002 by 7.5% to $1,020.8 million from $949.7 million in 2001. Gross margin increased to 23.4% of revenue in 2002 as compared to 21.2% of revenue in 2001. Gross margin increased to 20.5% of pro forma revenue in 2002 as compared to 20.0% of pro forma revenue in 2001. In our analysis of our pro forma gross margin percentages for 2002 and 2001, we identified the following items that are important in understanding this change:

In 2001, we recorded $25.9 million of charges, including $20.9 million relating to the bankruptcy of a customer, ANC Rental Corporation, and $5.0 million from reducing the basis of software and other assets used in service offerings that we exited.

As discussed above in Exiting of a Customer Contract, the pro forma gross profit for 2001 includes an additional $0.9 million associated with the adoption of EITF 00-21 for a contract we exited ($0.9 million as additional revenue).

As discussed above in Exiting of a Customer Contract, the pro forma gross profit for 2002 includes a reduction of $20.4 million associated with the adoption of EITF 00-21 for a contract we exited ($9.8 million as a reduction of revenue and $10.6 million as an increase in direct cost of services).

In 2002, we received a $3.0 million payment from ANC that was previously believed to be unrecoverable, and we recorded $13.7 million of gross profit (on $14.6 million of revenue) associated with fees paid in connection with the termination of services provided through two joint ventures that we exited during 2002.

In 2003, our gross margin was reduced primarily as a result of generally lower gross margins on contracts signed since the middle of 2001 and on acquisitions consummated in 2002. Partially offsetting this decline in gross margin was lower expense for associate incentive programs in 2002 consistent with market conditions.

Selling, General and Administrative Expenses

SG&A for 2002 decreased 23.8% to $195.6 million from $256.6 million in 2001. SGA for 2002 was 15.1% of pro forma revenue, which is lower than SG&A for 2001 of 21.6% of pro forma revenue. In our analysis of SG&A for both 2002 and 2001, we identified the following items that are important in understanding this change:

As discussed in more detail below, in 2001 we recorded $69.7 million in expense relating primarily to severance and facility related costs as a result of realigning our operating structure.

In 2001, we recorded $6.5 million of expense associated with the amortization of goodwill and assembled workforce intangibles, which was no longer allowed beginning in 2002.

In 2002, we recorded an additional $11.1 million relating to severance and other costs to exit certain activities as we continued our efforts to streamline our operations; and

During 2002, we recorded $8.7 million of expense relating to an investigation of our involvement in the California energy market.

During 2002, SG&A expenses decreased as compared to 2001 due to a temporary decline in selling expense and due to our focused efforts to reduce SG&A costs as a percentage of revenue.

Other Statement of Operations Items

Interest income, net, decreased by 56.2% to $3.9 million in 2002 from $8.9 million in 2001 due to a decrease in the average cash balance in 2002 as compared to 2001 and an overall decrease in interest rates.

Equity in earnings of unconsolidated affiliates was $4.7 million in 2002 compared to $8.4 million in 2001. This decrease from 2001 is primarily due to a reduction in our equity in earnings from TSI. Equity in earnings from TSI decreased to $4.7 million in 2002 from $9.2 million in 2001. This decrease was due primarily to a charge to write down the goodwill related to an acquisition, which reduced our equity in earnings by approximately $1.6 million, and $1.9 million of expense related to a contingent liability. In addition, TSI had experienced an overall reduction in their revenue related to the weak demand for custom application development services. In 2001, we recorded $0.7 million of losses associated with BillingZone, a start-up joint venture that we sold in 2002.

Other income (expense), net, was a $2.1 million net expense in 2002 as compared to a $1.9 million net expense in 2001. During 2002, we recorded a $1.0 million loss when we divested our share of BillingZone, and during 2001 we recorded a $0.6 million expense for the impairment of an investment in marketable equity securities.

Our effective tax rate for 2002 was 35.9%. Income tax expense for 2002 included a $2.7 million benefit from the reduction of a valuation allowance against certain foreign deferred tax assets as well as $1.1 million of other tax benefits. Our effective tax rate for 2001 was 119.4% due to an $11.0 million valuation allowance that we recorded in 2001 against certain foreign deferred tax assets due to the significant uncertainty as to the ultimate realization of these deferred tax assets.

Realigned Operating Structure

During 2001, we realigned our operating structure, resulting in charges totaling $74.7 million, of which $33.7 million was recorded during the first quarter of 2001 and $41.0 million was recorded during the third quarter of 2001. We recorded these charges in the consolidated statements of operations as $5.0 million in direct cost of services and $69.7 million in SG&A, and these charges consist of the following:

$39.6 million expense related to the elimination of approximately 900 administrative and non-billable positions in all business functions and in all geographic areas of the Company;

$25.9 million expense for the consolidation and closure of facilities, including those facilities impacted by our realigned operating structure and the consolidation of our Dallas area operations into one facility located in Plano, Texas; and

$9.2 million expense related to adjustments to reduce the basis of certain facility related assets and the basis of software and other assets used in exited service offerings to their net realizable value.

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As mentioned above, during 2002 we recorded an additional $11.1 million relating to severance and other costs to exit certain activities as we continued our efforts to streamline our operations. As a result of these realignment activities, we realized savings that helped to offset profit pressures. During 2003, we recorded a reduction of expense of $7.3 million resulting from revising our estimate of liabilities associated with actions in prior years to streamline our operations.

As a result of these realignment activities, we reduced both our direct cost of services and our SG&A expenses, primarily resulting from reduced salary and facility costs. These expense reductions helped offset profit pressures that we have experienced since 2001. We are unable to determine whether these savings will continue to be realized in the future, as we may decide to increase our spending in SG&A areas as our business or the market environment changes.

Liquidity and Capital Resources

During 2003 and 2002, cash and cash equivalents decreased $89.1 million and $46.3 million, respectively, as compared to 2001, during which cash and cash equivalents increased $19.5 million. These changes in net cash flow between years are primarily a result of differences in the amount of cash provided by operating activities and amounts used during each year for investing activities.

Operating Activities

Net cash provided by operating activities was $102.9 million in 2003 as compared to $60.1 million in 2002 and $95.0 million in 2001. The primary reasons for the changes in cash provided by operating activities for these three years are changes in the amount of cash paid for our realignment activities, associate year-end bonuses and income taxes.

During 2003, 2002 and 2001 we made cash payments of $9.1 million, $19.8 million and $33.8 million, respectively, in connection with our actions in 2002 and 2001 to realign our operating structure.

Year-end bonuses paid to associates under our corporate year-end bonus plan in 2003, 2002 and 2001 (relating to the prior year s bonus plan) were $4.1 million, $13.6 million and $6.9 million, respectively. The bonuses paid under our corporate year-end bonus plan exclude certain associates that are paid under bonus plans that are separately funded by a customer, associates in our Government Services segment who have their own bonus plan, and associates in certain delivery units that have separate compensation plans.

During 2003 and 2002, we made net cash payments for income taxes of $10.3 million in 2003 and $8.5 million in 2002. In 2001, we received net income tax refunds in the amount of $17.8 million.

Cash provided by operating activities was also affected by the amount of long-term accrued revenue that was recorded in each year. Long-term accrued revenue increased by $7.3 million in 2003 as compared to an increase of $40.5 million in 2002 and an increase of $24.0 million in 2001. As discussed above, we adopted EITF 00-21 effective January 1, 2003. This change in our method of accounting for revenue from arrangements with multiple deliverables had the impact of reducing the amount of revenue that we recorded on long-term fixed-price contracts during 2003 as compared to 2002 and 2001. The increase in 2002 as compared to 2001 resulted from more revenue being recognized on fixed-price contracts in 2002 as we recognized a full year of revenue on several large fixed-price contracts which began in the middle of 2001. These revenues can only be billed and collected in accordance with the applicable contractual billing terms.

Investing Activities

Net cash used in investing activities increased to $214.7 million for 2003 as compared to $134.0 million for 2002 and $84.2 million for 2001. These changes in cash used in investing activities are due primarily to net cash paid for acquisitions of businesses.

During 2003, we paid $188.8 million net cash for acquisitions, including $99.4 million net cash for the acquisition of HPS, $73.8 million net cash for the acquisition of Soza and $10.0 million as additional

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consideration related to the acquisition of ARS.

During 2002, we paid $97.9 million net cash for acquisitions, including $49.2 million net cash for the acquisition of Claim Services Resource Group, Inc., $37.8 million of net cash for the acquisition of ADI, and $10.0 million as additional consideration related to the acquisition of ARS.

During 2001, we paid $53.2 million net cash for acquisitions, including $52.2 million net cash for the acquisition of ARS.

Other Activities

Net cash provided by financing activities has not changed significantly for the last three years, which was $12.0 million for 2003, $17.0 million for 2002 and $11.8 million for 2001. In 2002, we received more proceeds from the issuance of common stock due to the exercise of more stock options to purchase Class B Common Stock during 2002 as compared to 2003 and 2001. In addition, in 2002 we repurchased more shares of our Class A Common Stock as compared to 2003 and 2001.

We routinely maintain cash balances in certain European and Asian currencies to fund operations in those regions. During 2003, foreign exchange rate fluctuations positively impacted our non-domestic cash balances by $10.7 million, as British pounds, Swiss francs, and Euros all strengthened against the U.S. dollar. Our foreign exchange policy does not call for hedging foreign exchange exposures that are not likely to impact net income or working capital.

As discussed below under Subsequent Events, on January 20, 2004, we entered into a revolving credit facility with a syndicate of banks that allows us to borrow up to $100.0 million. We anticipate that existing cash and cash equivalents and short-term investments, expected cash flows from operating activities, and the $100.0 million available under the revolving credit facility will provide us sufficient funds to meet our operating needs for the foreseeable future.

Contractual Obligations and Contingent Commitments

The following table sets forth our significant contractual obligations at December 31, 2003, and the effect such obligations are expected to have on our liquidity and cash flows for the periods indicated (in millions):

	2004	2005-2006	2007-2008	Thereafter	Total
Operating leases	$23.5	$31.8	$17.2	$ 15.9	$ 88.4
Long-term debt			75.5		75.5
Purchase commitments	28.9	6.0			34.9
Restructuring payments	0.4	0.5			0.9
Total	$52.8	$38.3	$92.7	$ 15.9	$199.7

We discuss these contractual obligations in Note 8, Long-term Debt, Note 14, Commitments and Contingencies, and Note 19, Realigned Operating Structure, of Notes to the Consolidated Financial Statements, which are included herein. We also discuss purchase commitments below. Minimum lease payments related to facilities abandoned as part of our prior years realigned operating structures are included in the operating lease amounts above.

The following table sets forth our significant contingent commitments for the periods indicated (in millions) and represent the maximum principal amount of such commitments:

	2004	2005-2006	2007-2008	Total
Contingent payments for acquisitions	$21.3	$48.6	$1.1	$71.0
Total	$21.3	$48.6	$1.1	$71.0

The contingent payments for significant acquisitions are discussed below and in Note 4, Acquisitions, of Notes to the Consolidated Financial Statements.

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Purchase Commitments

We have agreements with three telecommunication service providers to purchase services from, or sell services on behalf of, these providers at varying annual levels. We are currently satisfying the minimum purchase requirements for two of the vendors, both of which expire in 2004 and total approximately $12.4 million in 2004. With regard to the third vendor, under the terms and conditions of this agreement, we agreed to purchase or sell services having a gross value of $19.5 million over a four-year commitment period. We entered into discussions with this vendor to restructure the terms of the commitment. Because both parties were unable to agree to change the terms, we have entered into arbitration, which we expect to be resolved in the first half of 2004. In 2003, we recorded expense of $5.6 million associated with this unfulfilled minimum purchase commitment.

In June 2000, we entered into an agreement with an airline to purchase a minimum of $10.0 million of air travel mileage on an annual basis for five years. We have made four of the five annual payments, with the remaining payment to be made in June of 2004.

Other Commitments and Contingencies

As discussed in Note 4, Acquisitions, we may be required to make additional payments related to three acquisitions, dependent upon these three companies achieving certain financial targets over designated time periods. We may be required to make two additional payments to the sellers of Advanced Receivables Strategy, Inc. (ARS) totaling $20.0 million over the next two years. Up to 50% of each additional payment to the sellers of ARS may be in stock, at our discretion. In addition, we may be required to pay to the sellers of ADI an additional $12.0 million over the next two years, $5.3 million of which may be paid in 2004. At our discretion, we may pay up to 60% of these additional amounts in stock. In addition, we may be required to pay to the sellers of Soza additional payments totaling up to $32.0 million over the next two years, $15.0 million of which may be paid in 2004. At our discretion, we may pay up to 70% of these additional amounts in stock.

As discussed in Note 11, Termination of Business Relationships, during 2003 we exited an under-performing contract. As a result of the exiting of this contract, we determined that certain contract-related assets were impaired and additional expenses would be incurred related to the exiting of this contract, resulting in a loss of $17.7 million recorded in direct cost of services. This estimated loss represents our current estimate of the loss related to exiting this contract. The amount of actual loss with respect to exiting this contract may exceed our current estimates.

Critical Accounting Policies

The Consolidated Financial Statements and Notes to Consolidated Financial Statements contain information that is important to management s discussion and analysis. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities.

Critical accounting policies are those that reflect significant judgments and uncertainties and may result in materially different results under different assumptions and conditions. We believe that our critical accounting policies are limited to those described below. For a detailed discussion on the application of these and other accounting policies, see Note 1 in the Notes to Consolidated Financial Statements.

Revenue Recognition

We provide services to our customers under contracts that contain various pricing mechanisms and other terms. These services generally fall into one of the following categories:

IT outsourcing services includes application systems outsourcing, technology infrastructure outsourcing (including mainframe and network support services, maintenance services and helpdesk services), and back office outsourcing. The fees under these arrangements are generally based on the level-of-effort incurred in delivering the services, including cost plus and time and materials fee arrangements, on a contracted fixed-price for contracted services, or on a contracted per-unit price of each service delivered. The term of our outsourcing contracts generally range between five and ten years.

Business process services includes services such as claims processing, revenue cycle management, travel agent commission settlement, and engineering services. The fees for these services are generally based on time and materials, on a contracted price per unit of service delivered, or on a contracted fixed-price for the contracted level of services. The term of our business process services contracts generally range from month-to-month to five years.

Consulting services includes services such as application development and maintenance, system design and implementation services, application systems migration and testing, and management consulting and IT strategy services. The fees for these services are generally based on a contracted level-of-effort, including time and materials contracts and cost plus contracts, and on a contracted fixed-price. The term of our consulting contracts varies based on the complexity of the services provided and the customers needs.

Within these three categories of services, our contracts include non-construction-type service deliverables, including technology and back office outsourcing, and construction-type service deliverables, such as application development. Revenue for non-construction-type service deliverables is recognized as the services are rendered in accordance with SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, which provides that revenues should be recognized when persuasive evidence of an arrangement exists, the fee is fixed or determinable, and collectibility is reasonably assured. Under our policy, persuasive evidence of an arrangement exists when a final understanding between us and our customer exists as to the specific nature and terms of the services that we are going to provide, as documented by an executed contract.

Accounting for Revenue in Single-Deliverable Arrangements

Revenue from fixed-fee arrangements is recognized on a straight-line basis over the longer of the term of the contract or the expected service period, regardless of the amounts that can be billed in each period, unless evidence suggests that the revenue is earned or our obligations are fulfilled in a different pattern. If we are to provide a similar level of non-construction-type services each period during the term of a contract, we would recognize the revenue on a straight-line basis since our obligations are being fulfilled in a straight-line pattern. If our obligations are being fulfilled in a pattern that is not consistent over the term of a contract, then we would recognize revenue consistent with the proportion of our obligations fulfilled in each period. In determining the proportion of our obligations fulfilled in each period, we consider the nature of the deliverables we are providing to the customer and whether the volume of those deliverables are easily measured, such as when we provide a contractual number of full time equivalent associate resources. If the amount of our obligations fulfilled in each period is not easily distinguished by reference to the volumes of services provided, then we would recognize revenue on a straight-line basis.

Revenue from time and materials contracts and unit-priced contracts is recognized as the services are provided at the contractual unit price.

For construction-type services, revenue is recognized in accordance with the provisions of Statement of Position No. 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. In general, SOP 81-1 requires the use of the percentage-of-completion method to recognize revenue and profit as our work progresses, and we generally use the cost or hours incurred to date to measure our progress towards completion. This method relies on estimates of total expected costs or total expected hours to complete the construction service, which are compared to costs or hours incurred to date, to arrive at an estimate of how much revenue and profit has been earned to date.

Because these estimates may require significant judgment, depending on the complexity and length of the construction services, the amount of revenues and profits that have been recognized to date are subject to revisions. If we do not accurately estimate the amount of costs or hours required or the scope of work to be performed, or do not complete our projects within the planned periods of time, or do not satisfy our obligations under the contracts, then revenues and profits may be significantly and negatively affected or losses may need to be recognized. Revisions to revenue and profit estimates are reflected in income in the period in which the facts that give rise to the revision become known.

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