

DST SYSTEMS INC  
Form 10-Q  
August 07, 2012  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2012

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-14036

**DST SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: DST SYSTEMS INC - Form 10-Q

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**43-1581814**

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

**333 West 11th Street, Kansas City, Missouri**

(Address of principal executive offices)

**64105**

(Zip Code)

**(816) 435-1000**

(Registrant's telephone number, including area code)

**No Changes**

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

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Number of shares outstanding of the Company's common stock as of July 31, 2012:

Common Stock \$0.01 par value 45,094,787



Table of Contents

**DST Systems, Inc.**

**Form 10-Q**

**June 30, 2012**

**Table of Contents**

	<b>Page(s)</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Financial Statements (unaudited)</u></b>
	<b><u>Introductory Comments</u></b> 3
	<b><u>Condensed Consolidated Balance Sheet June 30, 2012 and December 31, 2011</u></b> 4
	<b><u>Condensed Consolidated Statement of Income Three and six months ended June 30, 2012 and 2011</u></b> 5
	<b><u>Condensed Consolidated Statement of Comprehensive Income Three and six months ended June 30, 2012 and 2011</u></b> 6
	<b><u>Condensed Consolidated Statement of Cash Flows Six months ended June 30, 2012 and 2011</u></b> 7
	<b><u>Notes to Condensed Consolidated Financial Statements</u></b> 8-24
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b> 25-57
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b> 57-58
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b> 58-59
<b><u>Item 4T.</u></b>	<b><u>Controls and Procedures</u></b> 59
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b> 59
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b> 59-66
<b><u>Item 2.</u></b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b> 67
<b><u>Item 3.</u></b>	<b><u>Defaults Upon Senior Securities</u></b> 67
<b><u>Item 4.</u></b>	<b><u>Mine Safety Disclosures</u></b> 67
<b><u>Item 5.</u></b>	<b><u>Other Information</u></b> 67

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

Table of Contents

**DST Systems, Inc.**

**Form 10-Q**

**June 30, 2012**

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Introductory Comments**

The Condensed Consolidated Financial Statements of DST Systems, Inc. ( "DST" or the "Company" ) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to enable a reasonable understanding of the information presented. These Condensed Consolidated Financial Statements should be read in conjunction with the Company's audited financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year 2012.

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

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 93.2	\$ 40.9
Funds held on behalf of clients	281.2	272.6
Client funding receivable	44.1	42.6
Accounts receivable	325.6	325.2
Deferred income taxes	9.1	8.4
Other assets	64.7	77.2
	817.9	766.9
Investments	1,078.3	1,072.8
Unconsolidated affiliates	376.1	370.8
Properties	509.9	523.9
Intangible assets	161.1	169.0
Goodwill	484.9	487.0
Other assets	66.0	38.2
Total assets	\$ 3,494.2	\$ 3,428.6
<b>LIABILITIES AND EQUITY</b>		
Current liabilities		
Current portion of debt	\$ 298.8	\$ 320.8
Client funds obligations	325.3	315.2
Accounts payable	90.8	96.0
Accrued compensation and benefits	101.7	119.6
Deferred revenues and gains	79.7	101.3
Income tax payable	39.5	
Other liabilities	106.0	120.8
	1,041.8	1,073.7
Long-term debt	915.6	1,059.5
Income taxes payable	73.3	60.7
Deferred income taxes	332.4	326.5
Other liabilities	78.4	72.5
Total liabilities	2,441.5	2,592.9
Commitments and contingencies (Note 10)		
<b>Equity</b>		
DST Systems, Inc. stockholders' equity		
Preferred stock, \$0.01 par; 10 million shares authorized and unissued		
Common stock, \$0.01 par; 400 million shares authorized, 95.3 million shares issued	1.0	1.0
Additional paid-in capital	229.4	246.0
Retained earnings	3,373.0	3,191.3
Treasury stock (50.3 million and 51.2 million shares, respectively), at cost	(2,842.2)	(2,896.1)

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Accumulated other comprehensive income	291.5	277.8
Total DST Systems, Inc. stockholders' equity	1,052.7	820.0
Non-controlling interest		15.7
Total equity	1,052.7	835.7
Total liabilities and equity	\$ 3,494.2	\$ 3,428.6

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



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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Operating revenues	\$ 465.5	\$ 424.1	\$ 941.4	\$ 853.6
Out-of-pocket reimbursements	167.3	158.1	344.6	320.3
Total revenues	632.8	582.2	1,286.0	1,173.9
Costs and expenses	539.6	477.6	1,098.7	969.9
Depreciation and amortization	42.3	31.3	76.3	61.4
Income from operations	50.9	73.3	111.0	142.6
Interest expense	(11.7)	(12.0)	(23.4)	(23.7)
Other income, net	194.2	14.6	223.9	31.8
Equity in earnings of unconsolidated affiliates	1.4	7.2	6.7	15.6
Income before income taxes and non-controlling interest	234.8	83.1	318.2	166.3
Income taxes	89.9	28.7	118.0	58.8
Net income	144.9	54.4	200.2	107.5
Net loss attributable to non-controlling interest		0.8		1.1
Net income attributable to DST Systems, Inc.	\$ 144.9	\$ 55.2	\$ 200.2	\$ 108.6
Average common shares outstanding	45.0	46.5	44.7	46.4
Average diluted shares outstanding	45.7	47.2	45.5	47.1
Basic earnings per share	\$ 3.22	\$ 1.19	\$ 4.48	\$ 2.34
Diluted earnings per share	\$ 3.17	\$ 1.17	\$ 4.40	\$ 2.31
Cash dividends per share of common stock	\$	\$	\$ 0.40	\$ 0.35

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income attributable to DST Systems, Inc.	\$ 144.9	\$ 55.2	\$ 200.2	\$ 108.6
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on investments:				
Unrealized holding gains (losses) arising during the period	(26.1)	(4.0)	30.0	(20.9)
Proportional share of unconsolidated affiliate interest rate swap				2.0
Unrealized gain (loss) on interest rate swaps	0.1	(0.7)	0.5	0.1
	(26.0)	(4.7)	30.5	(18.8)
Less reclassification adjustments for net gains included in net income	(3.5)	(6.2)	(12.7)	(11.1)
Total unrealized gains (losses) on investments and interest rate swaps, net of taxes (benefits) of (\$19.1), (\$6.8), \$11.3 and (\$18.8)	(29.5)	(10.9)	17.8	(29.9)
Foreign currency translation adjustments, net of taxes (benefits) of (\$0.6), \$1.4, (\$1.8) and \$1.9	(4.4)	3.6	(4.1)	9.6
Other comprehensive income (loss), net of tax	(33.9)	(7.3)	13.7	(20.3)
Comprehensive income	\$ 111.0	\$ 47.9	\$ 213.9	\$ 88.3

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

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

	<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows operating activities:</b>		
Net income	\$ 200.2	\$ 107.5
Depreciation and amortization	76.3	61.4
Net gains on investments	(161.2)	(18.3)
Amortization of share based compensation	14.8	10.7
Equity in earnings of unconsolidated affiliates	(6.7)	(15.6)
Dividends from unconsolidated affiliates	0.9	6.3
Deferred income taxes	(4.5)	(1.3)
Changes in accounts receivable	(0.3)	11.7
Change in client funds obligations	1.5	(27.8)
Change in client funding receivable	(1.5)	27.8
Changes in accounts payable and accrued liabilities	(14.0)	16.8
Changes in income taxes payable	81.5	7.6
Changes in deferred revenues and gains	(21.6)	(3.3)
Changes in accrued compensation and benefits	(17.5)	(23.3)
Other, net	(38.2)	(4.3)
Total adjustments to net income	(90.5)	48.4
Net	109.7	155.9
<b>Cash flows investing activities:</b>		
Capital expenditures	(50.4)	(31.6)
Investments in securities	(142.9)	(262.8)
Proceeds from sales/maturities of investments	319.0	222.3
Net (increase) decrease in restricted cash and cash equivalents held to satisfy client funds obligations	(6.1)	100.0
Acquisition of businesses, net of cash acquired		(65.5)
Other, net	6.3	2.4
Net	125.9	(35.2)
<b>Cash flows financing activities:</b>		
Proceeds from issuance of common stock	43.5	42.9
Principal payments on debt	(10.5)	(14.9)
Repurchases of senior convertible debentures		(8.8)
Net borrowings (payments) on revolving credit facilities	(164.6)	(37.7)
Payment of debt issuance costs	(0.2)	(1.9)
Net increase (decrease) in client funds obligations	8.6	(90.4)
Common stock repurchased	(27.9)	(43.5)
Payment for acquisition of non-controlling interest	(17.7)	
Payment of cash dividends	(17.9)	(16.2)
Excess tax benefits from share based compensation	3.4	1.3
Net	(183.3)	(169.2)
Net increase in cash and cash equivalents	52.3	(48.5)
Cash and cash equivalents, beginning of period	40.9	139.8
Cash and cash equivalents, end of period	\$ 93.2	\$ 91.3

Edgar Filing: DST SYSTEMS INC - Form 10-Q

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

Table of Contents

**DST Systems, Inc.**

**Notes to Condensed Consolidated Financial Statements**

*(unaudited)*

**1. Summary of Accounting Policies**

The Condensed Consolidated Financial Statements of DST Systems, Inc. ( "DST" or the "Company" ) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission ( "SEC" ). Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ( "GAAP" ) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to enable a reasonable understanding of the information presented. The Condensed Consolidated Balance Sheet as of December 31, 2011 has been derived from the audited Consolidated Balance Sheet at that date, but does not include all of the information and notes required by GAAP for complete financial statements. These Condensed Consolidated Financial Statements should be read in conjunction with the Company's audited financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the consolidated financial position of the Company and its subsidiaries at June 30, 2012, and the results of operations and comprehensive income for the three and six months ended June 30, 2012 and 2011 and cash flows for the six months ended June 30, 2012 and 2011.

Certain amounts in the 2011 financial statements have been reclassified to conform to the 2012 presentation.

The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year 2012.

New Authoritative Accounting Guidance

*Comprehensive Income*

On January 1, 2012, DST adopted an accounting standard that modifies the presentation of comprehensive income in the financial statements. The standard requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company elected the latter presentation option upon adopting this accounting standard. The adoption of this guidance did not have a significant

effect on the consolidated financial statements.

*Testing Goodwill for Impairment*

On January 1, 2012, DST adopted an accounting standard related to testing for goodwill impairments. The guidance permits an entity to first assess qualitative factors to determine whether it is more than likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. The adoption of this guidance did not have a significant effect on the consolidated financial statements.

*Fair Value Measurement and Disclosure*

On January 1, 2012, DST adopted an accounting standard related to fair value measurements and disclosure requirements. The guidance is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP

Table of Contents

and International Financial Reporting Standards. The adoption of this guidance did not have a significant effect on the consolidated financial statements.

*Revenue recognition*

On January 1, 2011, the Company adopted new authoritative accounting guidance related to revenue recognition for multiple element arrangements. The guidance eliminated the use of the residual method of allocation and required that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. The Company adopted this guidance on a prospective basis and applied it to relevant revenue arrangements originating or materially modified on or after January 1, 2011.

Revenue arrangements with multiple deliverables are evaluated to determine if the deliverables (items) can be divided into more than one unit of accounting. An item can generally be considered a separate unit of accounting if all of the following criteria are met: 1) the delivered item(s) has value to the customer on a standalone basis; 2) there is objective and reliable evidence of the fair value of the undelivered item(s); and 3) if the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. Once separate units of accounting are determined, the arrangement consideration is allocated at the inception of the arrangement to all deliverables using the relative selling price method. Relative selling price is obtained from sources such as vendor-specific objective evidence ( VSOE ), which is based on the separate selling price for that or a similar item or from third-party evidence ( TPE ) such as how competitors have priced similar items. If such evidence is unavailable, the Company uses its best estimate of the selling price ( BESP ), which includes various internal factors such as our pricing strategy and market factors. It is not common for the Company to use TPE and BESP as VSOE can be established for the majority of DST 's client arrangements.

For multiple element revenue arrangements entered prior to January 1, 2011, in cases where there was objective and reliable evidence of the fair value of the undelivered item(s) in an arrangement but no such evidence for the delivered item(s), the residual method was used to allocate the arrangement consideration. For units of accounting which include more than one deliverable, the Company generally defers all revenue for the unit of accounting until the period over which the last undelivered item is delivered. The adoption of this new authoritative accounting guidance did not have a significant impact to the Company 's results.

**2. Client Funds/Obligations**

The Company had \$281.2 million and \$272.6 million of funds held on behalf of clients at June 30, 2012 and December 31, 2011, respectively. Included in these amounts were \$16.8 million and \$14.3 million of fixed-income marketable securities at June 30, 2012 and December 31, 2011, respectively, which have been classified as available-for-sale investments. There were no significant unrealized gains or losses associated with these fixed-income securities at June 30, 2012 and December 31, 2011. During the six months ended June 30, 2012 and 2011, the Company received \$61.7 million and \$59.3 million, respectively, of proceeds from the sales/maturities of investments in available-for-sale securities held to satisfy client funds obligations. Gross realized gains and gross realized losses associated with the sales/maturities of these available-for-sale securities held to satisfy client funds obligations were not significant during both the three and six months ended June 30, 2012 and 2011.

Table of Contents**3. Investments**

Investments are as follows (in millions):

	2012 Ownership Percentage	June 30, 2012	Carrying Value December 31, 2011
<b>Available-for-sale securities:</b>			
State Street Corporation	2%	\$ 461.2	\$ 416.4
Computershare Ltd.	2%	90.6	122.7
Euronet Worldwide	4%	32.2	34.8
Other available-for-sale securities		181.1	199.1
		765.1	773.0
<b>Other:</b>			
Trading securities		42.9	39.9
Held-to-maturity		14.9	15.4
Cost method, private equity and other investments		255.4	244.5
		313.2	299.8
<b>Total investments</b>		<b>\$ 1,078.3</b>	<b>\$ 1,072.8</b>

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

	June 30, 2012	December 31, 2011
Book cost basis	\$ 284.5	\$ 315.6
Gross unrealized gains	465.5	438.3
Gross unrealized losses	(3.2)	(4.3)
Unrealized gain - foreign currency exchange rates	18.3	23.4
<b>Market value</b>	<b>\$ 765.1</b>	<b>\$ 773.0</b>

During the six months ended June 30, 2012 and 2011, the Company received \$109.4 million and \$153.7 million, respectively, from the sale of investments in available-for-sale securities. Gross realized gains of \$8.3 million and \$10.8 million and gross realized losses of \$1.0 million and \$0.5 million were recorded during the three months ended June 30, 2012 and 2011, respectively, from available-for-sale securities. Gross realized gains of \$24.8 million and \$19.1 million and gross realized losses of \$2.1 million and \$0.7 million were recorded during the six months ended June 30, 2012 and 2011, respectively, from available-for-sale securities. In addition, the Company recorded unrealized losses on available-for-sale securities of \$1.6 million and \$1.9 million for the three and six months ended June 30, 2012, respectively, compared to \$0.1 million for both the three and six months ended June 30, 2011 related to other than temporary investment impairments.

The following table summarizes the fair value and gross unrealized losses of the Company's investments by the length of time that the securities have been in a continuous loss position, at June 30, 2012 (in millions):



Edgar Filing: DST SYSTEMS INC - Form 10-Q

	Less than 12 months		Greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock	\$ 42.3	\$ 3.2	\$	\$	\$ 42.3	\$ 3.2

Table of Contents

In addition to recording other than temporary investment impairments on available-for-sale securities, the Company records lower of cost or market valuation adjustments on private equity fund investments and other cost method investments when impairment conditions are present. During the three and six months ended June 30, 2012, the Company recorded \$0.3 million and \$0.7 million, respectively, of impairments on other investments as compared to none and \$1.0 million during the three and six months ended June 30, 2011. The impairments recorded related primarily to investments in the Financial Services Segment and the Investments and Other Segment. A decline in a security's net realizable value that is other than temporary is treated as a loss based on quoted or derived market value and is reflected in Other Income, net in the Condensed Consolidated Statement of Income.

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

The Company is a limited partner in various private equity funds. At June 30, 2012 and December 31, 2011, the Company's carrying value of these private equity fund investments was approximately \$232.6 million and \$221.5 million, respectively. At June 30, 2012, the Company had future capital commitments related to these private equity fund investments of approximately \$22.5 million.

In May 2012, DST recorded cash proceeds and a gain of \$138.7 million from the sale of a portion of its investment in a privately held company (a cost method investment) in a transaction arranged by that company. In addition, DST received a \$47.3 million cash dividend from the same privately held company. Cash from these transactions were primarily used to reduce debt.

**4. Unconsolidated Affiliates**

Unconsolidated affiliates are as follows (in millions):

	2012 Ownership Percentage	June 30, 2012	Carrying Value December 31, 2011
Unconsolidated affiliates:			
Boston Financial Data Services, Inc.	50%	\$ 184.6	\$ 179.1
International Financial Data Services, U.K.	50%	92.9	90.0
International Financial Data Services, L.P.	50%	48.7	48.6
Unconsolidated real estate affiliates		38.1	38.4
Other unconsolidated affiliates		11.8	14.7
Total		\$ 376.1	\$ 370.8

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

Edgar Filing: DST SYSTEMS INC - Form 10-Q

	Three Months Ended		Six Months Ended	
	2012	June 30, 2011	2012	June 30, 2011
Boston Financial Data Services, Inc.	\$ 2.3	\$ 3.1	\$ 5.5	\$ 6.3
International Financial Data Services, U.K.	0.2	3.4	1.8	7.5
International Financial Data Services, L.P.	1.2	0.4	1.1	2.1
Other unconsolidated affiliates	(2.3)	0.3	(1.7)	(0.3)
	\$ 1.4	\$ 7.2	\$ 6.7	\$ 15.6

Table of Contents

**5. Fair Value Measurements**

Authoritative accounting guidance on fair value measurements establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of June 30, 2012 and December 31, 2011, the Company held certain investment assets and certain liabilities that are required to be measured at fair value on a recurring basis. These investment assets include the Company's available-for-sale equity securities and trading securities whereby fair value is determined using quoted prices in active markets. Accordingly, the fair value measurements of these investments have been classified as Level 1 in the table below. Fair value for deferred compensation liabilities that are credited with deemed gains or losses of the underlying hypothetical investments, primarily equity securities, have been classified as Level 1 in the tables below. In addition, the Company has investments in available-for-sale fixed income securities, pooled funds and interest rate swaps that are required to be reported at fair value. Fair value for the available-for-sale fixed income securities and for the interest rate swaps was determined using inputs from quoted prices for similar assets and liabilities in active markets that are directly or indirectly observable. Fair value for investments in pooled funds is determined using net asset value. Accordingly, the Company's investments in available-for-sale fixed income securities, pooled funds and interest rate swaps have been classified as Level 2 in the table below.

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Table of Contents

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

	Fair Value Measurements at Reporting Date Using			
	June 30, 2012	Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$ 796.8	\$ 796.8	\$	\$
Investments in pooled funds	47.2		47.2	
Fixed income securities	28.0		28.0	
Deferred compensation liabilities	(42.9)	(42.9)		
Interest rate swap liability	(3.3)		(3.3)	
Total	\$ 825.8	\$ 753.9	\$ 71.9	\$

	Fair Value Measurements at Reporting Date Using			
	December 31, 2011	Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$ 808.2	\$ 808.2	\$	\$
Investments in pooled funds	46.0		46.0	
Fixed income securities	19.0		19.0	
Deferred compensation liabilities	(39.9)	(39.9)		
Interest rate swap liability	(4.3)		(4.3)	
Total	\$ 829.0	\$ 768.3	\$ 60.7	\$

At June 30, 2012 and December 31, 2011, one of DST's unconsolidated affiliates had an interest rate swap with a fair market value liability of \$75.5 million and \$73.0 million, respectively. The unconsolidated affiliate used inputs from quoted prices for similar assets and liabilities in active markets that are directly or indirectly observable relating to the measurement of the interest rate swap. The fair value measurement of the interest rate swap has been classified as Level 2 by the unconsolidated affiliate. The above table presents only assets and liabilities measured at fair value for which the Company controls, and accordingly excludes items held by unconsolidated affiliates.

Table of Contents**6. Intangible Assets and Goodwill***Intangible Assets*

The following table summarizes intangible assets (in millions):

	June 30, 2012		December 31, 2011	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Amortizable intangible assets:				
Customer relationships	\$ 169.9	\$ 29.6	\$ 169.9	\$ 23.1
Other	27.8	7.0	27.8	5.6
<b>Total</b>	<b>\$ 197.7</b>	<b>\$ 36.6</b>	<b>\$ 197.7</b>	<b>\$ 28.7</b>

Amortization of intangible assets for the three and six months ended June 30, 2012 was approximately \$3.9 million and \$7.9 million, respectively as compared to \$1.3 million and \$2.6 million for the three and six months ended June 30, 2011. Amortization for intangible assets recorded as of June 30, 2012 is estimated to be (in millions):

Remainder of 2012	\$ 7.8
2013	15.3
2014	15.0
2015	14.4
2016	14.1
Thereafter	94.5
<b>Total</b>	<b>\$ 161.1</b>

*Goodwill*

The following table summarizes the changes in the carrying amount of goodwill for the six months ended June 30, 2012, by Segment (in millions):

	December 31, 2011		Acquisitions	Disposals	Other	June 30, 2012	
Financial Services	\$ 394.0	\$	\$	\$	(1.8)	\$ 392.2	
Output Solutions	93.0				(0.3)	92.7	
<b>Total</b>	<b>\$ 487.0</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>(2.1)</b>	<b>\$ 484.9</b>	



Table of Contents**7. Debt**

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

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Accounts receivable securitization program	\$ 135.0	\$ 135.0
Secured promissory notes	15.0	16.6
Equipment credit facilities	13.6	10.0
Real estate credit agreement	103.5	105.2
Term loan credit facility	125.0	125.0
Series C convertible senior debentures	88.3	86.5
Revolving credit facilities	195.1	328.3
Senior notes	370.0	370.0
Related party credit agreements	149.4	156.7
Other indebtedness	19.5	47.0
	1,214.4	1,380.3
Less current portion of debt	298.8	320.8
Long-term debt	\$ 915.6	\$ 1,059.5

*Accounts Receivable Securitization Program*

DST securitizes certain of its domestic accounts receivable through an accounts receivable securitization program with a third-party bank. The maximum amount that can be outstanding under this program is \$150 million. On May 17, 2012, the Company renewed its accounts receivable securitization program. The facility will expire by its terms on May 16, 2013, unless renewed.

At both June 30, 2012 and December 31, 2011, the outstanding amount under the program was \$135.0 million. During the six months ended June 30, 2012 and 2011, total proceeds from the accounts receivable securitization program were approximately \$459.3 million and \$433.4 million and total repayments were approximately \$459.3 million and \$433.4 million, respectively, which comprises the net cash flow in the financing section of the cash flow statement.

*Related Party Credit Agreements*

In June 2012, the Company repaid its loan with International Financial Data Services Limited, which had an outstanding balance of \$6.2 million at December 31, 2011.

*Other Indebtedness*



Edgar Filing: DST SYSTEMS INC - Form 10-Q

Other indebtedness includes a borrowing arrangement denominated in British Pounds between DST Output UK (formerly Innovative Output Solutions or IOS) and a bank that is secured by accounts receivable of DST Output UK. The amount outstanding under this facility was repaid in June 2012. During the six months ended June 30, 2012 proceeds received from this loan were \$143.0 million and total repayments were \$164.3 million, which has been included in net payments on revolving credit facilities in the financing section of the cash flow statement.

Table of Contents*Fair Value*

Based upon the borrowing rates currently available to the Company and its subsidiaries for indebtedness with similar terms and average maturities, the carrying value of long-term debt, with the exception of the senior debentures and senior notes is considered to approximate fair value at June 30, 2012 and December 31, 2011. The estimated fair value of the convertible debentures and senior notes was derived principally from quoted prices (Level 2 in the fair value hierarchy). As of June 30, 2012 and December 31, 2011, the carrying and estimated fair value of the Series C convertible debentures and senior notes were as follows (in millions):

	June 30, 2012		December 31, 2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Convertible senior debentures - Series C	\$ 88.3	\$ 101.2	\$ 86.5	\$ 99.7
Senior Notes - Series A	40.0	40.7	40.0	40.8
Senior Notes - Series B	105.0	111.1	105.0	109.7
Senior Notes - Series C	65.0	69.5	65.0	68.1
Senior Notes - Series D	160.0	174.3	160.0	169.7
Total	\$ 458.3	\$ 496.8	\$ 456.5	\$ 488.0

**8. Income Taxes**

The Company records income tax expense during interim periods based on its best estimate of the full year's tax rate. Certain items are given discrete period treatment and, as a result, the tax effects of such items are reported in full in the relevant interim period. The Company's tax rate was 38.3% and 37.1% for the three and six months ended June 30, 2012, respectively, compared to 34.5% and 35.4% for the three and six months ended June 30, 2011. The Company's tax rate for the three and six months ended June 30, 2012 was higher than the statutory federal income tax rate of 35% primarily because of lower foreign tax credits, higher domestic income and increased losses in international subsidiaries for which no current tax benefit exists.

The full year 2012 tax rate can be affected as a result of variances among the estimates and amounts of full year sources of taxable income (e.g., domestic consolidated, joint venture and/or international), the realization of tax credits (e.g., historic rehabilitation, research and experimentation, foreign tax and state incentive), adjustments which may arise from the resolution of tax matters under review and the Company's assessment of its liability for uncertain tax positions.

As described in the Company's 2011 Annual Report on Form 10-K, the Company has filed federal income tax refund claims for research and experimentation credits and for the Domestic Manufacturing Deduction (under Internal Revenue Code Section 199). The Company has not recorded any significant tax benefits associated with these refund claims because the realization of the benefit is uncertain. The Company and the IRS are having active settlement discussions on the above refund claims. The Company believes that based upon the discussions to date, it is possible that a favorable settlement may be reached in regards to the refund claims. However, at June 30, 2012, the Company did not have sufficient information to have a basis to record additional benefits associated with the claims.



Table of Contents**9. Equity***Earnings per share*

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income attributable to DST Systems, Inc.	\$ 144.9	\$ 55.2	\$ 200.2	\$ 108.6
Average common shares outstanding	45.0	46.5	44.7	46.4
Incremental shares from restricted stock units and assumed conversions of stock options and debentures	0.7	0.7	0.8	0.7
Average diluted shares outstanding	45.7	47.2	45.5	47.1
Basic earnings per share	\$ 3.22	\$ 1.19	\$ 4.48	\$ 2.34
Diluted earnings per share	\$ 3.17	\$ 1.17	\$ 4.40	\$ 2.31

The Company had approximately 45.1 million and 46.5 million shares outstanding at June 30, 2012 and 2011, respectively. Shares from options to purchase common stock, excluded from the diluted earnings per share calculation because they were anti-dilutive, totaled 0.8 million for both the three and six months ended June 30, 2012, compared to 0.8 million and 0.9 million for the three and six months ended June 30, 2011. The Company's convertible senior debentures would have a potentially dilutive effect on the Company's stock if converted in the future. At June 30, 2012, outstanding Series C debentures would be convertible into 1.7 million shares of common stock, subject to adjustment. The Company intends to settle any conversions with cash for the principal amount of the bonds and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amount. Related to the debentures, the calculation of diluted earnings per share includes an incremental amount of shares assumed to be issued for the conversion spread when the Company's average daily stock price exceeds the average accreted bond price per share. For the three and six months ended June 30, 2012 and 2011, respectively, there was an insignificant amount of dilution related to the Company's average share price exceeding the average accreted bond price per share.

*Share Based Compensation*

The Company has a share based compensation plan covering its employees. During the six months ended June 30, 2012, the Company granted approximately 0.1 million restricted stock units (RSUs). A portion of the RSU grants contain performance features. At June 30, 2012, the Company had outstanding 0.9 million unvested RSUs, 0.1 million unvested restricted shares and 2.5 million stock options (of which 1.3 million are not yet exercisable).

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

At June 30, 2012, the Company had \$30.5 million of total unrecognized compensation expense (included in Additional paid-in-capital on the Condensed Consolidated Balance Sheet) related to its share based compensation arrangements, net of estimated forfeitures. The Company estimates that the amortized compensation expense attributable to the stock option, restricted stock and restricted stock unit grants will be approximately \$16.9 million for the remainder of 2012, \$6.3 million for 2013, \$1.6 million for 2014 and \$0.2 million for 2015, based on awards currently outstanding. Increased consolidated earnings from the May 2012 sale of a portion of DST's investment in a privately held company and from a cash dividend received from that same investment, both as further described further in Note 3, caused the Company to revise the estimated vesting date for certain of these equity awards from March 2014 to March 2013 in accordance with the terms and conditions of the awards. Future amortization is not projected on approximately \$5.5 million of unrecognized compensation expense as the

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

### Table of Contents

related awards are not currently expected to achieve their required performance conditions and therefore are not expected to vest.

### *Other comprehensive income (loss)*

Accumulated other comprehensive income balances consist of the following (in millions), net of tax:

	<b>Investment and Interest Rate Swaps Unrealized Holding Gains (Losses)</b>		<b>Currency Translation Adjustments</b>		<b>Accumulated Other Comprehensive Income</b>
<b>Balance, December 31, 2011</b>	\$ 261.6	\$	16.2	\$	277.8
Current period change	17.8		(4.1)		13.7
<b>Balance, June 30, 2012</b>	\$ 279.4	\$	12.1	\$	291.5

One of DST's unconsolidated affiliates had an interest rate swap liability with a fair market value of \$75.5 million and \$73.0 million at June 30, 2012 and December 31, 2011, respectively. DST's 50% proportionate share of this interest rate swap liability was \$37.8 million and \$36.5 million at June 30, 2012 and December 31, 2011, respectively. The Company records in Investments and Accumulated other comprehensive income its proportionate share of this liability in an amount not to exceed the carrying value of its investment in this unconsolidated affiliate, which resulted in no liability recorded at June 30, 2012 and December 31, 2011.

### *Stock repurchases*

At June 30, 2012, there were approximately 2,050,000 shares remaining to be repurchased under the Company's existing share repurchase authorization plan. No shares were repurchased during the six months ended June 30, 2012. The Company repurchased 0.5 million shares of DST common stock for \$22.5 million or approximately \$49.94 per share during the six months ended June 30, 2011.

Shares received in exchange for satisfaction of the option exercise price and for tax withholding obligations arising from the exercise of options to purchase the Company's stock or from the vesting of restricted stock shares are included in common stock repurchased in the Condensed Consolidated Statement of Cash Flows. The amount of such share receipts and withholdings for option exercises and restricted stock vesting was \$27.9 million and \$21.0 million during the six months ended June 30, 2012 and 2011, respectively.

### *Dividends*

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

On February 24, 2012, the Board of Directors of DST declared a cash dividend of \$0.40 per common share. The total dividend was \$18.5 million, of which \$17.9 million was paid on April 10, 2012. The remaining amount of the dividend represents dividend equivalent shares of restricted stock units in lieu of the cash dividend.

### *Non-controlling interest*

As a result of the acquisition of dsicmm Group on July 30, 2010, the Company's DST Output U.K. (formerly, IOS) subsidiary had a non-controlling investor group, which initially owned approximately 29.5% of DST Output U.K. The amount included in Equity on the Condensed Consolidated Balance Sheet at December 31, 2011 associated with the non-controlling interest was \$15.7 million. In January 2012, DST repurchased the remaining shares held by the non-controlling investor group for \$17.7 million making DST Output U.K. a wholly-owned subsidiary. The \$2.0 million difference between the amount paid and the amount recorded as Non-controlling interest was recorded in Additional paid-in capital in the Condensed Consolidated Balance Sheet.

Table of Contents

**10. Commitments and Contingencies**

The Company has letters of credit of \$7.6 million outstanding at both June 30, 2012 and December 31, 2011. Letters of credit are secured by the Company's debt facility.

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

The Company has established trusts to provide for the funding of corporate commitments and entitlements of Company officers, directors, employees and others in the event of a change in control of the Company. Assets held in such trusts at June 30, 2012 and December 31, 2011 were not significant.

The Company has received a regulatory inquiry regarding information that the Company's pharmacy claims processing business prepared on behalf of its Medicare Part D Plan Sponsor customers that those Medicare Part D Plan Sponsor customers subsequently provided to the Center for Medicare and Medicaid Services (CMS), during the period 2006 to 2009. That information related to amounts that were paid to Louisiana pharmacies that dispensed prescription drugs to Medicare Part D plan members. The Company is in discussions as to the accuracy of such information and as to any civil penalties that might be assessed against the Company relative to any inaccuracies. The regulator has broad statutory authority in determining the resolution of the inquiry. The Company recorded a \$3.5 million loss accrual in 2011, which represents the Company's best estimate of the amount to resolve the matter should inaccuracies be established. There can be no assurance that the loss accrual will be sufficient to resolve the matter.

The Company received a legal claim relating to a 2001 international software development agreement. Although the software was never completed, the counterparty to the agreement has asserted that DST's failure to accept the software has resulted in damages ranging up to approximately \$10 million. A District Court and a Court of Appeals each concluded in 2004 and 2006, respectively, that the conditions for acceptance were not met. In October 2011, a Court of Appeals ruled that the parties need to engage an expert to decide whether the software met the acceptance criteria. The Company is vigorously defending the case and does not believe that a loss accrual is required. Although the ultimate resolution and impact of this litigation is not presently determinable, the Company's management believes the eventual outcome of such litigation will not have a material adverse effect on the overall financial condition, results of operations or cash flows of the Company.

Based on the current status of each of the above proceedings, the Company has no basis to make an estimate of possible outcomes or loss ranges beyond what has been disclosed.

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



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

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

The Company entered into an agreement to guarantee up to \$3.0 million plus any enforcement costs related to a \$32.0 million mortgage loan to a 50% owned real estate joint venture. The \$32.0 million loan matures on June 30, 2013. At June 30, 2012 and December 31, 2011, total borrowings on the loan were \$29.4 million and \$30.5 million, respectively, and the Company's guarantee totaled \$1.5 million for both June 30, 2012 and December 31, 2011.

Table of Contents

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

*Guarantees*

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

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

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

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

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

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

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

Table of Contents

The Company has entered into agreements with lenders providing financing to the Company pursuant to which the Company agrees to indemnify such lenders for third party claims arising from or relating to such financings. In connection with real estate mortgage financing, the Company has entered into environmental indemnity agreements in which the Company has agreed to indemnify the lenders for any damage sustained by the lenders relating to any environmental contamination on the subject properties.

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

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

At June 30, 2012 and December 31, 2011, the Company had not accrued any liability on the aforementioned guarantees or indemnifications as they relate to future performance criteria or indirect guarantees of indebtedness of others in accordance with accounting and reporting guidance on guarantees, including indirect guarantees of indebtedness of others.

## **11. Authoritative Accounting Guidance**

### *Earnings per Share Proposed Accounting Standard*

In August 2008, the FASB issued a revised exposure draft that would amend current earnings per share accounting guidance to clarify guidance for mandatorily convertible instruments, the treasury stock method, contingently issuable shares, and contracts that may be settled in cash or shares. The final authoritative accounting guidance has yet to be issued. In April 2009, the FASB decided to pause the earnings per share project.

The proposed guidance, which is designed for convergence with international accounting standards, would require the use of the if-converted method from the date of issuance of the convertible debentures. The proposed guidance would remove the ability of a company to support the

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

presumption that the convertible securities will be satisfied in cash and not converted into shares of common stock. Accordingly, the Company's stated intention to settle conversions of its convertible debentures with cash for the principal and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amounts would no longer be accepted under the current guidance, if amended as proposed. Retrospective application would be required for all changes, except that retrospective application would be prohibited for contracts that were either settled in cash prior to adoption or modified prior to adoption to require cash settlement. For DST, adoption of this accounting guidance, as proposed, will require retroactive restatement of the Company's diluted earnings per share calculations subsequent to the issuance of the convertible debentures. The revised exposure draft also contains other EPS computational changes (e.g., treasury stock method considerations) that may have

Table of Contents

an effect on the Company's diluted earnings per share calculation. DST is continuing to monitor the FASB's progress towards finalizing this proposed accounting guidance.

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

**12. Segment Information**

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

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

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Financial Services	\$ 1,883.2	\$ 1,799.5
Output Solutions	426.7	476.9
Investments and Other	1,251.5	1,220.8
Elimination Adjustments	(67.2)	(68.6)
	<b>\$ 3,494.2</b>	<b>\$ 3,428.6</b>

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

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Table of Contents

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

	Three Months Ended June 30, 2012					Consolidated Total
	Financial Services	Output Solutions	Investments / Other	Eliminations Adjustments		
Operating revenues	\$ 305.4	\$ 156.5	\$ 3.6	\$	\$	\$ 465.5
Intersegment operating revenues	2.1	2.2	11.5	(15.8)		
Out-of-pocket reimbursements	13.1	156.1		(1.9)		167.3
Total revenues	320.6	314.8	15.1	(17.7)		632.8
Costs and expenses	244.6	299.1	11.0	(15.1)		539.6
Depreciation and amortization	27.2	11.1	4.6	(0.6)		42.3
Income (loss) from operations	48.8	4.6	(0.5)	(2.0)		50.9
Other income, net	0.6		193.6			194.2
Equity in earnings of unconsolidated affiliates	0.9		0.5			1.4
Earnings (loss) before interest, income taxes and non-controlling interest	\$ 50.3	\$ 4.6	\$ 193.6	\$ (2.0)	\$	\$ 246.5

	Three Months Ended June 30, 2011					Consolidated Total
	Financial Services	Output Solutions	Investments / Other	Eliminations Adjustments		
Operating revenues	\$ 278.8	\$ 142.4	\$ 2.9	\$	\$	\$ 424.1
Intersegment operating revenues	2.2	1.9	10.8	(14.9)		
Out-of-pocket reimbursements	10.2	148.6	0.8	(1.5)		158.1
Total revenues	291.2	292.9	14.5	(16.4)		582.2
Costs and expenses	208.9	273.0	9.5	(13.8)		477.6
Depreciation and amortization	18.3	11.0	2.6	(0.6)		31.3
Income (loss) from operations	64.0	8.9	2.4	(2.0)		73.3
Other income, net	1.3	0.2	13.1			14.6
Equity in earnings (losses) of unconsolidated affiliates	6.4		0.8			7.2
Earnings (loss) before interest, income taxes and non-controlling interest	\$ 71.7	\$ 9.1	\$ 16.3	\$ (2.0)	\$	\$ 95.1

Earnings before interest, income taxes and non-controlling interest in the segment reporting information above less interest expense of \$11.7 million and \$12.0 million for the three months ended June 30, 2012 and 2011 is equal to the Company's income before income taxes and non-controlling interest on a consolidated basis for the corresponding periods.

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Table of Contents

	Six Months Ended June 30, 2012				
	Financial Services	Output Solutions	Investments / Other	Eliminations Adjustments	Consolidated Total
Operating revenues	\$ 614.5	\$ 319.9	\$ 7.0	\$	\$ 941.4
Intersegment operating revenues	4.1	4.2	22.5	(30.8)	
Out-of-pocket reimbursements	27.6	320.8	0.1	(3.9)	344.6
Total revenues	646.2	644.9	29.6	(34.7)	1,286.0
Costs and expenses	497.1	611.0	20.0	(29.4)	1,098.7
Depreciation and amortization	48.2	22.1	7.3	(1.3)	76.3
Income (loss) from operations	100.9	11.8	2.3	(4.0)	111.0
Other income, net	5.6		218.3		223.9
Equity in earnings of unconsolidated affiliates	5.4	0.2	1.1		6.7
Earnings (loss) before interest, income taxes and non-controlling interest	\$ 111.9	\$ 12.0	\$ 221.7	\$ (4.0)	\$ 341.6

	Six Months Ended June 30, 2011				
	Financial Services	Output Solutions	Investments / Other	Eliminations Adjustments	Consolidated Total
Operating revenues	\$ 561.0	\$ 286.6	\$ 6.0	\$	\$ 853.6
Intersegment operating revenues	4.3	4.0	21.8	(30.1)	
Out-of-pocket reimbursements	20.8	301.1	1.4	(3.0)	320.3
Total revenues	586.1	591.7	29.2	(33.1)	1,173.9
Costs and expenses	423.1	555.7	19.0	(27.9)	969.9
Depreciation and amortization	35.9	21.6	5.2	(1.3)	61.4
Income (loss) from operations	127.1	14.4	5.0	(3.9)	142.6
Other income, net	3.3	0.3	28.2		31.8
Equity in earnings (losses) of unconsolidated affiliates	15.3	0.4	(0.1)		15.6
Earnings (loss) before interest, income taxes and non-controlling interest	\$ 145.7	\$ 15.1	\$ 33.1	\$ (3.9)	\$ 190.0

Earnings before interest, income taxes and non-controlling interest in the segment reporting information above less interest expense of \$23.4 million and \$23.7 million for the six months ended June 30, 2012 and 2011 is equal to the Company's income before income taxes and non-controlling interest on a consolidated basis for the corresponding periods.



Table of Contents

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

*The discussions set forth in this Quarterly Report on Form 10-Q contain statements concerning potential future events. Such forward-looking statements are based upon assumptions by the Company's management, as of the date of this Quarterly Report, including assumptions about risks and uncertainties faced by the Company. In addition, management may make forward-looking statements orally or in other writings, including, but not limited to, in press releases, in the annual report and in the Company's other filings with the Securities and Exchange Commission (SEC). Forward-looking statements include, but are not limited to, (i) all statements, other than statements of historical fact, that address activities, events or developments that we expect or anticipate will or may occur in the future or that depend on future events, or (ii) statements about our future business plans and strategy and other statements that describe the Company's outlook, objectives, plans, intentions or goals, and any discussion of future operating or financial performance. Whenever used, words such as may, will, would, should, potential, strategy, anticipates, estimates, expects, project, predict, intends, plans, believes, targets and other terms of similar meaning are intended to identify such forward-looking statements. Forward-looking statements are uncertain and to some extent unpredictable, and involve known and unknown risks, uncertainties, and other important factors that could cause actual results to differ materially from those expressed or implied in, or reasonably inferred from, such forward-looking statements. If any of management's assumptions prove incorrect or should unanticipated circumstances arise, the Company's actual results could materially differ from those anticipated by such forward looking statements. The differences could be caused by a number of factors or combination of factors including, but not limited to, those factors referred to below in Part II, Item 1A, Risk Factors. Readers are strongly encouraged to consider those factors when evaluating any forward looking statements concerning the Company. The Company's reports filed with or furnished to the SEC on Form 8-K, Form 10-K, Form 10-Q and other forms and any amendments to those reports, may be obtained by contacting the SEC's Public Reference Branch at 1-800-SEC-0330 or by accessing the forms electronically, free of charge, through the SEC's Internet website at <http://www.sec.gov> or through the Company's Internet website, as soon as reasonably practicable after filing with the SEC, at <http://www.dstsystems.com>. The Company undertakes no obligation to update any forward-looking statements in this Quarterly Report on Form 10-Q to reflect new information, future events or developments, or otherwise.*

*The information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto included in this Form 10-Q and the audited Consolidated Financial Statements and Notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.*

**INTRODUCTION**

DST Systems, Inc. (the Company or DST) provides sophisticated information processing and software services and products to the financial services industry (primarily mutual funds, broker/dealers and investment managers), telecommunications, video and utilities industries, the healthcare industry and other service industries.

The Company's operating business units are reported as two operating Segments (Financial Services and Output Solutions). In addition, investments in the Company's real estate subsidiaries and joint ventures, equity securities, private equity funds, and certain financial interests have been aggregated into the Investments and Other Segment.

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

**Financial Services**

The Company's Financial Services Segment provides technology based solutions using its own proprietary software systems. The principal industries serviced include mutual fund/investment management, brokerage, retirement, life and property/casualty insurance and healthcare payer industries. The Company's proprietary software systems include shareowner recordkeeping and distribution support systems for United States ( U.S. ) and international mutual fund companies, broker/dealers and financial advisors; a defined-contribution participant recordkeeping system for the U.S. retirement plan market; investment management systems offered to U.S. and international investment managers and fund accountants; a business process management and customer contact system offered to

Table of Contents

a broad variety of industries; medical and pharmacy claims administration processing systems and services offered to providers of healthcare plans, third party administrators, medical practice groups and pharmacy benefit managers; and an electronic file system offered to mutual fund companies, insurance companies and professional service (legal, accounting and others) firms. In certain cases, multiple products are integrated into a single solution.

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

**Output Solutions**

The Company's Output Solutions Segment prints, mails and electronically delivers transactional, marketing and compliance documents. The Segment's single source, customer communications solutions include customized statement and bill production; postal optimization; electronic presentment, payment and distribution solutions; fulfillment; direct marketing; and data-driven personalization services. These capabilities enable the Output Solutions Segment to provide services to industries that place a premium on high-quality, highly relevant customer communications.

The Output Solutions North America business has operating facilities located in the United States and Canada, and is among the largest users of continuous, high-speed, full-color inkjet printing systems and among the largest First-class mailers in the United States. The North America business provides digital print, direct marketing and fulfillment services, in addition to electronic solutions. The acquisition of Newkirk Products, Inc. in 2011 expanded the North America business to include participant enrollment and compliance communications related to retirement, insurance, mutual funds and healthcare plans. The business also provides significant cross-sell opportunities and leverage in DST's retirement and healthcare-related businesses.

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

Output United Kingdom ( Output U.K. and formerly known as Innovative Output Solutions Limited or IOS ) has several operating facilities in the United Kingdom and is among the largest direct communications manufacturers in that country. The acquisition of Lateral Group Limited in 2011 expanded the U.K. business to include data analytics and enhanced data-driven marketing services.

**Investments and Other**

The Investments and Other Segment is comprised of investments in the Company's real estate subsidiaries and joint ventures, equity securities, private equity funds, and certain financial interests. The assets held by the Investments and Other Segment are primarily passive in nature. The Company owns and operates real estate mostly in the U.S. and U.K., primarily for lease to the Company's other business segments. The

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

Company is a partner in certain real estate joint ventures that lease office space to the Company, certain of its unconsolidated affiliates and unrelated third parties. The Investments and Other Segment holds investments in available-for-sale equity securities with a market value of approximately \$722.7 million at June 30, 2012, including approximately 10.3 million shares of State Street Corporation ( State Street ), 11.9 million shares of Computershare Ltd. ( Computershare ) and 1.9 million shares of Euronet Worldwide, Inc., with a market value of \$461.2 million, \$90.6 million and \$32.2 million respectively, based on closing exchange values at June 30, 2012.

Table of Contents

The following table summarizes the square footage of U.S. real estate facilities wholly-owned by DST or owned through unconsolidated affiliates of DST as of June 30, 2012 (in millions):

	<b>DST wholly- owned*</b>	<b>Joint venture- owned*</b>
Occupied by DST and related affiliates	1.9	0.5
Occupied by third parties	0.9	2.4
<b>Total</b>	<b>2.8</b>	<b>2.9</b>

---

\* Amounts exclude square footage of wholly-owned data centers and related property and a joint venture-owned 1,000 room convention hotel.

DST considers its data centers and surrounding property to be specialized operational assets and does not consider them to be real estate assets. Therefore, its data centers are not included in its real estate operations, but rather the Financial Services Segment.

Table of Contents**RESULTS OF OPERATIONS**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenues</b>				
<b>Operating revenues</b>				
Financial Services	\$ 307.5	\$ 281.0	\$ 618.6	\$ 565.3
Output Solutions	158.7	144.3	324.1	290.6
Investments and Other	15.1	13.7	29.5	27.8
Elimination Adjustments	(15.8)	(14.9)	(30.8)	(30.1)
	465.5	424.1	941.4	853.6
% change from prior year period	9.8%		10.3%	
<b>Out-of-pocket reimbursements</b>				
Financial Services	13.1	10.2	27.6	20.8
Output Solutions	156.1	148.6	320.8	301.1
Investments and Other		0.8	0.1	1.4
Elimination Adjustments	(1.9)	(1.5)	(3.9)	(3.0)
	167.3	158.1	344.6	320.3
% change from prior year period	5.8%		7.6%	
<b>Total revenues</b>	\$ 632.8	\$ 582.2	\$ 1,286.0	\$ 1,173.9
% change from prior year period	8.7%		9.5%	
<b>Income from operations</b>				
Financial Services	\$ 48.8	\$ 64.0	\$ 100.9	\$ 127.1
Output Solutions	4.6	8.9	11.8	14.4
Investments and Other	(0.5)	2.4	2.3	5.0
Elimination Adjustments	(2.0)	(2.0)	(4.0)	(3.9)
	50.9	73.3	111.0	142.6
Interest expense	(11.7)	(12.0)	(23.4)	(23.7)
Other income, net	194.2	14.6	223.9	31.8
Equity in earnings of unconsolidated affiliates	1.4	7.2	6.7	15.6
<b>Income before income taxes and non-controlling interest</b>	234.8	83.1	318.2	166.3
Income taxes	89.9	28.7	118.0	58.8
<b>Net income</b>	144.9	54.4	200.2	107.5
Net loss attributable to non-controlling interest		0.8		1.1
<b>Net income attributable to DST Systems, Inc.</b>	\$ 144.9	\$ 55.2	\$ 200.2	\$ 108.6
Basic earnings per share	\$ 3.22	\$ 1.19	\$ 4.48	\$ 2.34
Diluted earnings per share	\$ 3.17	\$ 1.17	\$ 4.40	\$ 2.31
Non-GAAP diluted earnings per share	\$ 0.77	\$ 1.05	\$ 1.82	\$ 2.13
Cash dividends per share of common stock	\$	\$	\$ 0.40	\$ 0.35



Table of Contents

**Consolidated revenues**

Consolidated total revenues (including out-of-pocket ( OOP ) reimbursements) for the three and six months ended June 30, 2012 were \$632.8 million and \$1,286.0 million, respectively, an increase of \$50.6 million or 8.7% and \$112.1 million or 9.5% compared to the three and six months ended June 30, 2011. Consolidated operating revenues for the three and six months ended June 30, 2012 increased \$41.4 million or 9.8% and \$87.8 or 10.3%, respectively, as compared to the same periods in 2011. The increase in consolidated operating revenues during the three months ended June 30, 2012 was attributable to an increase of \$26.5 million in the Financial Services Segment and \$14.4 million in the Output Solutions Segment. The increase in Financial Services operating revenues for the three months ended June 30, 2012 is primarily from DST's acquisition of ALPS Holdings, Inc. ( ALPS ) on October 31, 2011, which contributed \$23.6 million of operating revenues for the three months ended June 30, 2012. The increase in Output Solutions operating revenues for the three months ended June 30, 2012 reflects the acquisition of Lateral Group Limited ( Lateral ) in August 2011 and a full quarter of Newkirk Products, Inc. ( Newkirk ), which was acquired in May 2011.

The increase in consolidated operating revenues during the six months ended June 30, 2012 was attributable to an increase of \$53.3 million in the Financial Services Segment and \$33.5 million in the Output Solutions Segment. The increase in Financial Services operating revenues for the six months ended June 30, 2012 is primarily attributable to DST's acquisition of ALPS, which contributed \$47.4 million of operating revenues for the six months ended June 30, 2012. The increase in Output Solutions operating revenues for the six months ended June 30, 2012 reflects the acquisitions of Lateral and Newkirk.

Consolidated OOP reimbursements for the three and six months ended June 30, 2012 increased \$9.2 million or 5.8% and \$24.3 million or 7.6%, respectively, as compared to the same periods in 2011. OOP reimbursements for Output Solutions increased \$7.5 million or 5.0% and \$19.7 million or 6.5% for the three and six months ended June 30, 2012, respectively, as compared to the same periods in 2011. The increase in Output Solutions OOP reimbursements is attributable to higher volumes from new clients and volumes from Lateral and Newkirk. The increase in Financial Services OOP reimbursements during the three and six months ended June 30, 2012 is from the inclusion of ALPS.

**Income from operations**

Consolidated income from operations for the three and six months ended June 30, 2012, was \$50.9 million and \$111.0 million, respectively, a decrease of \$22.4 million or 30.6% and \$31.6 million or 22.2% as compared to the same periods in 2011. The decrease in operating income during the three months ended June 30, 2012 was attributable to a decrease of \$15.2 million or 23.8% in Financial Services, \$4.3 million or 48.3% in Output Solutions and \$2.9 million in Investments and Other.

*Discontinuing development of insurance processing solution for insurance market*

After a thorough evaluation, DST has ceased the development of a processing solution for the North America insurance market, which was being built around the Percana software licensed from IFDS Ireland, the Company's joint venture with State Street Corporation. DST is discontinuing the development of the solution due to the Company's current outlook for market demand and estimated costs to complete development. This decision does not impact IFDS Ireland or the Company's European solution being provided through IFDS.



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

As a result of this decision, DST recorded during the three months ended June 30, 2012 asset impairment charges of \$5.8 million (principally software costs, both internal and third party, associated with the development of the solution), employee termination expenses of \$1.9 million and other operating costs of \$1.4 million. DST does not anticipate significant additional charges during the remainder of 2012 as a result of this decision.

DST currently maintains relationships with more than 20 of the top 25 insurance companies in the United States, and that the insurance market continues to be a key vertical market for the Company. DST will continue to provide mutual fund, retirement, AWD and output solutions to this market.

Table of Contents

Excluding the \$9.1 million of costs related to ceasing the development of the insurance solution described above, Financial Services income from operations decreased \$6.1 million during the three months ended June 30, 2012. On this basis, the decrease in Financial Services income from operations is from lower contributions from mutual fund shareowner account processing, higher costs associated with new business initiatives (retirement, brokerage and insurance), higher employee termination costs, increased depreciation and amortization due to intangible asset amortization expense from 2011 acquisitions and higher employee compensation plan costs associated with higher earnings in 2012, partially offset by a \$3.9 million decrease in deferred compensation costs (the effect of which is offset as unrealized depreciation on trading securities in other income, net), contributions from the inclusion of ALPS and increased earnings from the DST Healthcare business. Output Solutions income from operations decreased during the three months ended June 30, 2012 due to higher operating costs to support new clients and conversion activities and from higher intangible asset amortization expense related to 2011 acquisitions. The decrease in Investments and Other operating income for the three months ended June 30, 2012 primarily results from real estate impairment and leased facility abandonment charges of \$3.6 million which were partially offset by higher operating revenues.

The decrease in operating income during the six months ended June 30, 2012 was attributable to a decrease of \$26.2 million or 20.6% in Financial Services, \$2.6 million or 18.1% in Output Solutions and \$2.7 million in Investments and Other. Absent \$9.1 million of insurance solution discontinuation costs described above, Financial Services income from operations decreased \$17.1 million during the six months ended June 30, 2012. On this basis, the decrease in Financial Services income from operations is from lower contributions from mutual fund shareowner account processing, higher costs associated with new business initiatives (retirement, brokerage and insurance), higher employee termination costs, increased depreciation and amortization due to intangible asset amortization expense from 2011 acquisitions and higher employee compensation plan costs associated with higher earnings in 2012, partially offset by a \$2.8 million decrease in deferred compensation costs (the effect of which is offset as unrealized depreciation on trading securities in other income, net), contributions from the inclusion of ALPS, increased earnings from the DST Healthcare business and higher AWD software license revenues. Output Solutions income from operations decreased during the six months ended June 30, 2012 from higher operating costs to support new clients and conversion activities and from higher intangible asset amortization expense related to 2011 acquisitions, partially offset by decreased employee termination expenses. The decrease in Investments and Other operating income for the six months ended June 30, 2012 primarily results from real estate impairment and leased facility abandonment charges of \$3.6 million, which were partially offset by higher operating revenues.

**Interest expense**

Interest expense for the three and six months ended June 30, 2012 was \$11.7 million and \$23.4 million, respectively, a decrease of \$0.3 million as compared to both the three and six months ended June 30, 2011. Lower weighted average interest rates were partially offset by higher weighted average debt amounts outstanding.

Table of Contents**Other income, net**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net realized gains from sale of available-for-sale securities	\$ 7.3	\$ 10.3	\$ 22.7	\$ 18.4
Net gain (loss) on private equity funds and other investments	1.8	1.4	4.2	1.1
Other than temporary impairments / unrealized losses on available-for-sale securities	(1.6)	(0.1)	(1.9)	(0.1)
Net gain (loss) on the disposition of senior convertible debentures		(0.9)		(0.9)
Dividend income	3.7	3.0	9.4	8.2
Private company investment dividend	47.3		47.3	
Gain on sale of private company investment	138.7		138.7	
Interest income	0.9	0.6	1.9	1.6
Miscellaneous items	(3.9)	0.3	1.6	3.5
Other income, net	\$ 194.2	\$ 14.6	\$ 223.9	\$ 31.8

Other income, net, was \$194.2 million and \$223.9 million for the three and six months ended June 30, 2012, respectively, as compared to \$14.6 million and \$31.8 for the three and six months ended June 30, 2011.

Net realized gains from the sale of available-for-sale securities were \$7.3 million and \$22.7 million for the three and six months ended June 30, 2012, as compared to \$10.3 million and \$18.4 million for the three and six months ended June 30, 2011. Included in the \$22.7 million of net gains from the sale of available-for-sale securities for the six months ended June 30, 2012 is a \$11.6 million gain from the sale of approximately 3.1 million shares of Computershare Ltd.

The Company incurred a net gain of \$1.8 million and \$4.2 million on private equity funds and other investments for the three and six months ended June 30, 2012, as compared to a net gain of \$1.4 million and \$1.1 million for the three and six months ended June 30, 2011.

The Company records investment impairment charges for available-for-sale securities with gross unrealized holding losses resulting from a decline in value that is other than temporary. During the three and six months ended June 30, 2012, the Company recorded \$1.6 million and \$1.9 million of impairments that were other than temporary.

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

The Company recorded a net loss during the three and six months ended June 30, 2011 of \$0.9 million associated with the repurchase and extinguishment of senior convertible debentures.

The Company receives dividend income from certain investments held. Dividend income was \$3.7 million and \$9.4 million for the three and six months ended June 30, 2012, respectively, as compared to \$3.0 million and \$8.2 million for the three and six months ended June 30, 2011. The increase in dividend income is primarily from State Street Corporation increasing its quarterly dividend per share to \$0.24, an increase of \$0.06 per share or approximately \$0.6 million and \$1.2 million as compared to the three and six months ended June 30, 2011.

The Company recorded dividend income from a privately held company investment of \$47.3 million during the three months ended June 30, 2012.

Table of Contents

The Company recorded a \$138.7 million gain on the sale of a portion of its shares of a privately held company investment during the three months ended June 30, 2012.

Interest income was \$0.9 million and \$1.9 million for the three and six months ended June 30, 2012, respectively, as compared to \$0.6 million and \$1.6 million for the three and six months ended June 30, 2011.

Miscellaneous items include unrealized gains and losses on marketable securities designated as trading securities, realized foreign currency gains and losses, amortization of deferred non-operating gains and other non-operating items. Miscellaneous items was a loss of \$3.9 million and a gain of \$1.6 million for the three and six months ended June 30, 2012, respectively, compared to a gain of \$0.3 million and \$3.5 million for the three and six months ended June 30, 2011. The \$4.2 million decrease in miscellaneous items for the three months ended June 30, 2012 is primarily from unrealized depreciation on trading securities (the effect of which is offset by a decrease in costs and expenses in the Financial Services Segment). The \$1.9 million decrease in miscellaneous items for the six months ended June 30, 2012 is attributable to unrealized depreciation on trading securities (the effect of which is offset by a decrease in costs and expenses in the Financial Services Segment), partially offset by higher foreign currency exchange gains in 2012.

**Equity in earnings of unconsolidated affiliates**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
BFDS	\$ 2.3	\$ 3.1	\$ 5.5	\$ 6.3
IFDS, U.K.	0.2	3.4	1.8	7.5
IFDS, L.P.	1.2	0.4	1.1	2.1
Other	(2.3)	0.3	(1.7)	(0.3)
	\$ 1.4	\$ 7.2	\$ 6.7	\$ 15.6

DST's equity in earnings of unconsolidated affiliates decreased \$5.8 million or 80.6% and \$8.9 million or 57.1% for the three and six months ended June 30, 2012, respectively, as compared to the same periods in 2011.

DST's equity in BFDS earnings for the three and six months ended June 30, 2012 was \$2.3 million and \$5.5 million, respectively, a decrease of \$0.8 million or 25.8% as compared to the three months ended June 30, 2011 and a decrease of \$0.8 million or 12.7% as compared to the six months ended June 30, 2011. The decrease in equity in BFDS earnings for the three months ended June 30, 2012 is from lower revenues associated with reduced levels of accounts serviced resulting from subaccounting conversions, which were partially offset by lower operating expenses. The decrease in equity in BFDS earnings for the six months ended June 30, 2012 is from lower revenues, which were partially offset by lower operating expenses and a lower income tax rate. BFDS derives investment earnings related to cash balances maintained on behalf of customers. Average daily client cash balances invested by BFDS were \$1.0 billion and \$1.1 billion during the three and six months ended June 30, 2012, as compared to \$1.0 billion during both the three and six months ended June 30, 2011. Average interest rates earned on the balances decreased from 0.13% during the six months ended June 30, 2011 to 0.12% during the six months ended June 30, 2012, a level which is

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

not sufficient to cover banking and transaction fees.

DST's equity in earnings of IFDS, U.K. for the three and six months ended June 30, 2012 was \$0.2 million and \$1.8 million, respectively, a decrease of \$3.2 million and \$5.7 million as compared to the same periods in 2011. The decline in IFDS U.K. earnings is attributable to costs for new product development initiatives and costs associated with client conversion activities. Shareowner accounts serviced by IFDS, U.K. were 8.3 million at

Table of Contents

June 30, 2012, an increase of 0.1 million accounts or 1.2% from March 31, 2012 and an increase of 0.7 million accounts or 9.2% from June 30, 2011.

DST's equity in earnings of IFDS, L.P. (which includes IFDS Canada, Ireland and Luxembourg) for the three and six months ended June 30, 2012 was \$1.2 million and \$1.1 million, respectively, an increase of \$0.8 million and \$1.0 million as compared to the same periods in 2011. The increase in IFDS L.P. earnings during the three and six months ended June 30, 2012 was primarily from the recognition of \$0.8 million (DST's share) of previously deferred gains. In addition, improved results for IFDS Ireland were mostly offset by reductions in IFDS Canada, attributable to costs associated with client conversion activities and lower revenues associated with reduced levels of accounts serviced. Accounts serviced by IFDS Canada were 10.3 million at June 30, 2012, a decrease of 0.1 million accounts or 1.0% from March 31, 2012 and a decrease of 0.4 million accounts or 3.7% from June 30, 2011.

As previously announced, IFDS U.K. is in the process of converting new shareowner processing clients with approximately 0.9 million accounts, of which 0.7 million accounts are expected to convert by December 31, 2012 with the remainder in early 2013. IFDS U.K. is also in the process of converting new life and pensions clients with 250,000 policies to their new policy system in late 2012 and 2013. As previously announced, IFDS Canada is in the process of converting a new client which is expected to increase shareowner accounts serviced by approximately 1.2 million accounts in fourth quarter 2012. IFDS projects that these new clients will, in the aggregate, produce approximately \$44.0 million of annualized revenue when fully converted. New product development and client conversion costs will continue to negatively impact IFDS earnings in 2012.

DST's equity in other unconsolidated affiliates was a loss of \$2.3 million and \$1.7 million for the three and six months ended June 30, 2012, respectively, a decrease of \$2.6 million and \$1.4 million as compared to the same periods in 2011. The decrease in equity in earnings of other unconsolidated affiliates was primarily from asset impairments of \$3.1 million recorded during the three months ended June 30, 2012.

**Income taxes**

The Company records income tax expense during interim periods based on its best estimate of the full year's tax rate. Certain items are given discrete period treatment and, as a result, the tax effects of such items are reported in full in the relevant interim period. The Company's tax rate was 38.3% and 37.1% for the three and six months ended June 30, 2012 compared to 34.5% and 35.4% for the three and six months ended June 30, 2011. The increase in the rate during the three and six months ended June 30, 2012 is primarily from lower foreign tax credits, higher domestic income and increased losses in international subsidiaries for which no current tax benefit exists.

Excluding the effects of discrete period items, the Company expects its tax rate to be approximately 37.0% in 2012, but this rate will likely vary depending on the timing of estimated 2012 sources of taxable income. The full year 2012 tax rate can be affected as a result of variances among the estimates and amounts of full year sources of taxable income (e.g., domestic consolidated, joint venture and/or international), the realization of tax credits (e.g., historic rehabilitation, research and experimentation, foreign tax and state incentive), adjustments which may arise from the resolution of tax matters under review and the Company's assessment of its liability for uncertain tax positions.

As described in the Company's 2011 Annual Report on Form 10-K, the Company has filed federal income tax refund claims for research and experimentation credits and for the Domestic Manufacturing Deduction (under Internal Revenue Code Section 199). The Company has not

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

recorded any significant tax benefits associated with these refund claims because the realization of the benefit is uncertain. The Company and the IRS are having active settlement discussions on the above refund claims. The Company believes that based upon the discussions to date, it is possible that a favorable settlement may be reached in regards to the refund claims. However, at June 30, 2012, the Company did not have sufficient information to have a basis to record additional benefits associated with the claims.



Table of Contents

**Business Segment Comparisons**

**FINANCIAL SERVICES SEGMENT**

**Revenues**

Financial Services Segment total revenues for the three and six months ended June 30, 2012 were \$320.6 million and \$646.2 million, respectively, an increase of \$29.4 million or 10.1% and \$60.1 million and 10.3% as compared to the same periods in 2011. Financial Services Segment operating revenues for the three and six months ended June 30, 2012 were \$307.5 million and \$618.6 million, respectively, an increase of \$26.5 million or 9.4% and \$53.3 million or 9.4% as compared to the same periods in 2011. ALPS contributed approximately \$23.6 million of operating revenues for the three months ended June 30, 2012. Healthcare and brokerage operating revenues increased as compared to the three months ended June 30, 2011. These operating revenue increases were partially offset by lower operating revenues for mutual fund registered shareowner account servicing.

ALPS contributed approximately \$47.4 million of operating revenues for the six months ended June 30, 2012. Healthcare and AWD operating revenues increased as compared to the three months ended June 30, 2011. These operating revenue increases were partially offset by lower operating revenues for mutual fund registered shareowner account servicing. Brokerage revenues increased slightly during the six months ended June 30, 2012, as compared to 2011, despite the absence of a \$3.5 million client termination fee received in 2011.

U.S. operating revenues for the three and six months ended June 30, 2012 were \$275.6 million and \$550.8 million, respectively, an increase of \$25.9 million or 10.4% and \$47.3 million and 9.4% as compared to the same periods in 2011. U.S. operating revenues for the three and six months ended June 30, 2012 increased primarily from the acquisition of ALPS.

International operating revenues for the three and six months ended June 30, 2012 were \$31.9 million and \$67.8 million, respectively, an increase of \$0.6 million or 1.9% and an increase of \$6.0 million or 9.7% as compared to the same periods in 2011. International operating revenues for the three months ended June 30, 2012 decreased primarily from the change in foreign currency exchange rates between the U.S. Dollar and other foreign currencies of approximately \$1.4 million. International operating revenues for the six months ended June 30, 2012 increased primarily from higher international AWD software license revenues, partially offset by the change in foreign currency exchange rates between the U.S. Dollar and other foreign currencies of approximately \$0.7 million.

Financial Services Segment OOP reimbursement revenues for the three and six months ended June 30, 2012 were \$13.1 million and \$27.6 million, respectively, an increase of \$2.9 million or 28.4% and \$6.8 million and 32.7% as compared to the same periods in 2011. The increase during the three and six months ended June 30, 2012 is primarily from ALPS.

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

### Table of Contents

The following table summarizes changes in registered accounts and subaccounts serviced (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Registered Accounts</b>				
Beginning balance	82.8	97.4	85.1	99.4
New client conversions		0.1	0.5	0.1
Subaccounting conversions to DST platforms	(0.1)	(0.2)	(1.8)	(0.7)
Subaccounting conversions to non-DST platforms	(2.0)	(2.5)	(3.4)	(5.0)
Conversions to non-DST platforms	(0.9)	(0.3)	(0.9)	(0.3)
Organic growth (decline)	0.4	0.7	0.7	1.7
Ending balance	80.2	95.2	80.2	95.2
<b>Subaccounts</b>				
Beginning balance	16.7	15.4	14.6	14.3
Conversions from non-DST registered platforms	0.1	0.2	0.2	0.7
Conversions from DST s registered accounts	0.1	0.2	1.8	0.7
Conversions to non-DST platforms				(0.6)
Organic growth (decline)	0.1	0.8	0.4	1.5
Ending balance	17.0	16.6	17.0	16.6
<b>Total accounts</b>	<b>97.2</b>	<b>111.8</b>	<b>97.2</b>	<b>111.8</b>

Total shareowner accounts serviced at June 30, 2012 were 97.2 million, a decrease of 2.3 million accounts or 2.3% from March 31, 2012 and a decrease of 14.6 million accounts or 13.1% from June 30, 2011.

Registered accounts decreased 2.6 million accounts or 3.1% from March 31, 2012 and decreased 15.0 million accounts or 15.8% from June 30, 2011. The decline in registered accounts from March 31, 2012 and June 30, 2011 is from accounts converting to subaccounting platforms and to non-DST platforms.

Tax-advantaged accounts were 42.3 million at June 30, 2012, a decrease of 0.4 million accounts or 0.9% from March 31, 2012, attributable to conversions to non-DST platforms and from organic declines. Tax-advantaged accounts decreased 0.9 million accounts or 2.1% as compared to June 30, 2011. Tax-advantaged accounts represent 52.7% of total registered accounts serviced at June 30, 2012 as compared to 45.4% at June 30, 2011.

As previously announced, two clients affiliated with Bank of New York Mellon Corporation ( BNYM ), a competitor of DST, are converting to BNYM s in-house platform. In second quarter 2012, approximately 0.8 million registered accounts were converted to BNYM s platform, and 5.8 million subaccounts are scheduled to convert during third quarter 2012.

Projections of registered accounts converting to subaccounts are based on information obtained from DST s clients and are subject to change. Based on results through June 30, 2012 and information provided by its clients regarding the remainder of the year, the Company currently expects total conversions of registered accounts to subaccounts in 2012 to be between 8-10 million, of which approximately 30% of these

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

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

ALPS operating revenues during the three and six months ended June 30, 2012 were \$23.6 million and \$47.4 million, respectively. Assets under active distribution by ALPS and assets under administration by ALPS at June 30, 2012 were \$57.4 billion and \$94.3 billion, respectively, essentially unchanged as compared to March 31, 2012.

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

### Table of Contents

Brokerage operating revenues increased during three months ended June 30, 2012 from higher levels of subaccounts serviced and revenues from acquired businesses. Brokerage operating revenues increased during the six months ended June 30, 2012 from higher levels of subaccounts serviced and revenues from acquired businesses, partially offset by the subaccounting client termination fee of \$3.5 million received in 2011. Subaccounts increased 0.3 million accounts or 1.8% from March 31, 2012 and increased 0.4 million accounts or 2.4% from June 30, 2011.

Retirement operating revenues during the three months ended June 30, 2012 were lower than the same period in 2011 resulting from lower levels of defined contribution participants serviced. Retirement operating revenues during the six months ended June 30, 2012 were lower than the same period in 2011 resulting from lower consulting and development services provided. The following table summarizes changes in defined contribution participants serviced during the three and six months ended March 31, 2012 (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,		
	2012	2011	2012	2011	
<b>Defined Contribution Participants</b>					
Beginning balance	4.7	4.7	4.6	4.5	
New client conversions					
Organic decline	(0.3)	(0.4)	(0.2)	(0.2)	
Ending balance	4.4	4.3	4.4	4.3	

Defined contribution ( DC ) participants were 4.4 million at June 30, 2012, a decrease of 0.3 million participants or 6.4% from March 31, 2012 and a decrease of 0.1 million participants 2.3% from June 30, 2011. The decrease in participants from March 31, 2012 is due to the annual removal of prior year terminated participants. Previously announced participant conversions totaling approximately 1.3 million are expected to occur in 2012 and 2013, with approximately 0.6 million participant conversions expected to occur in fourth quarter 2012.

DST HealthCare operating revenues increased during the three and six months ended June 30, 2012, as compared to the same periods in 2011, from the finalization of incentive fees related to claims processing activities, professional service fees related to a conversion that has been cancelled due to the client being acquired by another processor and higher volumes of claim processing. Pharmacy claims paid during the three and six months ended June 30, 2012 were 98.7 million and 197.9 million, respectively, an increase of 8.9 million claims or 9.9% and 16.4 million claims or 9.0% from the same periods in 2011. The increase in pharmacy claims paid is associated with new clients and higher volumes processed from existing clients. Covered lives using DST s medical claim processing platforms were 22.6 million at June 30, 2012, unchanged from March 31, 2012 and an increase of 0.1 million or 0.4% from June 30, 2011.

DST s business process and document management revenues, including revenues associated with AWD, increased during the three and six months ended June 30, 2012, from higher software license and consulting services. Active AWD users at June 30, 2012 were 201,000, essentially unchanged from March 31, 2012 and June 30, 2011.

DST Global Solutions (investment management) operating revenues during the three and six months ended June 30, 2012 were essentially unchanged from the same periods in 2011.

Financial Services Segment software license fee revenues are derived principally from DST Global Solutions (investment management), DST Health Solutions (medical claims processing) and AWD (business process management). Operating revenues include approximately \$8.2

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

million and \$19.6 million of software license fee revenues for the three and six months ended June 30, 2012, respectively, a decrease of \$1.2 million or 12.8% and an increase of \$1.4 million or 7.7% over the same periods in 2011. The decrease in software license fee revenues for the three months ended June 30, 2012 reflects lower medical claims and investment management license fee revenues, partially offset by higher AWD software license fee revenues. The increase in software license fee

Table of Contents

revenues for the six months ended June 30, 2012 reflects higher AWD software license fee revenues, partially offset by lower medical claims and investment management license fee revenues. While license fee revenues are not a significant percentage of DST's operating revenues, they can significantly impact earnings in the period in which they are recognized. Revenues and operating results from individual license sales depend heavily on the timing, size and nature of the contract.

**Costs and expenses**

Financial Services Segment costs and expenses (including OOP costs) were \$244.6 million and \$497.1 million for the three and six months ended June 30, 2012, respectively, an increase of \$35.7 million or 17.1% and \$74.0 million or 17.5% as compared to the same periods in 2011. Costs and expenses in the Financial Services Segment are primarily comprised of compensation and benefits costs but also include technology related expenditures and reimbursable operating expenses. Reimbursable operating expenses, included in costs and expenses, were \$13.1 million and \$27.6 million for the three and six months ended June 30, 2012, respectively, an increase of \$2.9 million or 28.4% and \$6.8 million or 32.7% as compared to the same periods in 2011.

Excluding reimbursable operating expenses in 2012 and 2011, costs and expenses were \$231.5 million for the three months ended June 30, 2012, an increase of \$32.8 million or 16.5% as compared to the same period in 2011. On this basis, the increase in costs and expenses is from the inclusion of ALPS and other 2011 business acquisitions, higher retirement and brokerage business development expenses, higher operating costs associated with discontinuing the development of a software solution as described above, increased employee compensation plan costs and higher employee termination expenses, partially offset by lower deferred compensation plan costs of \$3.9 million (the effect of which is offset as unrealized losses on trading securities in other income).

Excluding reimbursable operating expenses in 2012 and 2011, costs and expenses were \$469.5 million for the six months ended June 30, 2012, an increase of \$67.2 million or 16.7% as compared to the same period in 2011. On this basis, the increase in costs and expenses is from the inclusion of ALPS and other 2011 business acquisitions, higher retirement, brokerage and insurance business development expenses, higher operating costs associated with discontinuing the development of a software solution as described above, increased employee compensation plan costs and higher employee termination expenses, partially offset by lower deferred compensation plan costs of \$2.8 million (the effect of which is offset as unrealized losses on trading securities in other income).

Business development and start-up costs for the insurance, brokerage and retirement businesses during the three and six months ended June 30, 2012 were \$12.0 million and \$23.6, respectively, an increase of \$5.4 million and \$11.4 million as compared to the same periods in 2011. The Company anticipates that it will recognize \$0.26 of after tax expense per diluted share of business development and start-up expenses for the brokerage and retirement businesses in the second half of 2012.

**Depreciation and amortization**

Financial Services Segment depreciation and amortization costs for the three and six months ended June 30, 2012 were \$27.2 million and \$48.2 million, respectively, an increase of \$8.9 million or 48.6% and \$12.3 million or 34.3% as compared to the same periods in 2011. Excluding the \$5.8 million of asset impairment charges associated with ceasing the development of an insurance processing solution, depreciation and amortization increased \$3.1 million during the three months ended June 30, 2012, primarily from intangible asset amortization expense of \$2.3

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

million from the 2011 Financial Services Segment acquisitions, of which ALPS was \$1.6 million, and depreciation from recent capital expenditures, partially offset by lower intangible asset amortization from DST Health Solutions as certain assets became fully amortized at September 30, 2011. Excluding the \$5.8 million of asset impairment charges associated with ceasing the development of an insurance processing solution, depreciation and amortization increased \$6.5 million during the six months ended June 30, 2012, primarily from intangible asset amortization expense of \$4.6 million from the 2011 Financial Services Segment acquisitions and depreciation from recent capital expenditures, partially offset by lower intangible asset amortization from DST Health Solutions as certain assets became fully amortized at September 30, 2011.

Table of Contents

**Income from operations**

Financial Services Segment income from operations for the three and six months ended June 30, 2012 was \$48.8 million and \$100.9 million, respectively, a decrease of \$15.2 million or 23.8% and \$26.2 million or 20.6% as compared to the same periods in 2011.

Excluding the \$9.1 million of costs related to ceasing the development of the insurance solutions described above, Financial Services income from operations decreased \$6.1 million during the three months ended June 30, 2012. On this basis, the decrease in Financial Services income from operations is from lower contributions from mutual fund shareowner account processing, higher costs associated with new business initiatives (retirement, brokerage and insurance), higher employee termination costs, increased depreciation and amortization due to intangible asset amortization expense from 2011 acquisitions and higher employee compensation plan costs associated with higher earnings in 2012, partially offset by a \$3.9 million decrease in deferred compensation costs (the effect of which is offset as unrealized depreciation on trading securities in other income, net), contributions from the inclusion of ALPS and increased earnings from the DST Healthcare business.

Excluding the \$9.1 million of insurance solution discontinuation costs described above, Financial Services income from operations decreased \$17.1 million during the six months ended June 30, 2012. On this basis, the decrease in Financial Services income from operations is from lower contributions from mutual fund shareowner account processing, higher costs associated with new business initiatives (retirement, brokerage and insurance), higher employee termination costs, increased depreciation and amortization due to intangible asset amortization expense from 2011 acquisitions and higher employee compensation plan costs associated with higher earnings in 2012, partially offset by a \$2.8 million decrease in deferred compensation costs (the effect of which is offset as unrealized depreciation on trading securities in other income, net), contributions from the inclusion of ALPS, increased earnings from the DST Healthcare business and higher AWD software license revenues.



Table of Contents**OUTPUT SOLUTIONS SEGMENT****Revenues**

The following table presents the financial results of the Output Solutions Segment (in millions):

	Three Months Ended June 30,			
	2012		2011	
	Operating Revenue	Operating Income (Loss)	Operating Revenue	Operating Income (Loss)
North America	\$ 110.8	\$ 9.1	\$ 106.4	\$ 11.5
United Kingdom	47.9	(4.5)	37.9	(2.6)
Output Solutions Segment	\$ 158.7	\$ 4.6	\$ 144.3	\$ 8.9

	Six Months Ended June 30,			
	2012		2011	
	Operating Revenue	Operating Income (Loss)	Operating Revenue	Operating Income (Loss)
North America	\$ 224.5	\$ 18.7	\$ 213.9	\$ 17.8
United Kingdom	99.6	(6.9)	76.7	(3.4)
Output Solutions Segment	\$ 324.1	\$ 11.8	\$ 290.6	\$ 14.4

Output Solutions Segment total revenues for the three and six months ended June 30, 2012 were \$314.8 million and \$644.9 million, respectively, an increase of \$21.9 million or 7.5% and \$53.2 million or 9.0% as compared to the same periods in 2011. Output Solutions Segment operating revenues for the three and six months ended June 30, 2012 were \$158.7 million and \$324.1 million, respectively, an increase of \$14.4 million or 10.0% and \$33.5 million or 11.5% as compared to the same periods in 2011. The increase in operating revenue for the three and six months ended June 30, 2012 was primarily attributable to the acquisitions of Lateral in August 2011 and Newkirk in May 2011.

Out-of-pocket reimbursement revenues for the three and six months ended June 30, 2012 were \$156.1 million and \$320.8 million, respectively, an increase of \$7.5 million or 5.0% and \$19.7 million or 6.5% as compared to the same periods in 2011, attributable to higher volumes from new clients and volumes from the Lateral and Newkirk acquisitions.

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

### Table of Contents

The following table sets out images produced and packages mailed for the Output Solutions Segment (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Images Produced</b>				
North America	2,216.2	2,213.9	4,575.7	4,487.8
United Kingdom	544.1	476.1	1,100.9	972.8
Output Solutions Segment	2,760.3	2,690.0	5,676.6	5,460.6
<b>Packages Mailed</b>				
North America	527.4	472.1	1,073.3	986.2
United Kingdom	183.3	173.0	373.1	364.2
Output Solutions Segment	710.7	645.1	1,446.4	1,350.4

Output's North America operating revenues increased \$4.4 million or 4.1% and \$10.6 million or 5.0% for the three and six months ended June 30, 2012, respectively, as compared to the same periods in 2011. The increase in operating revenues were principally from the Newkirk acquisition and from new client revenues, which were partially offset by lower volumes from existing clients.

North America images produced during the three and six months ended June 30, 2012 were 2,216.2 million and 4,575.7 million, respectively, essentially unchanged as compared to the three months ended June 30, 2011 and an increase of 2.0% as compared to the six months ended June 30, 2011. North America packages mailed during the three and six months ended June 30, 2012 were 527.4 million and 1,073.3 million, respectively, an increase of 55.3 million or 11.7% as compared to the three months ended June 30, 2011 and an increase of 87.1 million or 8.8% as compared to the six months ended June 30, 2011. The increase in packages mailed for the three and six months ended June 30, 2012 was primarily the result of new client volumes, the mix of work from existing clients and the acquisition of Newkirk, partially offset by lower volumes from existing clients.

During second quarter 2012, Output Solutions received new client commitments in North America representing, when fully transitioned, approximately 19 million of aggregate packages annually, based on current volume levels. Full conversion activities related to these new clients is expected to be completed in the first quarter of 2013.

Output's United Kingdom operating revenues increased \$10.0 million or 26.4% and \$22.9 million or 29.9% for the three and six months ended June 30, 2012, respectively, as compared to the same periods in 2011, principally from the Lateral acquisition, partially offset by lower volumes from existing clients. DST Output U.K. images produced during the three and six months ended June 30, 2012 were 544.1 million and 1,100.9 million, respectively, an increase of 68.0 million or 14.3% and 128.1 million or 13.2% as compared to the same periods in 2011. DST Output U.K. packages mailed during the three and six months ended June 30, 2012 were 183.3 million and 373.1 million, respectively, an increase of 10.3 million or 6.0% and 8.9 million or 2.4% as compared to the same periods in 2011. The net increase in images produced and packages produced was primarily the result of the acquisition of Lateral, partially offset by lower volumes from existing clients.

### **Costs and expenses**

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

Output Solutions Segment costs and expenses (including OOP costs) were \$299.1 million and \$611.0 million for the three and six months ended June 30, 2012, an increase of \$26.1 million or 9.6% and \$55.3 million or 10.0% as compared to the same periods in 2011. Costs and expenses in the Output Solutions Segment are primarily comprised of reimbursable operating expenses (primarily postage), compensation and benefits costs, material costs (principally paper and ink) and other operating costs. Reimbursable operating expenses, included in costs

Table of Contents

and expenses, were \$156.1 million and \$320.8 million for the three and six months ended June 30, 2012, an increase of \$7.5 million or 5.0% and \$19.7 million or 6.5% as compared to the same periods in 2011. Excluding reimbursable operating expenses in 2012 and 2011, costs and expenses increased \$18.6 million or 15.0% and \$35.6 million or 14.0% for the three and six months ended June 30, 2012 to \$143.0 million and \$290.2 million, respectively. On this basis, Output's North America costs and expenses increased \$7.4 million for the three months ended June 30, 2012, primarily from higher costs associated with an increased workforce to support new clients and conversion activities, higher material costs from higher volumes of operating revenues, higher equity compensation costs, and higher costs from the inclusion of Newkirk for a full quarter in 2012. On the same basis, Output U.K.'s costs and expenses increased \$11.2 million during the three months June 30, 2012, as compared to the same period in 2011, primarily due to the acquisition of Lateral, higher material costs associated with higher operating revenues and higher employee termination expenses and lease abandonment costs associated with consolidating facilities post acquisition.

On this same basis, Output's North America costs and expenses increased \$10.9 million for the six months ended June 30, 2012, as compared to the same period in 2011, for the same reasons described above, partially offset by lower employee compensation expenses resulting from a reduction in force that occurred in 2011. Output U.K.'s costs and expenses for the six months ended June 30, 2012, as compared to the same period in 2011, increased \$24.7 million for the same reasons as the three month period ended June 30, 2012 described above.

Output U.K. continues to review its current cost structure in order to identify additional cost savings opportunities from the acquisition of Lateral. As previously announced, the Company has determined that it will close two U.K. operating locations before the end of 2012. The Company incurred employee related restructuring charges of approximately \$0.8 million during the three months ended June 30, 2012 associated with these actions. The Company expects to incur facility related restructuring charges later in 2012 as certain leased facilities become vacated.

**Depreciation and amortization**

Output Solutions Segment depreciation and amortization costs for the three and six months ended June 30, 2012 were \$11.1 million and \$22.1 million, respectively, an increase of \$0.1 million or 0.9% and \$0.5 million or 2.3% as compared to the same periods in 2011. Depreciation and amortization expense in the United Kingdom increased \$0.6 million and \$1.5 million during the three and six months ended June 30, 2012, as compared to the same periods in 2011, primarily from intangible asset amortization from the Lateral acquisition. Depreciation and amortization expense in North America decreased \$0.5 million and \$1.0 million during the three and six months ended June 30, 2012, as compared to the same periods in 2011, primarily from lower levels of capital expenditures, which was partially offset by intangible asset amortization from the Newkirk acquisition.

**Income from operations**

Output Solutions Segment income from operations for the three and six months ended June 30, 2012 was \$4.6 million and \$11.8 million, respectively, a decrease of \$4.3 million or 48.3% and \$2.6 million or 18.1% as compared to the same periods in 2011. During the three months ended June 30, 2012, Output North America income from operations decreased \$2.4 million and Output U.K. income from operations decreased \$1.9 million. The decrease in Output North America is from higher operating costs associated with an increased workforce to support new clients and conversion activities, higher equity compensation costs and from higher intangible asset amortization expense related to the Newkirk acquisition. The decrease in Output U.K. is from intangible asset amortization expense related to the Lateral acquisition, higher equity compensation costs and higher facility consolidation costs including employee termination charges and leased facility abandonment costs.

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

During the six months ended June 30, 2012, Output North America income from operations increased \$0.9 million and Output U.K. income from operations decreased \$3.5 million. The increase in Output North America is from lower employee termination costs from an action taken in 2011, which was partially offset by higher costs associated with an increased workforce to support new clients and conversion activities, higher equity compensation costs, higher intangible asset amortization related to the Newkirk acquisition and higher costs in Canada for plant expansion. The decrease in Output U.K. for the six months ended June 30, 2012 is from intangible asset

Table of Contents

amortization related to the Lateral acquisition, higher equity compensation costs and higher facility consolidation costs such as employee termination charges and leased facility abandonment costs.

**Use of EBITDA**

DST defines Operating EBITDA as income from operations before depreciation and amortization. This supplemental non-GAAP liquidity measure is provided in addition to, but not as a substitute for, cash flow from operations. As a measure of liquidity, the Company believes Operating EBITDA is useful as an indicator of its ability to generate cash flow. Operating EBITDA, as calculated by the Company, may not be consistent with computation of Operating EBITDA by other companies. The Company believes a useful measure of the Output Solutions and Investments and Other Segments' contribution to DST's results is to focus on cash flow and the Company's management believes Operating EBITDA is useful for this purpose. A reconciliation of Output Solutions and Investments and Other Segment income from operations to Operating EBITDA is included in the pages that follow. The non-GAAP adjustments to this reconciliation are used to calculate Adjusted Operating EBITDA and are described in the "Use of Non-GAAP Financial Information" included in Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

The following table presents Operating EBITDA of the Output Solutions Segment (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012 Operating EBITDA	2011 Operating EBITDA	2012 Operating EBITDA	2011 Operating EBITDA
North America	\$ 16.6	\$ 19.5	\$ 33.5	\$ 33.6
United Kingdom	(0.9)	0.4	0.4	2.4
Output Solutions Segment	\$ 15.7	\$ 19.9	\$ 33.9	\$ 36.0

For the three and six months ended June 30, 2012, Output Solutions Operating EBITDA was \$15.7 million and \$33.9 million, respectively, a decrease of \$4.2 million or 21.1% and \$2.1 million or 5.8% as compared to the same periods in 2011. The decrease for the three months ended June 30, 2012 is attributable to lower Operating EBITDA in North America from higher operating expenses, primarily associated with an increase in workforce to support new clients and conversion activities, higher equity compensation expense and higher costs in Canada for production plant expansion. The decrease in Operating EBITDA for Output U.K. is due to higher equity compensation and lower revenues.

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

### Table of Contents

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2012	2011	2012	2011	2012	2011	2012	2011
Output Solutions Segment income from operations	\$ 4.6	\$ 8.9	\$ 11.8	\$ 14.4	\$ 11.1	\$ 11.0	\$ 22.1	\$ 21.6
Depreciation and amortization								
Operating EBITDA, before Non-GAAP items	15.7	19.9	33.9	36.0				
Leased facility abandonment costs	0.4		0.4					
Employee termination expenses	0.8		2.2	4.1				
Business development expenses		0.2		0.2				
Adjusted Operating EBITDA, after Non-GAAP items	\$ 16.9	\$ 20.1	\$ 36.5	\$ 40.3				
Comprised of:								
North America	\$ 16.6	\$ 19.7	\$ 33.5	\$ 37.9				
United Kingdom	0.3	0.4	3.0	2.4				
	\$ 16.9	\$ 20.1	\$ 36.5	\$ 40.3				

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

### INVESTMENTS AND OTHER SEGMENT

#### Revenues

Investments and Other Segment total revenues, including out-of-pocket reimbursements, were \$15.1 million and \$29.6 million for the three and six months ended June 30, 2012, respectively, an increase of \$0.6 million or 4.1% and \$0.4 million or 1.4% as compared to the same periods in 2011. The majority of the revenues in the Investments and Other Segment are derived from the lease of facilities to the Company's other business segments. Operating revenues (excluding out-of-pocket reimbursements) were \$15.1 million and \$29.5 million for the three and six months ended June 30, 2012, an increase of \$1.4 million or 10.2% and \$1.7 million or 6.1% as compared to the same periods in 2011, primarily due to higher third party rental activities.

#### Costs and expenses

Occupancy costs are the single largest costs included in costs and expenses in the Investments and Other Segment. For the three and six months ended June 30, 2012, Investments and Other Segment costs and expenses were \$11.0 million and \$20.0 million, an increase of \$1.5 million and \$1.0 million as compared to the same periods in 2011. Reimbursable operating expenses, included in costs and expenses were zero and \$0.1

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

million for the three and six months ended June 30, 2012, respectively. Excluding reimbursable operating expenses in 2012 and 2011, costs and expenses increased \$2.3 million in both the three and six months ended June 30, 2012, as compared to 2011, attributable to a \$1.8 million leased facility abandonment charge in 2012 and from higher costs associated with the increase in third party rental revenues.

### **Depreciation and amortization**

Investments and Other Segment depreciation and amortization for the three and six months ended June 30, 2012 was \$4.6 million and \$7.3 million, an increase of \$2.0 million and \$2.1 million as compared to the same periods in 2011, primarily from \$1.8 million of real estate impairment charges recorded in 2012.



Table of Contents**Income from operations**

Investments and Other Segment recorded a loss from operations of \$0.5 million during the three months ended June 30, 2012, a decrease of \$2.9 million as compared to the same period in 2011. For the six months ended June 30, 2012, income from operations was \$2.3 million, a decrease of \$2.7 million as compared to the same period in 2011. The decrease in operating income for the three and six months ended June 30, 2012 is primarily from real estate impairment and leased facility abandonment charges of \$3.6 million which were partially offset by higher operating revenues.

*Review of DST's U.S. Real Estate Holdings*

DST's U.S. real estate holdings had \$3.9 million and \$9.2 million of Operating EBITDA (defined as operating income plus depreciation and amortization) for the three and six months ended June 30, 2012, a decrease of \$1.1 million and \$0.6 million as compared to the same periods in 2011, primarily from the leased facility abandonment charge described above.

At June 30, 2012, consolidated U.S. real estate related debt was \$109.5 million, a decrease of \$2.4 million as compared to December 31, 2011. DST's pro-rata share of debt associated with unconsolidated affiliates' real estate at June 30, 2012 was \$188.4 million, a decrease of \$5.3 million as compared to December 31, 2011, substantially all of which is non-recourse debt.

The reconciliation of the Investments and Other Segment income from operations to Operating EBITDA as used by management is set forth in the table below (in millions):

	Three Months Ended		Six Months Ended	
	2012	June 30, 2011	2012	June 30, 2011
<b>Reported GAAP income from operations</b>	\$ (0.5)	\$ 2.4	\$ 2.3	\$ 5.0
Adjusted to remove:				
GAAP income (loss) from non U.S. real estate operations	(0.9)	(0.4)	(1.0)	(0.5)
<b>U.S. Real Estate Operations GAAP income from operations</b>	0.4	2.8	3.3	5.5
Adjusted to remove:				
Depreciation and amortization	3.5	2.2	5.9	4.3
<b>Operating EBITDA, before non-GAAP items</b>	3.9	5.0	9.2	9.8
Adjusted to remove:				

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Leased facility abandonment costs		1.8				1.8	
<b>Adjusted operating EBITDA, after non-GAAP items</b>	\$	5.7	\$	5.0	\$	11.0	\$ 9.8

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

Table of Contents**Segment Operating Data**

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

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
<b>Financial Services Operating Data</b>		
Mutual fund shareowner accounts processed (millions)		
U.S.		
Registered accounts:		
Non tax-advantaged	37.9	42.4
Tax-advantaged:		
IRA mutual fund accounts	23.9	24.3
Other retirement accounts	8.8	8.9
Section 529 and Educational IRAs	9.6	9.5
	42.3	42.7
Total registered accounts	80.2	85.1
Subaccounts	17.0	14.6
Total accounts serviced	97.2	99.7
<b>International</b>		
United Kingdom (1)	8.3	8.1
Canada (2)	10.3	10.1
Defined Contribution / TRAC participants (millions)	4.4	4.6
ALPS-Assets Under Active Distribution (billions)	\$ 57.4	\$ 51.9
ALPS-Assets Under Administration (AUM) (billions)	\$ 94.3	\$ 93.6
Automated Work Distributor users (thousands)	201.0	204.3
DST Health Solutions covered lives (millions)	22.6	22.6

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>		
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>	
<b>Other Financial Services Operating Data</b>					
Pharmacy claims paid by Argus (millions)	98.7	89.8	197.9	181.5	
<b>Output Solutions Operating Data</b>					
North America images produced (millions)	2,216.2	2,213.9	4,575.7	4,487.8	
North America packages mailed (millions)	527.4	472.1	1,073.3	986.2	
United Kingdom images produced (millions)	544.1	476.1	1,100.9	972.8	
United Kingdom packages mailed (millions)	183.3	173.0	373.1	364.2	

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

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



Table of Contents

**USE OF NON-GAAP FINANCIAL INFORMATION**

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

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

*Description of Non-GAAP Adjustments*

The following items, which occurred during the three months ended June 30, 2012, have been treated as non-GAAP adjustments:

- Business advisory expenses associated with an action by the DST Board of Directors to retain independent advisors to assist the Board with its ongoing review of DST's business plan, assets and investment portfolio, included in costs and expenses, in the amount of \$0.5 million. The income tax benefit associated with these expenses was approximately \$0.2 million.
- Employee termination expenses of \$3.6 million associated with reductions in workforce in the Financial Services Segment (\$2.8 million) and the Output Solutions Segment (\$0.8 million), which were included in costs and expenses. The aggregate income tax benefit associated with these costs was approximately \$1.3 million.
- Leased facility abandonment costs of \$0.4 million, included in costs and expenses in the Output Solutions Segment, associated with properties not used in the U.K. operations. The aggregate income tax benefit associated with these costs was approximately \$0.1 million.

- Impairment charges on certain real estate assets not currently used in operations of \$1.8 million, included in depreciation and amortization expense in the Investments & Other Segment. The charge was comprised of impairments in the U.S. of \$1.2 million and internationally of \$0.6 million. The aggregate income tax benefit associated with these costs was approximately \$0.7 million.

Table of Contents

- Leased facility abandonment costs of \$1.8 million, included in costs and expenses in the Investments & Other Segment, associated with exiting a leased office building. The aggregate income tax benefit associated with these costs was approximately \$0.7 million.
- Pretax costs associated with ceasing the development of a processing solution for the insurance market, in the amount of \$8.3 million. The costs were comprised of asset impairment charges of \$5.8 million, which were included in depreciation and amortization expense, employee termination expenses of \$1.9 million and other operating costs of \$1.4 million, which were both included in costs and expenses. These costs were partially offset by the recognition of previously deferred IFDS L.P. software license revenues of \$0.8 million (DST's share), included in equity in earnings of unconsolidated affiliates, related to the 2011 sale of its Percana software license to DST. The aggregate income tax benefit associated with these net costs is \$3.2 million.
- Cash dividend and gain on sale of a private company investment of \$186.0 million, which was included in other income, net. In May 2012, the Company received a cash dividend of \$47.3 million and realized a gain of \$138.7 million on the sale of a portion of its shares in a privately held company investment. A portion of the dividend is estimated to qualify for the dividends received deduction. The aggregate income tax expense associated with this dividend and gain was approximately \$68.9 million.
- Other net gain, in the amount of \$7.5 million, associated with gains (losses) related to securities and other investments, which were included in other income, net. The income tax expense associated with this net gain was approximately \$3.0 million. The \$7.5 million of net gains on securities and other investments for second quarter 2012 was comprised of net realized gains from sales of available-for-sale securities of \$7.3 million and net gains on private equity funds and other investments of \$1.8 million, partially offset by other than temporary impairments on available-for-sale securities of \$1.6. The Company sold approximately 0.6 million shares of Computershare Ltd. during the three months ended June 30, 2012, and recorded a gain of \$1.5 million.
- Impairment of unconsolidated affiliates, in the amount of \$3.1 million, included in equity in earnings of unconsolidated affiliates. The aggregate income tax benefit associated with this expense was approximately \$1.2 million.

The following items, which occurred during the three months ended June 30, 2012 as described above, the following items, which occurred during the three months ended March 31, 2012, have been previously reported as non-GAAP adjustments:

- Business advisory expenses associated with an action by the DST Board of Directors to retain independent advisors to assist the Board with its ongoing review of DST's business plan, assets and investment portfolio, included in costs and expenses, in the amount of \$0.5 million. The income tax benefit associated with these expenses was approximately \$0.2 million.
- Employee termination expenses of \$4.0 million associated with reductions in workforce in the Financial Services Segment (\$2.6 million) and the Output Solutions Segment (\$1.4 million), which were included in costs and expenses. The aggregate income tax benefit associated with these costs was approximately \$1.3 million.

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

- Other net gain, in the amount of \$17.5 million, associated with gains (losses) related to securities and other investments, which were included in other income, net. The income tax expense associated with this net gain was approximately \$6.7 million. The \$17.5 million of net gains on securities and other investments for first quarter 2012 was comprised of net realized gains from sales of available-for-sale securities of \$15.4 million and net gains on private equity funds and other investments of \$2.4 million, partially offset by other than temporary impairments on available-for-sale securities of \$0.3 million. The Company sold 2.5 million shares of Computershare Ltd. during the three months ended March 31, 2012, and recorded a gain of \$10.1 million.



Table of Contents

The following items, which occurred during the three months ended June 30, 2011, have been treated as non-GAAP adjustments:

- Business development expenses (legal, accounting and other professional fees) associated with business acquisitions described in the business development activities section above, included in costs and expenses, in the amount of \$1.2 million (\$1.0 million in Financial Services and \$0.2 million in Output Solutions). The income tax benefit associated with these expenses was approximately \$0.5 million.
- Other net gain, in the amount of \$11.6 million, associated with gains (losses) related to securities and other investments, which were included in other income, net. The income tax expense associated with this net gain was approximately \$4.5 million. The \$11.6 million of net gain on securities and other investments for second quarter 2011 was comprised of net realized gains from sales of available-for-sale securities of \$10.3 million and net gains on private equity funds and other investments of \$1.4 million, partially offset by other than temporary impairments on available-for-sale securities of \$0.1 million.
- Net loss, in the amount of \$0.9 million, associated with the repurchase of senior convertible debentures, which was included in other income, net. The income tax benefit associated with this net loss was approximately \$0.3 million.

In addition to the items that occurred in the three months ended June 30, 2011 as described above, the following items, which occurred during the three months ended March 31, 2011, have been previously reported as non-GAAP adjustments:

- Contract termination payment, net of certain costs, resulting from the termination of a Financial Services subaccounting client, in the amount of \$2.0 million. The net contract termination gain was comprised of operating revenues of \$3.5 million, partially offset by certain costs of \$1.5 million that were included in cost and expenses. The aggregate income tax expense associated with this net contract termination gain was approximately \$0.8 million.
- Employee termination benefit expenses of \$5.4 million associated with reductions in workforce in the Financial Services Segment (\$1.3 million) and the Output Solutions Segment (\$4.1 million), which were included in costs and expenses. The aggregate income tax benefit associated with these costs was approximately \$2.1 million.
- Other net gain, in the amount of \$7.8 million, associated with gains (losses) related to the disposition of securities and other investments, which were included in other income, net. The income tax expense associated with this net gain was approximately \$3.0 million. The \$7.8 million of net gain on the disposition of securities and other investments for first quarter 2011 was comprised of net realized gains from sales of available-for-sale securities of \$8.1 million and net losses on private equity funds and other investments of \$0.3 million.

Table of Contents

## DST SYSTEMS, INC.

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

Three Months Ended June 30,

(Unaudited - in millions, except per share amounts)

	Operating Income	Pretax Income	2012 Net Income	DST Earnings*	Diluted EPS
<b>Reported GAAP income</b>	\$ 50.9	\$ 234.8	\$ 144.9	\$ 144.9	\$ 3.17
Adjusted to remove:					
<i>Included in operating income:</i>					
Business advisory expenses - Financial Services	0.5	0.5	0.3	0.3	0.01
Employee termination expenses - Financial Services	2.8	2.8	1.7	1.7	0.04
Employee termination expenses - Output Solutions	0.8	0.8	0.6	0.6	0.01
Leased facility abandonment costs - Output Solutions	0.4	0.4	0.3	0.3	0.01
Impairment of real estate assets - Investments & Other	1.8	1.8	1.1	1.1	0.02
Leased facility abandonment costs - Investments & Other	1.8	1.8	1.1	1.1	0.02
<i>Included in operating income and non-operating income:</i>					
Asset impairment, employee termination and other expenses from insurance processing business - Financial Services	9.1	8.3	5.1	5.1	0.11
<i>Included in non-operating income:</i>					
Net gain on securities and other investments		(7.5)	(4.5)	(4.5)	(0.10)
Dividend and gain on sale of a private company investment		(186.0)	(117.1)	(117.1)	(2.56)
Impairment of unconsolidated affiliates		3.1	1.9	1.9	0.04
<b>Adjusted Non-GAAP income</b>	\$ 68.1	\$ 60.8	\$ 35.4	\$ 35.4	\$ 0.77

	Operating Income	Pretax Income	2011 Net Income	DST Earnings*	Diluted EPS
<b>Reported GAAP income</b>	\$ 73.3	\$ 83.1	\$ 54.4	\$ 55.2	\$ 1.17
Adjusted to remove:					
<i>Included in operating income:</i>					
Business development expenses - Financial Services	1.0	1.0	0.6	0.6	0.01
Business development expenses - Output Solutions	0.2	0.2	0.1	0.1	
<i>Included in non-operating income:</i>					
Net gain on securities and other investments		(11.6)	(7.1)	(7.1)	(0.14)
Loss on repurchase of convertible debentures		0.9	0.6	0.6	0.01

Edgar Filing: DST SYSTEMS INC - Form 10-Q

<b>Adjusted Non-GAAP income</b>	\$	74.5	\$	73.6	\$	48.6	\$	49.4	\$	1.05
---------------------------------	----	------	----	------	----	------	----	------	----	------

---

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

\* DST Earnings has been defined as Net income attributable to DST Systems, Inc. (taking into account the net loss attributable to non-controlling interest).

Table of Contents

## DST SYSTEMS, INC.

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

Six Months Ended June 30,

(Unaudited - in millions, except per share amounts)

	Operating Income	Pretax Income	2012 Net Income	DST Earnings*	Diluted EPS
<b>Reported GAAP income</b>	\$ 111.0	\$ 318.2	\$ 200.2	\$ 200.2	\$ 4.40
Adjusted to remove:					
<i>Included in operating income:</i>					
Business advisory expenses - Financial Services	1.0	1.0	0.6	0.6	0.02
Employee termination expenses - Financial Services	5.4	5.4	3.3	3.3	0.07
Employee termination expenses - Output Solutions	2.2	2.2	1.7	1.7	0.04
Leased facility abandonment costs - Output Solutions	0.4	0.4	0.3	0.3	0.01
Impairment of real estate assets - Investments & Other	1.8	1.8	1.1	1.1	0.02
Leased facility abandonment costs - Investments & Other	1.8	1.8	1.1	1.1	0.02
<i>Included in operating income and non-operating income:</i>					
Asset impairment, employee termination and other expenses from insurance processing business - Financial Services	9.1	8.3	5.1	5.1	0.11
<i>Included in non-operating income:</i>					
Net gain on securities and other investments		(25.0)	(15.3)	(15.3)	(0.34)
Dividend and gain on sale of a private company investment		(186.0)	(117.1)	(117.1)	(2.57)
Impairment of unconsolidated affiliates		3.1	1.9	1.9	0.04
<b>Adjusted Non-GAAP income</b>	\$ 132.7	\$ 131.2	\$ 82.9	\$ 82.9	\$ 1.82

	Operating Income	Pretax Income	2011 Net Income	DST Earnings*	Diluted EPS
<b>Reported GAAP income</b>	\$ 142.6	\$ 166.3	\$ 107.5	\$ 108.6	\$ 2.31
Adjusted to remove:					
<i>Included in operating income:</i>					
Contract termination payment, net - Financial Services	(2.0)	(2.0)	(1.2)	(1.2)	(0.03)
Employee termination benefit expenses - Financial Services	1.3	1.3	0.8	0.8	0.02
Employee termination benefit expenses - Output Solutions	4.1	4.1	2.5	2.5	0.05
Business development expenses - Financial Services	1.0	1.0	0.6	0.6	0.01
Business development expenses - Output Solutions	0.2	0.2	0.1	0.1	

Edgar Filing: DST SYSTEMS INC - Form 10-Q

*Included in non-operating income:*

Net gain on securities and other investments			(19.4)		(11.9)		(11.9)		(0.24)	
Loss on repurchase of convertible debentures			0.9		0.6		0.6		0.01	
<b>Adjusted Non-GAAP income</b>	\$	147.2	\$	152.4	\$	99.0	\$	100.1	\$	2.13

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

\* DST Earnings has been defined as Net income attributable to DST Systems, Inc. (taking into account the net loss attributable to non-controlling interest).

Table of Contents

**Management's Analysis of Non-GAAP Results for the three and six months ended June 30, 2012 and 2011**

Taking into account the non-GAAP items described in the tables above, adjusted non-GAAP diluted earnings per share was \$0.77 and \$1.05 for the three months ended June 30, 2012 and 2011, respectively and \$1.82 and \$2.13 for the six months ended June 30, 2012 and 2011, respectively. Management's discussion of the Company's Results of Operations in the sections above are applicable for these changes in non-GAAP diluted earnings per share, when adjusting for the non-GAAP items in the reconciliation tables above. The decrease in non-GAAP diluted earnings per share for the three and six months ended June 30, 2012 is attributable to decreased Financial Services Segment income from operations resulting from higher costs associated with new business initiatives and decreased mutual fund registered shareowner processing operating revenues, and from decreased equity in earnings of unconsolidated affiliates resulting from higher new product development and new client conversion expenses.

**LIQUIDITY AND CAPITAL RESOURCES**

**Sources and Uses of Cash**

The Company's primary source of liquidity has historically been cash provided by operations. In addition, the Company has used returns on investments to fund other investment activities. Principal uses of cash are operations, reinvestment in the Company's proprietary technologies, capital expenditures, investment purchases, business acquisitions, payments on debt, stock repurchases and dividend payments. Information on the Company's consolidated cash flows for the six months ended June 30, 2012 and 2011 is presented in the Condensed Consolidated Statement of Cash Flows, categorized by operating activities, investing activities, and financing activities.

**Operating Activities**

Cash flows provided by operating activities were \$109.7 million during the six months ended June 30, 2012 compared to \$155.9 million for the six months ended June 30, 2011, a decrease of \$46.2 million. Operating cash flows for the six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year 2012. In May 2012, DST received a \$47.3 million cash dividend from an investment in a privately held company (cost method investment). In addition, DST recorded cash proceeds and a gain of \$138.7 million from the sale of a portion of its shares in this private company investment in May 2012. The dividend from this investment increased cash flows from operating activities during the six months ended June 30, 2012. Income tax expense resulting from this dividend and gain was approximately \$68.9 million and is expected to be paid in September 2012, which will reduce operating cash flows. The proceeds from the investment gain are included in investing activities, but the income taxes paid on the gain will be required to be treated as an operating cash outflow when paid.

The \$46.2 million decrease in operating cash flows during 2012 is attributable to changes in working capital and lower operating income, both as compared to the six months ended June 30, 2011. The significant working capital changes during 2012 include Other assets, Accounts payable and accrued liabilities, Deferred revenues and gains, Accounts receivable, Income taxes payable and Accrued compensation and benefits. During the six months ended June 30, 2012, the Company made a prepayment for software services that will be used over multiple years. The prepayment resulted in an increase in Other assets of approximately \$35.0 million, but caused a decrease in working capital. Accounts payable and accrued liabilities decreased by approximately \$14.0 million during the six months ended June 30, 2012 as compared to an increase of \$16.8 million during the six months ended June 30, 2011, a net decrease in working capital of \$30.8 million. Deferred revenues and gains decreased

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

\$21.6 million during 2012, as compared to a decrease in deferred revenues of \$3.3 million during 2011, a net decrease in working capital of \$18.3 million, mostly attributable to a decline in deferred revenues from BFDS resulting from the use of approximately half of the original \$40 million prepayment made in 2011 for 2012 DST processing services. Accounts receivable increased \$0.3 million during 2012, as compared to a decrease of \$11.7 million during 2011, a net decrease in working capital of \$12.0 million. These working capital decreases were partially offset by increases in income taxes payable (unrelated to the unpaid income taxes on the private

Table of Contents

company investment gain and dividend) of approximately \$12.6 million in 2012 as compared to \$7.6 million in 2011, and lower decreases in accrued compensation and benefit liabilities during 2012 as compared to 2011.

Operating cash flows during 2012 resulted principally from net income of \$200.2 million, changes in working capital described above and adjustments for non-cash items included in the determination of net income including depreciation and amortization expense of \$76.3 million, amortization of share based compensation of \$14.8 million and equity in earnings of unconsolidated affiliates of \$6.7 million. Cash and cash equivalents were \$93.2 million and \$91.3 million at June 30, 2012 and 2011, respectively.

**Investing Activities**

Cash flows provided by investing activities were \$125.9 million during the six months ended June 30, 2012 as compared to cash flows used in investing activities of \$35.2 million for the six months ended June 30, 2011, an increase of \$161.1 million. The increase in net cash flows used in investing activities during 2012 as compared to 2011 is attributable to higher net cash inflows for net investment activities (proceeds from sales net of investments in securities) of \$216.6 million and lower acquisitions of businesses of \$65.5 million, which were partially offset by lower cash flows in 2012 from restricted cash to satisfy client fund obligations of \$106.1 million and higher capital expenditures of \$18.8 million.

*Capital Expenditures*

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

	<b>Six Months Ended</b>					
	<b>2012</b>		<b>June 30,</b>		<b>2011</b>	
Financial Services Segment	\$	31.8	\$	21.3		
Output Solutions Segment		16.5		7.0		
Investments and Other Segment		2.1		3.3		
	\$	50.4	\$	31.6		

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

*Investments*

The Company purchased \$142.9 million and \$262.8 million of investments in available-for-sale securities and other investments during the six months ended June 30, 2012 and 2011, respectively. During the six months ended June 30, 2012, the Company received \$319.0 million from



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

the sale/maturities of investments as compared to \$222.3 million during the six months ended June 30, 2011. Included in the \$319.0 million of proceeds from sale/maturities of investments is \$138.7 million from proceeds associated with the privately held investment described above.

### **Financing Activities**

Cash flows used in financing activities were \$183.3 million during the six months ended June 30, 2012 as compared to cash flows used in financing activities of \$169.2 million for the six months ended June 30, 2011, an increase of \$14.1 million. The increase in net cash flows used in financing activities during 2012 as compared to 2011 is primarily attributable to higher repayments of revolving credit facilities of \$126.9 million, partially offset by lower net cash outflows in 2012 on client fund obligations of \$99.0 million and lower repurchases of convertible debentures of \$8.8 million. During the six months ended June 30, 2012, cash outflows were from net repayments under the revolving credit facilities of \$164.6 million primarily from proceeds received from the privately held investment gain and dividend, share repurchase activities of \$27.9 million, payment of cash

Table of Contents

dividends of \$17.9 million and the purchase of the remaining non-controlling interest in DST Output U.K. (formerly IOS) of \$17.7 million, which were partially offset by proceeds received from the issuance of common stock of \$43.5 million. During the six months ended June 30, 2011, cash outflows were from share repurchase activities of \$43.5 million and net repayments under the revolving credit facilities in the aggregate amount of \$37.7 million, which were partially offset by financing cash inflows of \$42.9 million from proceeds received from issuance of common stock.

*Common Stock Issuances and Repurchases*

The Company received proceeds of \$43.5 million and \$42.9 million from the issuance of common stock from the exercise of employee stock options during the six months ended June 30, 2012 and 2011, respectively. The Company repurchased 0.5 million shares of DST common stock for \$22.5 million or approximately \$49.94 per share during the six months ended June 30, 2011, but no shares were repurchased during the six months ended June 30, 2012 under the Company's share repurchase plan. At June 30, 2012, the Company has approximately 2,050,000 shares authorized for repurchase under its share repurchase plan.

Payments related to shares received in exchange for satisfaction of the exercise price and for tax-withholding obligations arising from the exercise of options to purchase the Company's stock or from the vesting of restricted shares are included in common stock repurchased in the Condensed Consolidated Statement of Cash Flows. The amount of such share receipts and withholdings for option exercises and restricted stock vesting was \$27.9 million and \$21.0 million during the six months ended June 30, 2012 and 2011, respectively.

*Dividends*

DST paid cash dividends of \$17.9 million or \$0.40 per share during the six months ended June 30, 2012 as compared to payments of \$16.2 million or \$0.35 per share during the same period in 2011.

*Off Balance Sheet Obligations*

As of June 30, 2012, the Company had no material off balance sheet arrangements.

*Financing Sources*

The Company has used the following primary sources of financing: its syndicated line of credit facility; convertible debentures; subsidiary line of credit facilities; secured promissory notes; term loan credit facilities; loans from unconsolidated affiliates; accounts receivable securitization program; privately placed senior notes; and secured borrowings. The Company has also utilized bridge loans as necessary to augment the above sources of debt financing. The Company had \$1,214.4 million and \$1,380.3 million of debt outstanding at June 30, 2012 and December 31,

2011, respectively, a decrease of \$165.9 million during 2012.

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

### Table of Contents

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

	June 30, 2012	December 31, 2011
Accounts receivable securitization program	\$ 135.0	\$ 135.0
Secured promissory notes	15.0	16.6
Equipment credit facilities	13.6	10.0
Real estate credit agreement	103.5	105.2
Term loan credit facility	125.0	125.0
Series C convertible senior debentures	88.3	86.5
Revolving credit facilities	195.1	328.3
Senior notes	370.0	370.0
Related party credit agreements	149.4	156.7
Other indebtedness	19.5	47.0
	1,214.4	1,380.3
Less current portion of debt	298.8	320.8
Long-term debt	\$ 915.6	\$ 1,059.5

#### *Accounts Receivable Securitization Program*

DST securitizes certain of its domestic accounts receivable through an accounts receivable securitization program with a third-party bank. The maximum amount that can be outstanding under this program is \$150 million. On May 17, 2012, the Company renewed its accounts receivable securitization program. The facility will expire by its terms on May 16, 2013, unless renewed.

At both June 30, 2012 and December 31, 2011, the outstanding amount under the program was \$135.0 million. During the six months ended June 30, 2012 and 2011, total proceeds from the accounts receivable securitization program were approximately \$459.3 million and \$433.4 million and total repayments were approximately \$459.3 million and \$433.4 million, respectively, which comprises the net cash flow in the financing section of the cash flow statement.

#### *Related Party Credit Agreements*

In June 2012, the Company repaid its loan with International Financial Data Services Limited, which had an outstanding balance of \$6.2 million at December 31, 2011.

#### *Other Indebtedness*

Other indebtedness includes a borrowing arrangement denominated in British Pounds between DST Output U.K. (formerly Innovative Output Solutions or IOS) and a bank that is secured by accounts receivable of DST Output U.K. The amount outstanding under this facility was repaid

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

in June 2012. During the six months ended June 30, 2012 proceeds received from this loan were \$143.0 million and total repayments were \$164.3 million, which has been included in net payments on revolving credit facilities in the financing section of the cash flow statement.

### *Company's Assessment of Short-Term and Long-Term Liquidity*

The Company believes that its existing cash balances and other current assets, together with cash provided by operating activities and, as necessary, the Company's revolving credit facilities, will suffice to meet the Company's operating and debt service requirements and other current liabilities for at least the next 12 months. Further, the Company believes that its short-term liquidity may be increased by monetizing available-for-sale securities owned by its domestic subsidiaries (which were \$765.1 million at June 30, 2012) and other assets, and that its longer term liquidity and

Table of Contents

capital requirements will also be met through cash provided by operating activities, bank credit facilities and available-for-sale securities and other investments. In addition, at June 30, 2012, the Company had approximately \$485 million of availability under its domestic revolving credit facilities.

*Guarantees*

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

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

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

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

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

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

The Company has entered into agreements with lenders providing financing to the Company pursuant to which the Company agrees to indemnify such lenders for third party claims arising from or relating to such financings. In connection with real estate mortgage financing, the Company has entered into environmental indemnity agreements in which the Company has agreed to indemnify the lenders for any damage sustained by the lenders relating to any environmental contamination on the subject properties.

In connection with the acquisition or disposition of real estate by the Company, the Company has entered into real estate contracts containing indemnification provisions, the terms of which vary depending on the negotiated terms of each respective contract, but which are generally described as follows: (i) in connection with acquisitions by the Company, the Company has agreed to indemnify the seller against third party claims made against the seller

Table of Contents

arising from the Company's on-site inspections, tests and investigations of the subject property made by the Company as part of its due diligence and against third party claims relating to the operations on the subject property after the closing of the transaction, and (ii) in connection with dispositions by the Company, the Company has agreed to indemnify the buyer for damages incurred by the buyer due to the buyer's reliance on representations and warranties relating to the subject property made by the Company in the real estate contract if such representations or warranties were untrue when made and against third party claims relating to operations on the subject property prior to the closing of the transaction.

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

At June 30, 2012 and December 31, 2011, the Company had not accrued any liability on the aforementioned guarantees or indemnifications as they relate to future performance criteria or indirect guarantees of indebtedness of others in accordance with accounting and reporting guidance on guarantees, including indirect guarantees of indebtedness of others.

**OTHER**

**Comprehensive income (loss)**

The Company recorded comprehensive income of \$111.0 million and \$213.9 million for the three and six months ended June 30, 2012 compared to \$47.9 million and \$88.3 million for the three and six months ended June 30, 2011. Comprehensive income includes net income attributable to DST Systems, Inc. of \$144.9 million and \$200.2 million for the three and six months ended June 30, 2012 compared to \$55.2 million and \$108.6 million for the three and six months ended June 30, 2011, and other comprehensive loss of \$33.9 million and other comprehensive income of \$13.7 million for the three and six months ended June 30, 2012 compared to other comprehensive loss of \$7.3 million and \$20.3 million for the three and six months ended June 30, 2011, respectively. Other comprehensive income (loss) consists of unrealized gains (losses) on available-for-sale securities, reclassifications for net gains and losses included in net income, unrealized gain (loss) on interest rate swaps, the Company's proportional share of unconsolidated affiliates interest rate swaps, foreign currency translation adjustments and deferred income taxes applicable to these items. The principal difference between net income and comprehensive net income is the net change in unrealized gains (losses) on available-for-sale securities.

**Other than temporary impairments**

At June 30, 2012, the Company's available-for-sale securities had gross unrealized holding losses of \$3.2 million. If it is determined that a reduction in a security's net realizable value is other than temporary, a realized loss will be recognized in the statement of operations and the cost



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

basis of the security reduced to its estimated fair value. The Company does not believe that the gross unrealized losses at June 30, 2012 are other than temporary.

The Company recognized \$1.6 million and \$1.9 million of investment impairments for the three and six months ended June 30, 2012, respectively, and \$0.1 million of investment impairments for both the three and six months ended June 30, 2011, respectively, which were other than temporary. The Company records lower of cost or market valuation adjustments on private equity fund investments and other cost method investments when impairment conditions are present. During the three and six months ended June 30, 2012, the Company recorded \$0.3 million and \$0.7 million, respectively, and none and \$1.0 million for the three and six months ended June 30, 2011, respectively, of impairments on private equity and other investments. The impairments recorded related

Table of Contents

primarily to investments in the Financial Services Segment and the Investments and Other Segment. A decline in a security's net realizable value that is other than temporary is treated as a loss based on quoted or derived market value and is reflected in Other Income, net in the Condensed Consolidated Statement of Income.

**Seasonality**

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

**Authoritative Accounting Guidance**

*Earnings Per Share Proposed Accounting Standard*

In August 2008, the FASB issued a revised exposure draft, that would amend current earnings per share accounting guidance to clarify guidance for mandatorily convertible instruments, the treasury stock method, contingently issuable shares, and contracts that may be settled in cash or shares. The final statement has yet to be issued. In April 2009, the FASB decided to pause the earnings per share project. DST is currently evaluating the impact of this proposed accounting standard and currently believes that this proposed amendment would impact the way the Company treats the incremental shares to be issued from the assumed conversion of the convertible debentures in calculating diluted earnings per share. The proposed amendment would require the use of the if-converted method from the date of issuance of the convertible debentures. The proposed amendment would remove the ability of a company to support the presumption that the convertible securities will be satisfied in cash and not converted into shares of common stock. Under this if-converted method, GAAP diluted earnings per share would have been \$3.07 and \$1.14 (versus GAAP reported earnings of \$3.17 and \$1.17) for the three months ended June 30, 2012 and 2011, respectively, and \$4.27 and \$2.24 (versus GAAP reported earnings of \$4.40 and \$2.31) for the six months ended June 30, 2012 and 2011, respectively. The above information presents only the effect on diluted earnings per share of the if-converted method included in the exposure draft, but does not include any other computational changes (e.g., treasury stock method considerations) discussed in the exposure draft. DST is continuing to monitor the FASB's progress towards finalizing this proposed accounting standard.

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

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

In the operations of its businesses, the Company's financial results can be affected by changes in equity pricing, interest rates and currency exchange rates. Changes in interest rates and exchange rates have not materially impacted the consolidated financial position, results of

operations or cash flows of the Company. Changes in equity values of the Company's investments have had a material effect on the Company's comprehensive income and financial position.

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

The Company's investments in available-for-sale equity securities are subject to price risk. The fair value of the Company's available-for-sale investments as of June 30, 2012 was approximately \$765.1 million. The impact of a 10% change in fair value of these investments would be approximately \$46.8 million to comprehensive income. As discussed under Management's Discussion and Analysis of Financial Condition and Results of Operations Comprehensive Income (Loss) above, net unrealized gains and losses on the Company's investments in

Table of Contents

available-for-sale securities have had a material effect on the Company's comprehensive income (loss) and financial position.

**Interest rate risk**

The Company and certain of its joint ventures derive a certain amount of their service revenues from investment earnings related to cash balances maintained in bank accounts on which the Company is the agent for clients. The balances maintained in the bank accounts are subject to fluctuation. For the six months ended June 30, 2012, the Company and BFDS had average daily cash balances of approximately \$1.7 billion maintained in such accounts, of which approximately \$1.1 billion were maintained at BFDS. The Company estimates that a 50 basis point change in interest earnings rate would equal approximately \$2.9 million of net income (loss).

At June 30, 2012, the Company had \$1,214.4 million of debt, of which \$616.8 million was subject to variable interest rates (Federal Funds rates, LIBOR rates, Prime rates). Included in this amount are program fees incurred on proceeds from the sale of receivables under the Company's accounts receivable securitization program, which are determined based on variable interest rates associated with LIBOR. The Company estimates that a 10% increase in interest rates would not be material to the Company's consolidated pretax earnings or to the fair value of its debt.

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

**Foreign currency exchange rate risk**

The operation of the Company's subsidiaries in international markets results in exposure to movements in currency exchange rates. The principal currencies involved are the British pound, Canadian dollar, Australian dollar, Thai baht and Indian rupee. Currency exchange rate fluctuations have not historically materially affected the consolidated financial results of the Company. At June 30, 2012, the Company's international subsidiaries had approximately \$201.6 million in total assets, and for the three and six months ended June 30, 2012, these international subsidiaries recorded net losses of approximately \$3.0 million and \$1.9 million, respectively. The Company estimates that a 10% change in exchange rates could change total consolidated assets by approximately \$20.2 million. Furthermore, a 10% change in exchange rates based upon historical earnings in international operations could change consolidated reported net income by approximately \$0.3 million and \$0.2 million for the three and six months ended June 30, 2012.

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

**Item 4. Controls and Procedures**

*Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures designed to ensure that information required to be disclosed in the reports it files or submits under the Securities Exchange Act of 1934 (the Exchange Act ) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, including without limitation, controls and procedures designed to ensure that information required to be disclosed in reports that it files under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on an evaluation of the Company's disclosure controls and procedures as of the end of the period covered by this report conducted by the Company's management, with the participation of the Chief Executive and Chief Financial Officer, the Chief Executive and Chief Financial Officer concluded that these controls and procedures were effective as of June 30, 2012.

Table of Contents

*Internal Control over Financial Reporting*

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13(a)-15 and 15(d)-15 under the Exchange Act) during the quarter ended June 30, 2012, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 4T. Controls and Procedures**

Not applicable.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

**COMPANY-SPECIFIC TRENDS AND RISKS**

There are many risks and uncertainties that can affect our future business, financial performance or share price. Many of these are beyond our control. A description follows of some of the important factors that could have a material negative impact on our future business, operating results, financial condition or share price. This discussion includes a number of forward-looking statements. You should refer to the description of the qualifications and limitations on forward-looking statements in the first paragraph under Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations of our Form 10-K for the year ended December 31, 2011. The risk factors have not changed materially from the date of our periodic report on Form 10-K for the year ended December 31, 2011 other than the addition of a risk related to the potential impact on the Company if a change in control of subsidiaries of the Company's subsidiary ALPS Holdings, Inc. were deemed to occur as a result of certain changes in ownership of the Company.

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

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

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

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

Table of Contents

Events that adversely affect our clients' businesses, rates of growth or numbers of customers they serve, including decreased demand for our customers' products and services, adverse conditions in our customers' markets or adverse economic conditions generally could decrease demand for our products and services and the number of transactions we process. We may be unsuccessful in predicting the needs of changing industries and whether potential customers will accept our products or services. If trends or events do not occur as we expect, we could be negatively impacted.

**The Securities and Exchange Commission may issue regulations impacting third-party distributors of mutual funds, which could adversely affect our business.**

The SEC may issue regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 or other legislative authority that would require brokers and financial intermediaries that distribute mutual funds to make more detailed fee disclosures at the point-of-sale. Additionally, brokers and financial intermediaries may be subject to new fiduciary standards-of-care that could cause them to alter their methods of distribution. We cannot predict the requirements the SEC may propose and finally adopt. Regulations that would cause current distribution channels or interest in mutual fund investing to change could impact the number of accounts on our systems and could adversely affect our revenues.

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

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

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

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

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



**The quality or availability of postal system services could decrease, reducing the volume of printed customer communications and negatively impacting our business.**

The Company is dependent on postal delivery systems for final delivery of printed customer communications. Postal delivery systems are facing economic pressures from the reduction in first class mail and certain postal delivery systems have experienced work stoppages and other interruptions. Accuracy and speed of delivery are important factors for clients using printed communications in their businesses. Changes in the timeliness and quality of postal delivery could negatively impact the level of printed communications delivered by our customers to their clients. A decrease in such communications could lower our revenues.

Table of Contents

**Decreased demand for traditional printed and mailed communications may adversely affect our business, depending on the extent to which our customers and their clients acceptance of electronic alternatives continues to grow.**

To the extent clients customers select electronic presentment and delivery of communications, the demand for our services for production and distribution of printed documents will decrease. We provide electronic presentment and delivery solutions, but they are priced differently and require different capabilities than print-mail solutions. Customers may choose to perform electronic hosting and distribution of communications to customers internally or select electronic solution providers other than the Company. These events could result in lower revenues.

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

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

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

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

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

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

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

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

A number of our businesses are subject to U.S. or foreign regulation, including privacy, licensing, processing, recordkeeping, investment adviser, broker/dealer, reporting and related regulations. Any violation of applicable regulations could expose us or those businesses to significant fines or sanctions or damage our reputation, which could adversely affect our business or financial performance. Governmental changes and uncertainties surrounding services we provide could increase our costs of business or diminish business, which could materially and adversely affect the Company's financial results.

Table of Contents

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

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

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

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

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

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

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

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

**Our revenues and profit margins could decrease if client contracts are terminated or fail to renew or if clients renegotiate contracts or utilize our services at lower than anticipated levels.**

We derive most of our revenue by selling products and services under long-term contracts, which often contain terms and conditions based on anticipated levels of utilization of our services. We cannot unilaterally extend the terms of these contracts when they expire. Contracts can terminate during the term of agreement for various reasons, including through termination for convenience clauses in some contracts that enable clients to cancel by written notice. Our revenues and profit margins could decrease as a result of terminations or non-renewals of client contracts; extensions of client contracts under, or contract re-negotiations resulting in, less favorable terms; or utilization of services at less than anticipated levels.

Table of Contents

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

Our proprietary applications and related consulting and other services include the processing of financial and healthcare transactions for our clients and their customers and the design of benefit plans and compliance programs. The dollar amount of transactions processed is vastly higher than the revenues derived from providing these services. Transaction processing or operational errors, or process mismanagement, could cause, among other potential issues, processing delays, disclosure of protected information, miscalculations, failure to follow a client's instructions or meet specifications, failure of third parties (including regulatory authorities) to recognize the limitations of our role as our clients' agent or consultant, mishandling of pass-through disbursements or other processes, or fraud committed by third parties. We may be subject to claims, including class actions, for reimbursements, losses or damages arising from any transaction processing or operational error, or from process mismanagement. Because of the sensitive nature of the financial and healthcare transactions we process, our liability and any alleged damages may significantly exceed the fees we receive for performing the service at issue. Litigation could include class action claims based, among other theories, upon various regulatory requirements and consumer protection and privacy laws that class action plaintiffs may attempt to use to assert private rights of action. Any of these claims and related settlements or judgments could affect our profitability, damage our reputation, decrease demand for our services, or cause us to make costly operating changes.

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

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

**Failure to protect our confidential information and that of our clients, their customers, and our employees could hurt our business.**

We electronically maintain trade secrets and proprietary or sensitive information, including financial, personal health and other information of our clients, their customers and our employees. In certain circumstances, vendors have access to such information in order to assist us with responsibilities such as, producing benefit plan identification cards, maintaining software we license on our own behalf or resell to others, or helping clients comply with anti-money laundering regulations. A breach of our security systems and procedures or those of our vendors could cause us to receive significant claims for liability or to incur significant costs for notices required by law to be sent to affected individuals. It could also cause our customers to reconsider using our services and products, damage our reputation, or otherwise have a material adverse effect on us. We maintain systems and procedures to protect against unauthorized access to electronic information and cybersecurity attacks, and we generally impose security requirements on our vendors, but we cannot guarantee these systems, procedures or requirements will always protect us. Rapid advances in technology may prevent us from anticipating all potential security threats or promptly identifying all security breaches, and the limits and costs of technology, skills and manpower could prevent us from adequately addressing these threats.

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

We invest in joint ventures and other unconsolidated affiliates as part of our business strategy, and part of our net income is derived from our pro rata share of the earnings of those businesses. Despite owning significant equity

Table of Contents

interests in those companies and having directors on their boards, we do not control their operations, strategies or financial decisions. The other owners may have economic, business or legal interests or goals that are inconsistent with our goals or the goals of the businesses we co-own. Our pro rata share of any losses due to unfavorable performance of those companies could negatively impact our financial statements.

**Some of our joint venture investments are subject to buy-sell agreements, which may, among other things, restrict us from selling our interests even when we determine it is prudent to do so.**

We own interests in unconsolidated entities including Boston Financial Data Services, International Financial Data Services Limited Partnership, International Financial Data Services Limited, and various real estate joint ventures, and in consolidated entities owned less than 100% by the Company. Our interests in such unconsolidated and in certain consolidated entities are subject to buy/sell arrangements, which may restrict our ability to sell our interests when we believe it is prudent to do so. These arrangements may also allow us to purchase the other owners' interests to prevent someone else from acquiring them and we cannot control the timing of occasions to do so. The businesses or other owners may encourage us to increase our investment in or make contributions to the businesses at an inopportune time.

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

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

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

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

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

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



**Various plans, agreements, laws and organizational documents may have anti-takeover effects.**

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

- super-majority stockholder approval required for certain actions
- staggered terms for directors
- specific procedures for stockholders to nominate new directors

Table of Contents

- the Board's authority to issue and set the terms of preferred stock
- a stockholders' rights plan that would cause substantial dilution to a person or group that acquires 15% or more of our outstanding common stock (as determined pursuant to the rights plan) without the approval of our Board of Directors
- various rights of debenture holders, joint venture co-owners, lenders and certain customers and executives in the event of a change in control
- public reporting of ownership and of changes in ownership by stockholders with at least a 5% interest in us
- legal restrictions on business combinations with certain stockholders

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

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

**Certain changes in ownership of the Company could potentially affect the continuation of investment advisory and distribution services provided by ALPS subsidiaries, which could potentially limit the Company's share repurchases and negatively impact the Company's financial results.**

The Company's wholly owned subsidiary, ALPS Holdings, Inc., has subsidiaries that serve as investment advisors or distributors for certain registered investment companies ( Funds ). Under applicable law, if more than 25% of the Company's outstanding voting securities were to become held by a single owner, a change of control of the ALPS subsidiaries constituting an assignment of their investment advisory contracts and distribution contracts could be deemed to have occurred. Any deemed assignment would automatically terminate the ALPS subsidiaries' investment advisory and distribution contracts with the Funds, and the Funds would be required to seek shareowner approval of new investment

advisory contracts in order to continue an advisory relationship with the ALPS subsidiaries. There can be no assurance that any Fund with a distribution contract would retain the ALPS subsidiary as its distributor or that any Fund with an investment advisory contract would obtain the required shareowner vote to retain, or that it would retain, the ALPS subsidiary as its investment advisor. The potential impact of a deemed assignment may limit the Company's ability to repurchase its shares. The loss by ALPS subsidiaries of investment advisory and/or distribution contracts could negatively impact the financial condition and earnings of the Company.

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

Our directors, officers and certain managers have received restricted stock units and options to purchase our common stock as part of their compensation. These equity grants could have a dilutive effect on our common stock. The rights plan would cause substantial dilution to a person or group that acquires 15% or more of our

Table of Contents

outstanding common stock (as determined pursuant to the rights plan) without the approval of our Board of Directors. A triggering of the rights plan could in some circumstances be dilutive in value to common stockholders who do not exercise their rights.

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

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

**We may not pay cash dividends on our common stock in the future.**

In 2010, we began paying cash dividends on our common stock. Future cash dividends will depend upon our financial condition, earnings and other factors deemed relevant by our Board of Directors. Payment of dividends is subject to applicable laws and to restrictions in applicable debt agreements.

**If we cannot successfully complete acquisitions or integrate acquired businesses, our growth may be limited and our financial condition adversely affected.**

Our business strategy anticipates that we will supplement internal growth by pursuing acquisitions of complementary businesses. We may be unable to identify suitable businesses to acquire. We compete with other potential buyers for the acquisition of other complementary businesses. If we cannot complete acquisitions, our growth may be limited and our financial condition may be adversely affected. Information we obtain about an acquisition target may be limited and there can be no assurance that an acquisition will perform as expected or positively impact our financial performance. Potential acquisitions involve risk, including the risk we would be unable to effectively integrate the acquired technologies, operations and personnel into our business, and the risk that management's attention and our capital would be diverted from other areas of our business.

**If our new investments and business initiatives are not successful, our financial condition could be adversely affected.**

We are investing heavily in our products for the brokerage and retirement industries. Our investments may not lead to successful deployment of our new products and increases in the level of volumes of certain businesses. If we are not successful in creating value from our investments, the lack of new product sales could have a negative impact on the Company's financial condition and prospects.



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

The following table sets forth information with respect to shares of Company common stock purchased by the Company during the three months ended June 30, 2012.

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs</b>
April 1 - April 30	957(1)	\$ 54.67		2,049,500
May 1 - May 31	21,563(1)	\$ 55.15		2,049,500
June 1 - June 30	6,881(1)	\$ 52.10		2,049,500
Total	29,401	\$ 54.42		2,049,500

(1) For the three months ended June 30, 2012, the Company purchased, in accordance with the 2005 Equity Incentive Plan (formerly the 1995 Stock Option and Performance Award Plan), 29,401 shares of its common stock for participant income tax withholding in conjunction with stock option exercises or from the vesting of restricted shares, as requested by the participants, or from shares surrendered in satisfaction of option exercise price. These purchases were not made under the publicly announced repurchase plans or programs, but were allowed by the rules of the Compensation Committee of the DST Board of Directors. Of these shares, 957 shares were purchased in April 2012, 21,563 shares were purchased in May 2012 and 6,881 shares were purchased in June 2012.

(2) As previously announced, DST's Board of Directors increased its share repurchase authorization by 2.0 million shares in fourth quarter 2011. This additional new share repurchase program became effective January 1, 2012 and expires on December 31, 2013. The Company may enter into one or more plans with its brokers or banks for pre-authorized purchases within defined limits pursuant to Rule 10b5-1 to effect all or a portion of such share repurchases.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

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

None.

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

None.

Table of Contents

**Item 6. Exhibits**

(a) Exhibits:

10.1 The Amendment and Restatement, dated May 17, 2012, of the Term Letter Loan Agreement between the Company and Bank of America, N.A.

31.1 Certification of the Chief Executive Officer of Registrant

31.2 Certification of the Chief Financial Officer of Registrant

32 Certification Pursuant to 18 U.S.C. Section 1350 of Chief Executive Officer of Registrant and Chief Financial Officer of Registrant

101 The following financial information from DST's Quarterly Report on Form 10-Q for the period ended June 30, 2012, filed with the SEC on August 7, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheet at June 30, 2012 and December 31, 2011, (ii) the Condensed Consolidated Statement of Income for the three and six months ended June 30, 2012 and 2011, (iii) the Condensed Consolidated Statement of Comprehensive Income for the three and six months ended June 30, 2012 and 2011, (iv) the Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2012 and 2011, and (v) Notes to Condensed Consolidated Financial Statements.

**SIGNATURE**

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

August 7, 2012

DST Systems, Inc.

/s/ Kenneth V. Hager

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



