

DST SYSTEMS INC  
Form 10-Q  
May 07, 2013  
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 March 31, 2013

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-14036

DST Systems, Inc. (Exact name of registrant as specified in its charter)	
Delaware (State or other jurisdiction of incorporation or organization)	43-1581814 (I.R.S. Employer Identification No.)
333 West 11 <sup>th</sup> 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.

Edgar Filing: DST SYSTEMS INC - Form 10-Q

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 April 30, 2013:  
Common Stock \$0.01 par value — 43,906,173

---

---

Table of Contents

DST Systems, Inc.  
 Form 10-Q  
 March 31, 2013  
 Table of Contents

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited)</u>	
<u>Introductory Comments</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheet —     March 31, 2013 and December 31, 2012</u>	<u>4</u>
<u>Condensed Consolidated Statement of Income —     Three months ended March 31, 2013 and 2012</u>	<u>5</u>
<u>Condensed Consolidated Statement of Comprehensive Income —     Three months ended March 31, 2013 and 2012</u>	<u>6</u>
<u>Condensed Consolidated Statement of Cash Flows —     Three months ended March 31, 2013 and 2012</u>	<u>7</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>41</u>
<u>Item 4. Controls and Procedures</u>	<u>42</u>
<u>Item 4T. Controls and Procedures</u>	<u>42</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>43</u>
<u>Item 1A. Risk Factors</u>	<u>43</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>49</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>50</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>50</u>
<u>Item 5. Other Information</u>	<u>50</u>
<u>Item 6. Exhibits</u>	<u>51</u>

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.

2

---

Table of Contents

DST Systems, Inc.  
Form 10-Q  
March 31, 2013

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, 2012.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the full year 2013.

Table of Contents

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

	March 31, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 120.8	\$ 88.3
Funds held on behalf of clients	333.4	398.9
Client funding receivable	49.5	43.8
Accounts receivable	356.4	360.5
Other assets	70.4	62.8
	930.5	954.3
Investments	971.4	922.1
Unconsolidated affiliates	390.8	403.0
Properties	468.7	475.0
Intangible assets	148.9	152.7
Goodwill	422.6	422.1
Other assets	84.4	63.3
Total assets	\$ 3,417.3	\$ 3,392.5
<b>LIABILITIES AND EQUITY</b>		
Current liabilities		
Current portion of debt	\$ 564.5	\$ 519.4
Client funds obligations	382.9	442.7
Accounts payable	95.3	94.1
Accrued compensation and benefits	101.7	140.0
Deferred revenues and gains	78.6	67.6
Income taxes payable	30.3	9.5
Other liabilities	100.9	105.2
	1,354.2	1,378.5
Long-term debt	473.9	492.2
Income taxes payable	80.1	76.4
Deferred income taxes	300.6	296.2
Other liabilities	68.7	69.5
Total liabilities	2,277.5	2,312.8
Commitments and contingencies (Note 10)		
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	203.3	234.3
Retained earnings	3,557.4	3,477.7
Treasury stock (51.2 million and 51.0 million shares, respectively), at cost	(2,912.6	) (2,890.1
Accumulated other comprehensive income	290.7	256.8

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Total stockholders' equity	1,139.8	1,079.7
Total liabilities and stockholders' equity	\$3,417.3	\$3,392.5

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 March 31,	
	2013	2012
Operating revenues	\$495.2	\$475.9
Out-of-pocket reimbursements	187.2	177.3
Total revenues	682.4	653.2
Costs and expenses	574.6	559.1
Depreciation and amortization	33.2	34.0
Income from operations	74.6	60.1
Interest expense	(9.6	) (11.7
Other income, net	73.2	29.7
Equity in earnings of unconsolidated affiliates	5.6	5.3
Income before income taxes	143.8	83.4
Income taxes	50.6	28.1
Net income	\$93.2	\$55.3
Average common shares outstanding	44.3	44.5
Average diluted shares outstanding	45.6	45.2
Basic earnings per share	\$2.10	\$1.24
Diluted earnings per share	\$2.04	\$1.22
Cash dividends per share of common stock	\$0.30	\$0.40

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 March 31,	
	2013	2012
Net income	\$93.2	\$55.3
Other comprehensive income, net of tax and reclassifications to earnings:		
Unrealized holding gains on available-for-sale securities	37.9	47.1
Unrealized gains on cash flow hedges	0.4	0.2
Foreign currency translation adjustments	(4.4	) 0.3
Other comprehensive income	33.9	47.6
Comprehensive income	\$127.1	\$102.9

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)

	Three Months Ended March 31,	
	2013	2012
Cash flows — operating activities:		
Net income	\$93.2	\$55.3
Depreciation and amortization	33.2	34.0
Net gains on investments	(70.0)	(16.7)
Amortization of share based compensation	5.9	6.0
Equity in earnings of unconsolidated affiliates	(5.6)	(5.3)
Dividends from unconsolidated affiliates	0.2	0.2
Deferred income taxes	(1.0)	(0.5)
Changes in accounts receivable	4.0	(12.2)
Changes in other assets	(10.3)	(34.5)
Changes in accounts payable and accrued liabilities	(5.8)	26.5
Changes in income taxes payable	25.4	22.9
Changes in deferred revenues and gains	11.1	(9.8)
Changes in accrued compensation and benefits	(43.9)	(20.6)
Other, net	5.8	(2.5)
Total adjustments to net income	(51.0)	(12.5)
Net	42.2	42.8
Cash flows — investing activities:		
Capital expenditures	(27.6)	(30.7)
Proceeds from unconsolidated affiliates	3.1	0.1
Investments in securities	(31.7)	(70.6)
Proceeds from sales/maturities of investments	133.6	89.1
Net (increase) decrease in restricted cash and cash equivalents held to satisfy client funds obligations	44.8	(32.7)
Other, net	(17.8)	2.3
Net	104.4	(42.5)
Cash flows — financing activities:		
Proceeds from issuance of common stock	12.2	38.5
Principal payments on debt	(15.1)	(5.4)
Net borrowings (payments) on revolving credit facilities	40.5	(17.9)
Net increase (decrease) in client funds obligations	(65.5)	36.6
Common stock repurchased	(74.1)	(26.3)
Payment for acquisition of non-controlling interest		(17.7)
Payment of cash dividends	(13.3)	
Excess tax benefits from share based compensation	1.2	3.3
Net	(114.1)	11.1
Net increase in cash and cash equivalents	32.5	11.4
Cash and cash equivalents, beginning of period	88.3	40.9
Cash and cash equivalents, end of period	\$120.8	\$52.3

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, 2012 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, 2012.

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 March 31, 2013, and the results of operations, comprehensive income and cash flows for the three months ended March 31, 2013 and 2012.

Certain amounts in the 2012 financial statements have been reclassified to conform to the 2013 presentation.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the full year 2013.

New Authoritative Accounting Guidance

Comprehensive Income

On January 1, 2013, DST adopted new authoritative accounting guidance that modifies the reporting of reclassifications out of accumulated other comprehensive income. The standard requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the consolidated statement of income if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference to other required disclosures that provide additional detail about those amounts. The adoption of this guidance did not have a significant effect on the consolidated financial statements.

2. Client Funds/Obligations

The Company had \$333.4 million and \$398.9 million of funds held on behalf of clients at March 31, 2013 and December 31, 2012, respectively. Included in these amounts were \$4.2 million and \$11.8 million of fixed-income marketable securities at March 31, 2013 and December 31, 2012, 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 March 31, 2013 and December 31, 2012. During the three months ended March 31, 2013 and 2012, the Company received \$29.7 million and \$31.3 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 months ended March 31, 2013 and 2012.

8

---

Table of Contents

## 3. Investments

Investments are as follows (in millions):

	Carrying Value	
	March 31, 2013	December 31, 2012
Available-for-sale securities:		
State Street Corporation	\$518.8	\$436.3
Other available-for-sale securities	163.1	175.2
	681.9	611.5
Other:		
Trading securities	52.6	46.8
Held-to-maturity		14.9
Cost method, private equity and other investments	236.9	248.9
	289.5	310.6
Total investments	\$971.4	\$922.1

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

	March 31, 2013	December 31, 2012
Book cost basis	\$209.9	\$200.9
Gross unrealized gains	473.0	412.5
Gross unrealized losses	(1.0	) (1.9
Market value	\$681.9	\$611.5

During the three months ended March 31, 2013 and 2012, the Company received \$94.3 million and \$56.0 million, respectively, from the sale of investments in available-for-sale securities. Gross realized gains of \$69.1 million and \$16.5 million and gross realized losses of \$0.4 million and \$1.1 million were recorded during the three months ended March 31, 2013 and 2012, respectively, from the sale of available-for-sale securities.

In addition, the Company recorded unrealized losses on available-for-sale securities of \$0.2 million and \$0.3 million for the three months ended March 31, 2013 and 2012, respectively, 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 March 31, 2013 and December 31, 2012 (in millions):

	Less than 12 months		Greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2013						
Common Stock	\$15.5	\$1.0	\$	\$	\$15.5	\$1.0
December 31, 2012						
Common Stock	\$25.7	\$1.9	\$	\$	\$25.7	\$1.9

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 months ended March 31, 2013 and 2012, the Company recorded \$0.3 million and \$0.4 million, respectively, of impairments on other investments. 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.

Table of Contents

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 March 31, 2013 and December 31, 2012, the Company's carrying value of these private equity fund investments was approximately \$220.2 million and \$231.4 million, respectively. At March 31, 2013, the Company had future capital commitments related to these private equity fund investments of approximately \$11.9 million.

## 4. Unconsolidated Affiliates

Unconsolidated affiliates are as follows (in millions):

	Ownership Percentage	Carrying Value March 31, 2013	December 31, 2012
Unconsolidated affiliates:			
Boston Financial Data Services, Inc.	50%	\$191.1	\$189.3
International Financial Data Services, U.K.	50%	91.9	97.3
International Financial Data Services, L.P.	50%	68.2	68.9
Unconsolidated real estate and other affiliates		39.6	47.5
Total		\$390.8	\$403.0

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

	Three Months Ended March 31,	
	2013	2012
Boston Financial Data Services, Inc.	\$1.8	\$3.2
International Financial Data Services, U.K.	0.8	1.6
International Financial Data Services, L.P.	1.1	(0.1)
Unconsolidated real estate and other affiliates	1.9	0.6
	\$5.6	\$5.3

## 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 March 31, 2013 and December 31, 2012, 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.

Table of Contents

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

	March 31, 2013	Fair Value Measurements at Reporting Date Using		
		Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$712.8	\$ 712.8	\$	\$
Investments in pooled funds	40.8		40.8	
Fixed income securities	25.9		25.9	
Deferred compensation liabilities	(52.6 )	(52.6 )		
Interest rate swap liability	(1.6 )		(1.6 )	
Total	\$725.3	\$ 660.2	\$ 65.1	\$

	December 31, 2012	Fair Value Measurements at Reporting Date Using		
		Quoted prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$651.7	\$ 651.7	\$	\$
Investments in pooled funds	47.9		47.9	
Fixed income securities	18.4		18.4	
Deferred compensation liabilities	(43.8 )	(43.8 )		
Interest rate swap liability	(2.3 )		(2.3 )	
Total	\$671.9	\$ 607.9	\$ 64.0	\$

At March 31, 2013 and December 31, 2012, one of DST's unconsolidated affiliates had an interest rate swap with a fair market value liability of \$68.8 million and \$73.5 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):

	March 31, 2013		December 31, 2012	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Amortizable intangible assets:				
Customer relationships	\$168.3	\$37.6	\$169.4	\$36.0
Other	26.6	8.4	27.8	8.5
Total	\$194.9	\$46.0	\$197.2	\$44.5

Amortization expense of intangible assets for the three months ended March 31, 2013 and 2012 was approximately \$3.8 million and \$4.0 million, respectively. Annual amortization for intangible assets recorded as of March 31, 2013 is estimated to be (in millions):

Remainder of 2013	\$11.5
2014	14.9
2015	14.3
2016	14.1
2017	14.1
Thereafter	80.0
Total	\$148.9

## Goodwill

The following table summarizes the changes in the carrying amount of goodwill for the three months ended March 31, 2013, by Segment (in millions):

	December 31, 2012	Acquisitions	Disposals	Other	March 31, 2013
Financial Services	\$389.0	\$	\$	\$0.5	\$389.5
Customer Communications	33.1				33.1
Total	\$422.1	\$	\$	\$0.5	\$422.6

Table of Contents

## 7. Debt

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

	March 31, 2013	December 31, 2012
Accounts receivable securitization program	\$135.0	\$135.0
Secured promissory notes	13.1	14.5
Equipment credit facilities		12.0
Real estate credit agreement	100.8	101.7
Term loan credit facility	125.0	125.0
Series C convertible senior debentures	91.9	90.1
Revolving credit facilities	78.6	31.1
Senior notes	370.0	370.0
Related party credit agreements	107.4	114.9
Other indebtedness	16.6	17.3
	1,038.4	1,011.6
Less current portion of debt	564.5	519.4
Long-term debt	\$473.9	\$492.2

## 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 March 31, 2013 and December 31, 2012, the outstanding amount under the program was \$135.0 million. During the three months ended March 31, 2013 and 2012, total proceeds from the accounts receivable securitization program were approximately \$226.5 million and \$222.9 million and total repayments were approximately \$226.5 million and \$222.9 million, respectively.

## Series C convertible senior debentures

Holders of the Company's Series C convertible senior debentures were eligible to convert these bonds as of April 1, 2013 as a result of DST's common stock trading above 120% of the applicable conversion price for at least 20 trading days during the period of 30 consecutive trading days ended March 31, 2013. The senior debentures will continue to be convertible through June 30, 2013 and, as a result, they have been classified as a current liability as of March 31, 2013. Conversion rights, and ultimate classification as a current or non-current liability, for subsequent quarters will be a function of future DST stock prices. Additionally, holders of unconverted bonds are eligible to receive contingent interest during the period from February 14, 2013 through August 15, 2013, as the average trading price of the Series C debentures for the applicable five trading-day reference period exceeded 120% of the accreted principal amount of the Series C debentures.

The Company has received notification of conversions during the period from April 1, 2013 through April 30, 2013, resulting in an estimated cash settlement of approximately \$39.5 million during the second quarter of 2013, of which \$29.7 million is the accreted principal and accrued interest of the bonds. Cash will be used to settle the accreted principal, accrued and unpaid interest and conversion value over the principal and accrued and unpaid interest amounts of these conversions.

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 March 31, 2013. The estimated fair value of the convertible debentures and Senior Notes was derived principally from quoted prices from similar assets (Level 2 in the fair value hierarchy).

13

---

Table of Contents

As of March 31, 2013, the carrying and estimated fair value of the Series C convertible senior debentures and Senior Notes were as follows (in millions):

	March 31, 2013	
	Carrying Value	Estimated Fair Value
Convertible senior debentures - Series C	\$91.9	\$123.6
Senior Notes - Series A	40.0	41.3
Senior Notes - Series B	105.0	113.3
Senior Notes - Series C	65.0	71.1
Senior Notes - Series D	160.0	179.0
Total	\$461.9	\$528.3

## 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 35.2% for the three months ended March 31, 2013 compared to 33.7% for the three months ended March 31, 2012.

The Company had previously filed federal income tax refund claims for research and experimentation credits. The Company recorded an income tax benefit of \$2.0 million during the three months ended March 31, 2013 resulting from a resolution reached with the IRS in regards to the 2008 and 2009 refund claims. This income tax benefit relates to the resolved claim years and certain post-audit periods that are still subject to examination.

The full year 2013 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.

## 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 March 31,	
	2013	2012
Net income	\$93.2	\$55.3
Average common shares outstanding	44.3	44.5
Incremental shares from restricted stock units, stock options and convertible debentures	1.3	0.7
Average diluted shares outstanding	45.6	45.2
Basic earnings per share	\$2.10	\$1.24

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Diluted earnings per share	\$2.04	\$1.22
----------------------------	--------	--------

The Company had approximately 44.1 million and 44.9 million shares outstanding at March 31, 2013 and 2012, respectively. There were no shares from options to purchase common stock excluded from the diluted earnings per share calculation because they were anti-dilutive for the three months ended March 31, 2013, as compared to 0.8 million for the three months ended March 31, 2012. The Company's convertible senior debentures would have a potentially dilutive effect on the Company's stock if converted in the future. At March 31, 2013, outstanding Series C debentures would be convertible into 1.8 million shares of common stock, subject to adjustment. Related to the debentures, the calculation of diluted earnings per share includes

Table of Contents

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 months ended March 31, 2013, the dilutive effect of the debentures was 0.4 million shares related to the Company's average share price exceeding accreted bond price per share. For the three months ended March 31, 2012 the dilutive effect of debentures was not significant.

## Share Based Compensation

The Company has share based compensation plans covering its employees and non-employee directors. During the three months ended March 31, 2013, the Company granted approximately 0.5 million restricted stock units ("RSU's"), of which approximately 0.3 million are performance stock units ("PSU's"). A portion of the RSU grants contain performance features. Additionally, during the three months ended March 31, 2013, the Company had 0.7 million RSU's vest primarily as the result of the achievement of the performance features. At March 31, 2013, the Company had outstanding 0.6 million unvested RSU's and 1.4 million stock options (of which 0.5 million are not yet exercisable).

The Company recognized share based compensation expense of \$5.9 million during the three months ended March 31, 2013, as compared to \$6.0 million during the three months ended March 31, 2012.

At March 31, 2013, the Company had \$32.6 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 and restricted stock unit grants will be approximately \$12.3 million for the remainder of 2013, \$11.2 million for 2014, \$8.0 million for 2015 and \$1.1 million for 2016, based on awards currently outstanding.

## Other comprehensive income (loss)

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

	Unrealized Gain on Available-for-Sale Securities	Unrealized Loss on Cash Flow Hedges	Foreign Currency Translation Adjustments	Accumulated Other Comprehensive Income
Balance, December 31, 2012	\$ 253.7	\$(1.4 )	\$4.5	\$256.8
Net current period other comprehensive income (loss)	37.9	0.4	(4.4 )	33.9
Balance, March 31, 2013	\$ 291.6	\$(1.0 )	\$0.1	\$290.7



Table of Contents

Additions to and reclassifications out of accumulated other comprehensive income attributable to the Company:

	Three Months Ended			
	March 31, 2013		2012	
	Pretax	Net of Tax	Pretax	Net of Tax
Available-for-sale securities:				
Unrealized gains on available-for-sale securities	\$130.0	\$79.7	\$92.4	\$56.3
Reclassification of gains into net earnings on available-for-sale securities (1)	(68.5 )	(41.8 )	(15.1 )	(9.2 )
Gains on available-for-sale securities	61.5	37.9	77.3	47.1
Cash flow hedges:				
Unrealized losses on cash flow hedges			(0.3 )	(0.2 )
Reclassification of losses into net earnings on cash flow hedges (2)	0.7	0.4	0.7	0.4
Gains on cash flow hedges	0.7	0.4	0.4	0.2
Cumulative translation adjustments	(4.5 )	(4.4 )	(0.9 )	0.3
Total other comprehensive income	\$57.7	\$33.9	\$76.8	\$47.6

(1) Realized (gains)/losses on available for sale securities are recognized in other income, net.

(2) Reclassification to net earnings of derivatives qualifying as effective cash flow hedges are recognized in interest expense.

One of DST's unconsolidated affiliates had an interest rate swap liability with a fair market value of \$68.8 million and \$73.5 million at March 31, 2013 and December 31, 2012, respectively. DST's 50% proportionate share of this interest rate swap liability was \$34.4 million and \$36.8 million at March 31, 2013 and December 31, 2012, 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. Because the carrying value of this unconsolidated affiliate investment balance was zero at both March 31, 2013 and December 31, 2012, no interest rate swap liability was recorded in the consolidated financial statements.

#### Stock repurchases

The Company repurchased approximately 0.8 million shares of DST common stock for \$52.5 million during the three months ended March 31, 2013, resulting in approximately \$200.0 million remaining under the Company's existing share repurchase plan. No shares were repurchased during the three months ended March 31, 2012.

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 \$21.6 million and \$26.3 million during the three months ended March 31, 2013 and 2012, respectively.

#### Dividends

On January 30, 2013, the Board of Directors of DST declared a quarterly cash dividend of \$0.30 per common share. The total dividend was \$13.5 million, of which \$13.3 million was paid in March 2013. The remaining amount of the dividend represents dividend equivalent shares of restricted stock units in lieu of the cash dividend.

10. Commitments and Contingencies

The Company has letters of credit of \$7.2 million outstanding at both March 31, 2013 and December 31, 2012. Letters of credit are secured by the Company's debt facility.

## Table of Contents

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

The Company has established trusts to provide for the funding of corporate commitments and entitlements of Company officers, directors, employees and others in the event of a change in control of the Company. Assets held in such trusts at March 31, 2013 and December 31, 2012 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. There can be no assurance that the loss accrual for this inquiry will be sufficient to resolve the matter. Although the ultimate resolution and impact of this inquiry is not presently determinable, the Company's management believes the eventual outcome of such inquiry will not have a material adverse effect on the overall financial condition, results of operations or cash flows of the Company.

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 direct damages ranging up to approximately \$10.0 million. Claims for interest and other indirect damages could also be asserted. 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. 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.

As of March 31, 2013, the Company has \$7.9 million accrued related to the regulatory inquiry and legal claim described above. Based on the current status of each of the above proceedings, there is a reasonable possibility that losses in excess of the amounts accrued exists. The Company currently cannot make an estimate of possible outcomes or estimate the amount or range of additional reasonably possible losses 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.

## Guarantees

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 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 March 31, 2013 and

December 31, 2012, total borrowings on the loan were \$28.9 million and \$29.1 million, respectively, and the Company's guarantee totaled \$1.5 million at both March 31, 2013 and December 31, 2012.

The Company entered into an agreement, which became effective on January 28, 2013, for a performance guarantee up to \$5.0 million on a 20 year franchise agreement entered into by a 50% owned real estate joint venture. At March 31, 2013, the Company's liability recorded associated with the guarantee was \$0.8 million.

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

Table of Contents

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.

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

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.

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

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

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

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

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

Table of Contents

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.

Except for the \$0.8 million guarantee described above that has been accrued, at March 31, 2013 and December 31, 2012, 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. 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 Customer Communications). 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):

	March 31, 2013	December 31, 2012
Financial Services	\$1,927.0	\$1,971.1
Customer Communications	378.9	385.5
Investments and Other	1,177.0	1,102.3
Elimination Adjustments	(65.6	) (66.4
	\$3,417.3	\$3,392.5

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

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

	Three Months Ended March 31, 2013				
	Financial Services	Customer Communications	Investments / Other	Elimination Adjustments	Consolidated Total
Operating revenues	\$318.1	\$ 173.2	\$3.9	\$	\$495.2
Intersegment operating revenues	2.2	2.0	10.3	(14.5	)
Out-of-pocket reimbursements	13.3	175.9		(2.0	) 187.2
Total revenues	333.6	351.1	14.2	(16.5	) 682.4

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Costs and expenses	258.6	321.1	8.8	(13.9	) 574.6
Depreciation and amortization	20.5	10.8	2.5	(0.6	) 33.2
Income (loss) from operations	54.5	19.2	2.9	(2.0	) 74.6
Other income (loss), net	(4.4	) (0.8	) 78.4		73.2
Equity in earnings of unconsolidated affiliates	3.6	0.1	1.9		5.6
Earnings (loss) before interest and income taxes	\$53.7	\$ 18.5	\$83.2	\$(2.0	) \$153.4

19

---



Table of Contents

	Three Months Ended March 31, 2012				Consolidated Total
	Financial Services	Customer Communications	Investments / Other	Elimination Adjustments	
Operating revenues	\$309.1	\$ 163.4	\$3.4	\$	\$475.9
Intersegment operating revenues	2.0	2.0	11.0	(15.0 )	
Out-of-pocket reimbursements	14.5	164.7	0.1	(2.0 )	177.3
Total revenues	325.6	330.1	14.5	(17.0 )	653.2
Costs and expenses	252.5	311.9	9.0	(14.3 )	559.1
Depreciation and amortization	21.0	11.0	2.7	(0.7 )	34.0
Income (loss) from operations	52.1	7.2	2.8	(2.0 )	60.1
Other income, net	5.0		24.7		29.7
Equity in earnings of unconsolidated affiliates	4.5	0.2	0.6		5.3
Earnings (loss) before interest and income taxes	\$61.6	\$ 7.4	\$28.1	\$(2.0 )	\$95.1

Earnings before interest and income taxes in the segment reporting information above less interest expense of \$9.6 million and \$11.7 million for the three months ended March 31, 2013 and 2012 is equal to the Company's income before income taxes on a consolidated basis for the corresponding periods.

Table of Contents

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

The discussions set forth in this Quarterly Report on Form 10-Q contain statements concerning potential future events. Such forward-looking statements are based upon assumptions by the Company's management, as of the date of this Quarterly Report, including assumptions about risks and uncertainties faced by the Company. In addition, management may make forward-looking statements orally or in other writings, including, but not limited to, in press releases, in the annual report 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, 2012.

INTRODUCTION

DST Systems, Inc. (the "Company" or "DST") provides sophisticated information processing solutions and services. In addition to technology products and services, DST also provides integrated print and electronic statement and billing solutions. DST's data centers provide technology infrastructure support for asset management, insurance and healthcare companies around the globe. These business units are reported as two operating segments, Financial Services and Customer Communications. 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 the Investments and Other Segment.

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

Financial Services

The Company's Financial Services Segment provides a variety of solutions principally to the asset management, brokerage, retirement, insurance and healthcare industries.

The Company has developed a number of proprietary systems that are integrated into its solutions including the following:

-

Edgar Filing: DST SYSTEMS INC - Form 10-Q

Shareowner recordkeeping and distribution support systems for U.S. and international mutual fund companies, broker/dealers and financial advisors,  
• Investment management systems offered to U.S. and international investment managers and fund accountants,  
• Defined contribution participant recordkeeping system for the U.S. retirement plan market,  
• 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  
• Business process management and customer contact system offered to a broad variety of industries.

## Table of Contents

The Financial Services Segment distributes its services and products on a direct basis and through subsidiaries and joint venture affiliates in the United States (“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.

### Customer Communications

The Company's Customer Communications Segment helps businesses deploy customer communications while improving operational performance across critical business functions such as sales, marketing, customer service, technology, finance, operations, and compliance. The Segment's product offering combines data insights and analysis with business decision-making tools and multi-channel execution and delivery designed to help businesses acquire, grow, retain, and win-back customers. By delivering information in the desired combination of print, digital and archival formats, the Company helps its clients deliver better customer experiences at each point of interaction.

The Customer Communication's North America business has four operating facilities located in the U.S. 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 U.S. The North America business is substantially a provider of print and digital delivery services for client bills and statements related to transaction events. Customer Communications also has several operating facilities in the U.K. and is among the largest direct communications manufacturers in that country. The U.K. business is oriented to data-driven marketing communications and direct mail campaigns.

### Investments and Other

The Investments and Other Segment is comprised of the Company's real estate subsidiaries and joint ventures, investments in equity securities, private equity investments and other financial interests. The assets held by the Investments and Other Segment are primarily passive in nature.

The Company owns and operates real estate mostly in North America, primarily for lease to the Company's other business segments. The Company is a partner in certain real estate joint ventures that lease office space to the Company, certain of its unconsolidated affiliates and unrelated third parties. The Investments and Other Segment also holds investments in available-for-sale equity securities, including 8.8 million shares of State Street Corporation “State Street” as of March 31, 2013 with a market value of \$518.8 million based on closing exchange value.

### Seasonality

Generally, the Company does not have significant seasonal fluctuations in its business operations. Processing and Customer Communications 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.

Table of Contents

## RESULTS OF OPERATIONS

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

	Three Months Ended March 31,	
	2013	2012
Revenues		
Operating revenues		
Financial Services	\$320.3	\$311.1
Customer Communications	175.2	165.4
Investments and Other	14.2	14.4
Elimination Adjustments	(14.5)	(15.0)
	495.2	475.9
% change from prior year period	4.1	%
Out-of-pocket reimbursements		
Financial Services	13.3	14.5
Customer Communications	175.9	164.7
Investments and Other		0.1
Elimination Adjustments	(2.0)	(2.0)
	187.2	177.3
% change from prior year period	5.6	%
Total revenues	\$682.4	\$653.2
% change from prior year period	4.5	%
Income from operations		
Financial Services	\$54.5	\$52.1
Customer Communications	19.2	7.2
Investments and Other	2.9	2.8
Elimination Adjustments	(2.0)	(2.0)
	74.6	60.1
Interest expense	(9.6)	(11.7)
Other income, net	73.2	29.7
Equity in earnings of unconsolidated affiliates	5.6	5.3
Income before income taxes	143.8	83.4
Income taxes	50.6	28.1
Net income	\$93.2	\$55.3
Basic earnings per share	\$2.10	\$1.24
Diluted earnings per share	\$2.04	\$1.22
Non-GAAP diluted earnings per share	\$0.99	\$1.05
Cash dividends per share of common stock	\$0.30	\$0.40

Table of Contents

Consolidated revenues

Consolidated total revenues (including out-of-pocket (“OOP”) reimbursements) for the three months ended March 31, 2013 were \$682.4 million, an increase of \$29.2 million or 4.5% compared to the three months ended March 31, 2012. Consolidated operating revenues for the three months ended March 31, 2013 increased \$19.3 million or 4.1% as compared to the same periods in 2012. The increase in consolidated operating revenues during the three months ended March 31, 2013 was attributable to an increase of \$9.2 million in the Financial Services Segment and \$9.8 million in the Customer Communications Segment. The increase in Financial Services operating revenues for the three months ended March 31, 2013 is primarily from a \$6.0 million contract termination payment received from the partial termination of a retirement business client during first quarter 2013. Increased operating revenues from DST HealthCare, DST Retirement Solutions, ALPS and DST Brokerage Solutions were partially offset by lower operating revenues from mutual fund registered shareowner account processing and AWD software license and professional services. The increase in Customer Communications operating revenues for the three months ended March 31, 2013 is primarily from new client volumes in North America, partially offset by decreased revenues in the United Kingdom.

Consolidated OOP reimbursements for the three months ended March 31, 2013 increased \$9.9 million or 5.6% as compared to the same periods in 2012. OOP reimbursements for Customer Communications increased \$11.2 million or 6.8% for the three months ended March 31, 2013, as compared to the same periods in 2012. The increase in Customer Communications OOP reimbursements is attributable to higher volumes from new clients. The decrease in Financial Services OOP reimbursements during the three months ended March 31, 2013 is primarily due to lower mutual fund registered shareowner account processing.

Income from operations

Consolidated income from operations for the three months ended March 31, 2013, was \$74.6 million, an increase of \$14.5 million or 24.1% as compared to the same period in 2012. The increase in operating income during the three months ended March 31, 2013 was attributable to an increase of \$2.4 million or 4.6% in Financial Services, \$12.0 million in Customer Communications, and \$0.1 million in Investments and Other.

Increased Financial Services operating revenues were partially offset by increased employee and other costs associated with acquiring and supporting new business, a \$2.5 million incremental loss accrual related to a regulatory inquiry regarding the processing of pharmacy claims and from lower software license income. Customer Communications income from operations increased \$12.0 million during the three months ended March 31, 2013 primarily due to new client revenue in North America and lower costs from facility consolidations and reduced headcount in the U.K. The increase in Investments and Other operating income for the three months ended March 31, 2013 primarily results from lower depreciation expense and operating costs.

Interest expense

Interest expense for the three months ended March 31, 2013 was \$9.6 million, a decrease of \$2.1 million, as compared to the three months ended March 31, 2012, principally from lower weighted average debt balances outstanding and lower weighted average interest rates.



Table of Contents

## Other income, net

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

	Three Months Ended	
	March 31,	
	2013	2012
Net realized gains from sale of available-for-sale securities	\$68.7	\$15.4
Net gain on private equity funds and other investments	3.8	2.4
Other than temporary impairments	(0.2	) (0.3
Dividend income	3.3	5.7
Interest income	1.1	1.0
Foreign currency gain (loss)	(6.6	) 1.1
Miscellaneous items	3.1	4.4
Other income, net	\$73.2	\$29.7

The Company recorded net gains from the sale of available-for-sale securities of \$68.7 million during the three months ended March 31, 2013, an increase of \$53.3 million as compared to the same period in 2012. Included in the \$68.7 million of net gains from the sale of available-for-sale securities for the three months ended March 31, 2013 is a \$24.1 million gain from the sale of approximately 0.5 million shares of State Street Corporation.

The Company recognized a net gain of \$3.8 million on private equity funds and other investments for the three months ended March 31, 2013, as compared to a net gain of \$2.4 million for the three months ended March 31, 2012.

The Company receives dividend income from certain investments held. Dividend income was \$3.3 million for the three months ended March 31, 2013, as compared to \$5.7 million for the three months ended March 31, 2012. The decline in dividend income for the three months ended March 31, 2013 as compared to March 31, 2012 is primarily due to the sale of the Company's shares in Computershare Ltd in 2012.

The Company had unrealized losses on foreign currency translation of \$6.6 million during the three months ended March 31, 2013 as compared to unrealized gains on foreign currency translation of \$1.1 million during the three months ended March 31, 2012. The majority of the 2013 foreign currency loss was caused by negative movements in the U.K. pound versus the U.S. dollar on an intercompany loan that is expected to be repaid over the next five years.

Miscellaneous items include unrealized gains and losses on marketable securities designated as trading securities, amortization of deferred non-operating gains and other non-operating items. Miscellaneous items resulted in a gain of \$3.1 million for the three months ended March 31, 2013 compared to a gain of \$4.4 million for the three months ended March 31, 2012. The decrease in miscellaneous items is primarily attributable to lower unrealized gains on trading securities and other non-operational losses incurred.

## 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	
March 31,	
2013	2012



Edgar Filing: DST SYSTEMS INC - Form 10-Q

BFDS	\$1.8	\$3.2	
IFDS, U.K.	0.8	1.6	
IFDS, L.P.	1.1	(0.1	)
Other	1.9	0.6	
	\$5.6	\$5.3	

25

---

Table of Contents

DST's equity in earnings of unconsolidated affiliates increased \$0.3 million for the three months ended March 31, 2013.

DST's equity in BFDS earnings decreased \$1.4 million as compared to the three months ended March 31, 2012 primarily from lower revenues associated with reduced levels of accounts serviced. BFDS derives investment earnings related to cash balances maintained on behalf of customers. Average daily client cash balances invested by BFDS were \$1.4 billion during the three months ended March 31, 2013, as compared to \$1.2 billion during the three months ended March 31, 2012. Average interest rates earned on the balances increased from 0.10% during the three months ended March 31, 2012 to 0.14% during the three months ended March 31, 2013.

DST's equity in earnings of IFDS, U.K. decreased \$0.8 million during the three months ended March 31, 2013, as compared to the same period in 2012. 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 9.5 million at March 31, 2013, an increase of 0.1 million accounts or 1.1% from December 31, 2012 and an increase of 1.3 million accounts or 15.9% from March 31, 2012. The increase in accounts is attributable to organic account growth during the three months ended March 31, 2013. As previously announced, IFDS U.K. is in the process of converting new shareowner processing clients with approximately 0.2 million accounts which are scheduled to convert by June 30, 2013. New product development and client conversion costs are expected to continue to affect IFDS U.K. earnings.

DST's equity in earnings of IFDS L.P. (which includes IFDS Canada, Ireland and Luxembourg) increased \$1.2 million during the three months ended March 31, 2013, as compared to the same period in 2012. The increase in IFDS L.P. earnings during the three months ended March 31, 2013 was primarily attributable to higher revenues from a new client in Canada that converted 1.1 million accounts in fourth quarter 2012, partially offset by increased operating costs to support the new client and decreased earnings from a Canadian real estate partnership that was sold in December 2012. Shareowner accounts serviced by IFDS Canada were 11.5 million at March 31, 2013, an increase of 0.2 million accounts or 1.8% from December 31, 2012 and an increase of 1.1 million accounts or 10.6% from March 31, 2012. The increase in accounts from December 31, 2012 is attributable to organic account growth.

DST's equity in earnings of other unconsolidated affiliates increased \$1.3 million during the three months ended March 31, 2013, as compared to the same periods in 2012, primarily from improved performance at DST's real estate and other affiliates.

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 35.2% for the three months ended March 31, 2013, compared to 33.7% for the three months ended March 31, 2012. A change in the proportional mix of domestic and international income caused an increase in the tax rate in 2013 as compared to 2012. The increase was partially offset by \$2.0 million of federal research and experimentation credits recorded during the three months ended March 31, 2013. The Company had previously filed federal income tax claims for research and experimentation credits. During first quarter 2013, the Company and the IRS reached a resolution in regards to the 2008 and 2009 refund claims. This income tax credit relates to the resolved claim years and certain post-audit periods that are still subject to examination.

Excluding the effect of discrete period items, the Company expects its tax rate to be approximately 36.1% for full year 2013, but the rate for the remainder of the year is estimated to vary on a quarterly basis between 35.5% and 38.5% depending on the amount and timing of estimated 2013 sources of taxable income (e.g. domestic consolidated, international, and/or joint venture). The full year 2013 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.

#### Comprehensive income

The Company recorded comprehensive income of \$127.1 million for the three months ended March 31, 2013 compared to comprehensive income of \$102.9 million for the three months ended March 31, 2012. Comprehensive income includes net income of \$93.2 million for the three months ended March 31, 2013 compared to \$55.3 million for the three months ended

Table of Contents

March 31, 2012, and other comprehensive income of \$33.9 million for the three months ended March 31, 2013 compared to other comprehensive income of \$47.6 million for the three months ended March 31, 2012, respectively. Other comprehensive income consists of unrealized gains (losses) on available-for-sale securities, reclassifications for net gains and losses included in net income, unrealized gain (loss) on cash flow hedges, 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 income is the net change in unrealized gains (losses) on available-for-sale securities.

Business Segment Comparisons  
FINANCIAL SERVICES SEGMENT

Revenues

Financial Services Segment total revenues for the three months ended March 31, 2013 were \$333.6 million, an increase of \$8.0 million or 2.5% as compared to the same period in 2012. Financial Services Segment operating revenues for the three months ended March 31, 2013 were \$320.3 million, an increase of \$9.2 million or 3.0% as compared to the same period in 2012. The increase in Financial Services operating revenues for the three months ended March 31, 2013 is primarily from a \$6.0 million contract termination payment received from the partial termination of a retirement business client during first quarter 2013. The partial contract termination payment occurred from the Company's client not completing the contractual conversion of certain defined contribution participants to DST's retirement platform as a result of a business acquisition impacting the Company's client. Additionally, increased operating revenues from DST HealthCare, DST Retirement Solutions, ALPS and DST Brokerage Solutions were partially offset by lower operating revenues from mutual fund registered shareowner account processing and AWD software license and professional services.

U.S. operating revenues for the three months ended March 31, 2013 were \$285.8 million, an increase of \$10.6 million or 3.9% as compared to the same periods in 2012. U.S. operating revenues for the three months ended March 31, 2013 increased primarily from the partial contract termination payment received and increased operating revenues at DST HealthCare, DST Retirement Solutions, ALPS and DST Brokerage Solutions partially offset by lower operating revenues from mutual fund registered shareowner account processing.

International operating revenues for the three months ended March 31, 2013 were \$34.5 million, a decrease of \$1.4 million or 3.9% as compared to the same period in 2012. International operating revenues for the three months ended March 31, 2013 decreased primarily from the decline in international AWD software license and professional services and from changes in foreign currency exchange rates between the U.S. Dollar and other foreign currencies.

Financial Services Segment OOP reimbursement revenues for the three months ended March 31, 2013 were \$13.3 million, a decrease of \$1.2 million or 8.3% as compared to the same period in 2012. The decrease during the three months ended March 31, 2013 is primarily due to lower mutual fund registered shareowner account processing.

Table of Contents

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

	Three Months Ended March 31,	
	2013	2012
<b>Registered Accounts</b>		
Beginning balance	75.7	85.1
New client conversions	0.3	0.5
Subaccounting conversions to DST platforms	(0.7	) (1.7
Subaccounting conversions to non-DST platforms	(0.7	) (1.4
Organic growth	0.4	0.3
Ending balance	75.0	82.8
<b>Subaccounts</b>		
Beginning balance	12.4	14.6
New client conversions	5.7	
Conversions from non-DST registered platforms	0.5	0.1
Conversions from DST's registered accounts	0.7	1.7
Organic growth	0.7	0.3
Ending balance	20.0	16.7
<b>Total accounts</b>	<b>95.0</b>	<b>99.5</b>

Total shareowner accounts serviced at March 31, 2013 increased 6.9 million accounts or 7.8% from December 31, 2012 and decreased 4.5 million accounts or 4.5% from March 31, 2012.

Registered accounts decreased 0.7 million accounts or 0.9% from December 31, 2012 and decreased 7.8 million accounts or 9.4% from March 31, 2012. The decline in registered accounts from March 31, 2012 to March 31, 2013 is from accounts converting to subaccounting platforms and to non-DST platforms.

Tax-advantaged accounts were 41.4 million at both March 31, 2013 and December 31, 2012. Tax-advantaged accounts decreased 1.3 million accounts or 3.0% as compared to March 31, 2012. Tax-advantaged accounts represent 55.2% of total registered accounts serviced at March 31, 2013 as compared to 51.6% at March 31, 2012.

	March 31, 2013	December 31, 2012	March 31, 2012
<b>U.S. registered tax-advantaged accounts</b>			
IRA mutual fund accounts	23.4	23.5	24.2
Other retirement accounts	8.5	8.5	8.9
Section 529 and Educational IRA's	9.5	9.4	9.6
	41.4	41.4	42.7

The Company currently expects conversions of registered accounts to subaccounts for 2013 to be between 5-6 million, of which approximately 25% of these accounts are expected to 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.

DST Brokerage operating revenues increased during the three months ended March 31, 2013, as compared to the three months ended March 31, 2012, as a result of higher levels of subaccounts processed. The Company successfully

converted 5.7 million subaccounts to DST's subaccounting platform in the first quarter of 2013. New subaccount conversions were approximately 0.3 million accounts in excess of DST's previous estimates.

Table of Contents

ALPS operating revenues increased during the three months ended March 31, 2013 as compared to the three months ended March 31, 2012 from market appreciation and new clients. The following table summarizes ALPS operating statistics (in billions):

	March 31,	
	2013	2012
Assets Under Active Distribution	\$72.5	\$57.5
Assets Under Administration	115.5	94.2

DST Retirement operating revenues for the first quarter 2013 increased from first quarter 2012 from higher defined contribution participants processed. Total defined contribution participants processed were 7.1 million at March 31, 2013, an increase of 1.7 million participants from March 31, 2012 and an increase of 1.0 million from December 31, 2012.

To align with retirement plan industry reporting practices, beginning with first quarter 2013, DST will report total defined contribution participants on DST's retirement processing platform. Reporting periods prior to 2013 have been adjusted to conform to the current period reporting presentation. Total defined contribution participants include: 1) participants with account balances; 2) new employees in the process of becoming eligible to participate; 3) employees that have met plan eligibility requirements, but do not have account balances; and 4) terminated employees who are still treated as plan participants for purposes of annual plan compliance tests (such as participant discrimination tests) and for tax reporting purposes. As previously communicated, retirement plan record keepers generally experience an annual reduction in participants processed during the second quarter when tax and other compliance activities for the prior year are finalized.

The following table summarizes changes in defined contribution participants serviced (in millions):

	Three Months Ended	
	March 31,	
	2013	2012
Total Defined Contribution Participants		
Beginning balance, as adjusted	6.1	5.1
New client conversions	1.1	
Organic growth (decline)	(0.1	) 0.3
Ending balance	7.1	5.4

DST Retirement added 1.1 million participants from conversion activities in first quarter 2013. DST Retirement is incurring costs associated with first quarter 2013 participant conversions, as well as future conversions of previously announced new client participants (totaling approximately 2.3 million participants).

DST HealthCare operating revenues during the three months ended March 31, 2013 increased primarily from higher volumes of pharmacy claims processed. In addition, DST HealthCare had new operating revenues from new full service healthcare clients that successfully converted to DST HealthCare's processing platform in first quarter 2013. The increase in pharmacy claims paid is associated with increased Medicare and Medicaid members. The increase in covered lives is principally from organic growth within the existing customer base driven by Medicaid third party administration processing as well as new clients.

	March 31,	
	2013	2012
Pharmacy claims paid	109.2	99.2
Covered lives using DST's medical processing platform	23.1	22.6

DST's business process and document management revenues, including revenues associated with AWD, decreased during the three months ended March 31, 2013, from lower software license revenues and professional services. Active AWD workstations at March 31, 2013 were 0.2 million, essentially unchanged as compared to December 31, 2012 and an increase of 3.7% from March 31, 2012.

DST Global Solutions investment management operating revenues during the three months ended March 31, 2013 were essentially unchanged from the same period in 2012. Increased operating revenues were partially offset by changes in foreign currency exchange rates.



Table of Contents

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 \$9.1 million of software license fee revenues for the three months ended March 31, 2013, a decrease of \$3.1 million or 25.4% over the same period in 2012. The decrease in software license fee revenues for the three months ended March 31, 2013 primarily reflects lower AWD software license fee revenues. While license fee revenues are not a significant percentage of DST's total operations, they can significantly impact earnings in the period in which they are recognized. Revenues and operating results from individual license sales depend heavily on the timing, size and nature of the contract.

## Costs and expenses

Financial Services Segment costs and expenses (including OOP costs) were \$258.6 million for the three months ended March 31, 2013, an increase of \$6.1 million or 2.4% as compared to the same period in 2012. 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 \$13.3 million for the three months ended March 31, 2013, a decrease of \$1.2 million or 8.3% as compared to the same periods in 2012.

Excluding reimbursable operating expenses in 2013 and 2012, costs and expenses were \$245.3 million for the three months ended March 31, 2013, an increase of \$7.3 million or 3.1% as compared to the same period in 2012. On this basis, the increase in costs and expenses is primarily from increased compensation and benefits costs and other operating costs associated with acquiring and supporting new business. In addition, costs and expenses includes a \$2.5 million loss accrual recorded during the three months ended March 31, 2013 related to a regulatory inquiry into the processing of certain pharmacy claims from 2006 to 2009.

## Depreciation and amortization

Financial Services Segment depreciation and amortization costs for the three months ended March 31, 2013 were \$20.5 million, a decrease of \$0.5 million or 2.4% as compared to the same period in 2012. The decrease during the three months ended March 31, 2013 was primarily from certain assets becoming fully depreciated.

## Income from operations

Financial Services Segment income from operations for the three months ended March 31, 2013 was \$54.5 million, an increase of \$2.4 million or 4.6% as compared to the same period in 2012. The increase is attributable to higher operating revenues from receipt of a \$6.0 million partial contract termination payment, offset by lower software license revenues, higher employee costs to support and acquire new business and a \$2.5 million loss accrual described above.

## CUSTOMER COMMUNICATIONS SEGMENT

## Revenues

The following table presents the financial results and operating statistics of the Customer Communications Segment (in millions):

	Three Months Ended March 31,	
	2013	2012

Edgar Filing: DST SYSTEMS INC - Form 10-Q

	Operating Revenue	Operating Income	Operating Revenue	Operating Income (Loss)
North America	\$126.8	\$17.2	\$113.7	\$9.6
United Kingdom	48.4	2.0	51.7	(2.4 )
Customer Communications Segment	\$175.2	\$19.2	\$165.4	\$7.2

30

---

Table of Contents

	Three Months Ended	
	March 31,	
	2013	2012
Images Produced		
North America	2,598.0	2,359.5
United Kingdom	543.5	556.8
Customer Communications Segment	3,141.5	2,916.3
Packages Mailed		
North America	600.6	545.9
United Kingdom	192.5	189.8
Customer Communications Segment	793.1	735.7

Customer Communications Segment total revenues for the three months ended March 31, 2013 were \$351.1 million, an increase of \$21.0 million or 6.4% as compared to the same period in 2012. Customer Communications operating revenues for the three months ended March 31, 2013 were \$175.2 million, an increase of \$9.8 million or 5.9% as compared to the same period in 2012. The increase in operating revenue for the three months ended March 31, 2013 was primarily attributable to new client volumes in North America, partially offset by lower volumes from existing clients and lower revenues per image produced in the United Kingdom. Although the Customer Communications Segment does not have significant seasonal fluctuations in its business operations, volumes for mutual fund clients are usually highest during the first quarter primarily due to delivery of year-end statements and tax forms.

Out-of-pocket reimbursement revenues for the three months ended March 31, 2013 were \$175.9 million, an increase of \$11.2 million or 6.8% as compared to the same period in 2012, attributable to higher volumes.

Customer Communications' North America operating revenues increased \$13.1 million or 11.5% for the three months ended March 31, 2013, as compared to the same periods in 2012. North America images produced increased 10.1% during the three months ended March 31, 2013, as compared to the same period in 2012. North America packages mailed increased 54.7 million or 10.0% as compared to the three months ended March 31, 2012. The increase in operating revenues, images produced and packages mailed for the three months ended March 31, 2013 was primarily attributable to new client volumes.

Customer Communications' United Kingdom operating revenues decreased \$3.3 million or 6.4% for the three months ended March 31, 2013, as compared to the same period in 2012. Difficult economic conditions in the U.K. marketplace have continued to negatively impact the Customer Communication U.K.'s production volumes and operating revenues. The decrease in operating revenues for the three months ended March 31, 2013 was primarily due to lower images produced and foreign exchange rate movements. Images produced in the U.K. decreased 13.3 million or 2.4% during the three months ended March 31, 2013, as compared to the same period in 2012. Packages mailed in the U.K. increased 2.7 million or 1.4% during the three months ended March 31, 2013, as compared to the same period in 2012. The net decrease in images produced was primarily the result of lower volumes from existing clients. The increase in packages mailed is primarily the result of new client volumes.

## Costs and expenses

Customer Communications Segment costs and expenses (including OOP costs) were \$321.1 million for the three months ended March 31, 2013, an increase of \$9.2 million or 2.9% as compared to the same period in 2012. Costs and expenses in the Customer Communication Segment are primarily comprised of reimbursable operating expenses (primarily postage and freight), compensation and benefits costs, material costs (principally paper and ink) and other

operating costs. Reimbursable operating expenses included in costs and expenses were \$175.9 million for the three months ended March 31, 2013, an increase of \$11.2 million or 6.8% as compared to the same period in 2012. Excluding reimbursable operating expenses in 2013 and 2012, costs and expenses decreased \$2.0 million or 1.4% for the three months ended March 31, 2013 to \$145.2 million. Excluding OOP costs, Customer Communications' North America costs and expenses increased \$5.4 million for the three months ended March 31, 2013, primarily from higher costs associated with an increased workforce to support new clients and conversion activities as well as higher material costs from higher volumes of operating revenues. Excluding OOP costs, Customer Communications U.K.'s costs and expenses decreased \$7.4 million during the three months ended March 31, 2013, as compared to the same period in 2012, primarily due to lower material costs associated with lower operating revenues, lower costs from facility consolidations and lower employee compensation expenses resulting from lower headcount.

Table of Contents

Depreciation and amortization

Customer Communications Segment depreciation and amortization costs for the three months ended March 31, 2013 were \$10.8 million, a decrease of \$0.2 million or 1.8% as compared to the same period in 2012. Depreciation and amortization expense in the United Kingdom decreased \$0.3 million during the three months ended March 31, 2013, as compared to the same period in 2012. The decrease in the three months ended March 31, 2013 was primarily attributable to lower levels of assets due to closing certain operating locations in 2012. Depreciation and amortization expense in North America increased \$0.1 million during the three months ended March 31, 2013, as compared to the three months ended March 31, 2012.

Income from operations

Customer Communications Segment income from operations for the three months ended March 31, 2013 increased \$12.0 million, as compared to the same period in 2012. During the three months ended March 31, 2013, Customer Communications' North America income from operations increased \$7.6 million and Customer Communications U.K. income from operations increased \$4.4 million. The increase in Customer Communications North America is from higher operating revenue due primarily to new client volumes, partially offset by higher costs associated with an increased workforce to support new clients and conversion activities. The increase in Customer Communications U.K. income from operations is due to lower employee compensation expenses resulting from a reduced headcount and lower facility costs due to closing operating locations in 2012, partially offset by lower operating revenues.

INVESTMENTS AND OTHER SEGMENT

Revenues

Investments and Other Segment total revenues, including out-of-pocket reimbursements, were \$14.2 million for the three months ended March 31, 2013, a decrease of \$0.3 million or 2.1% as compared to the same period in 2012 due to decreased rental activities associated with the sale of leased properties in 2012. 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.

Costs and expenses

Occupancy costs are generally the largest costs included in costs and expenses in the Investments and Other Segment. For the three months ended March 31, 2013, Investments and Other Segment Costs and expenses were \$8.8 million, a decrease of \$0.2 million as compared to the same period in 2012, from reduced occupancy expenses associated with the sale of certain properties in 2012.

Depreciation and amortization

Investments and Other Segment depreciation and amortization for the three months ended March 31, 2013 was \$2.5 million, a decrease of \$0.2 million as compared to the same period in 2012, primarily from the sale of certain properties during 2012.

Income from operations

Investments and Other Segment recorded income from operations of \$2.9 million during the three months ended March 31, 2013, an increase of \$0.1 million as compared to the same period in 2012. The increase in operating

income for the three months ended March 31, 2013 is primarily from lower costs and expenses, partially offset by lower operating revenues as a result of the sale of certain leased properties during 2012.

Table of Contents

USE OF NON-GAAP FINANCIAL INFORMATION

In addition to reporting financial information 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." The non-GAAP financial information has been reconciled to the corresponding GAAP measures in the following financial schedules titled "Reconciliation of Reported Results to Income Adjusted for Certain Non-GAAP Items." 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. Additionally, the Company believes a useful measure of the Customer Communications Segment's contribution to DST's results is to focus on the components of operating income, excluding depreciation and amortization. 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 financial information 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 March 31, 2013, have been treated as non-GAAP adjustments:

Contract termination payment in the amount of \$6.0 million from the partial termination of a retirement business client in the Financial Services Segment, included in operating revenue. The partial contract termination payment occurred from DST's client not completing the contractual conversion of certain defined contribution participants to DST's retirement platform as a result of a business acquisition impacting DST's client. The income tax expense associated with this net gain was approximately \$2.3 million.

Incremental loss accrual recorded for a previously disclosed regulatory inquiry regarding the processing of certain pharmacy claims during the period 2006 to 2009, included in costs and expenses, in the amount of \$2.5 million. There was no income tax benefit attributed to this loss accrual.

Net gain on securities and other investments of \$72.3 million, which were included in other income, net, is comprised of net realized gains from sales of available-for-sale securities of \$68.7 million, net gains on private equity funds and other investments of \$3.8 million, partially offset by other than temporary impairments on available-for-sale securities of \$0.2 million. The income tax expense associated with the aggregate net gains on securities and other investments was approximately \$27.5 million.

Income tax benefits of \$2.2 million, primarily resulting from the resolution of historical research and experimentation credits.

The following items, which occurred during the quarter ended March 31, 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.



Table of Contents

Employee termination expenses of \$4.0 million associated with reductions in workforce in the Financial Services Segment (\$2.6 million) and the Customer Communications 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.

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.

## DST SYSTEMS, INC.

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

Three Months Ended March 31,

(Unaudited - in millions, except per share amounts)

	2013			
	Operating Income	Pretax Income	Net Income	Diluted EPS
Reported GAAP income	\$74.6	\$143.8	\$93.2	\$2.04
Adjusted to remove:				
Included in operating income:				
Contract termination payment - Financial Services	(6.0	) (6.0	) (3.7	) (0.08
Loss accrual - Financial Services	2.5	2.5	2.5	0.06
Included in non-operating income:				
Net gain on securities and other investments		(72.3	) (44.8	) (0.98
Income tax credits			(2.2	) (0.05
Adjusted Non-GAAP income	\$71.1	\$68.0	\$45.0	\$0.99
	2012			
	Operating Income	Pretax Income	Net Income	Diluted EPS
Reported GAAP income	\$60.1	\$83.4	\$55.3	\$1.22
Adjusted to remove:				
Included in operating income:				
Business development expenses - Financial Services	0.5	0.5	0.3	0.01
Employee termination expenses - Financial Services	2.6	2.6	1.6	0.04
Employee termination expenses - Customer Communications	1.4	1.4	1.1	0.02
Included in non-operating income:				
Net gain on securities and other investments		(17.5	) (10.8	) (0.24
Adjusted Non-GAAP income	\$64.6	\$70.4	\$47.5	\$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.

Table of Contents

## Management's Analysis of Non-GAAP Results for the three months ended March 31, 2013 and 2012

Taking into account the non-GAAP items described in the tables above, adjusted non-GAAP diluted earnings per share was \$0.99 and \$1.05 for the three months ended March 31, 2013 and 2012, 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 months ended March 31, 2013 is mostly attributable to unrealized foreign currency losses on intercompany loans, decreased dividend income and lower Financial Services operating income, which were partially offset by improved Customer Communications operating income.

## DST SYSTEMS, INC.

RECONCILIATION OF REPORTED RESULTS TO INCOME ADJUSTED FOR CERTAIN NON-GAAP ITEMS  
CUSTOMER COMMUNICATIONS SEGMENT

Three Months Ended March 31,

(Unaudited - in millions)

	2013				
	Operating Revenue	Out-of-pocket Reimbursements	Costs and Expenses	Depreciation and Amortization	Operating Income
Reported GAAP amount	\$ 175.2	\$ 175.9	\$ 321.1	\$ 10.8	\$ 19.2
Adjusted to remove: No adjustments					
Adjusted Non-GAAP amount	\$ 175.2	\$ 175.9	\$ 321.1	\$ 10.8	\$ 19.2
Comprised of:					
North America	\$ 126.8	\$ 160.8	\$ 263.0	\$ 7.4	\$ 17.2
United Kingdom	48.4	15.1	58.1	3.4	2.0
	\$ 175.2	\$ 175.9	\$ 321.1	\$ 10.8	\$ 19.2
	2012				
	Operating Revenue	Out-of-pocket Reimbursements	Costs and Expenses	Depreciation and Amortization	Operating Income
Reported GAAP amount	\$ 165.4	\$ 164.7	\$ 311.9	\$ 11.0	\$ 7.2
Adjusted to remove: Employee termination expenses - United Kingdom			(1.4 )		1.4
Adjusted Non-GAAP amount	\$ 165.4	\$ 164.7	\$ 310.5	\$ 11.0	\$ 8.6
Comprised of:					
North America	\$ 113.7	\$ 150.4	\$ 247.2	\$ 7.3	\$ 9.6
United Kingdom	51.7	14.3	63.3	3.7	(1.0 )

Edgar Filing: DST SYSTEMS INC - Form 10-Q

\$165.4	\$164.7	\$310.5	\$11.0	\$8.6
---------	---------	---------	--------	-------

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

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 net proceeds from investments to fund other investment and financing 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 three months ended March 31, 2013 and 2012 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 \$42.2 million during the three months ended March 31, 2013 compared to \$42.8 million for the three months ended March 31, 2012, a decrease of \$0.6 million. Operating cash flows for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the full year 2013. During the three months ended March 31, 2013, the Company has received significant proceeds from the sale of investments, including \$102.1 million from the sale of available-for-sale securities. Income tax expense resulting from these investment sales was approximately \$26.8 million, of which the majority is expected to be paid in the second quarter, and will reduce operating cash flows. The proceeds from these and other investment sales are included in investing activities, but the income taxes paid on these investment gains are required to be treated as an operating cash outflow.

The decrease in operating cash flows during 2013 is attributable to changes in working capital partially offset by higher operating income. Accrued compensation and benefits during the three months ended March 31, 2013 decreased \$23.3 million as compared to the same period in 2012, associated with the timing of the funding of DST's profit sharing contribution which occurred in first quarter 2013 for the 2012 contribution, but second quarter 2012 for the 2011 contribution, and higher incentive compensation. Deferred revenues and gains increased \$11.1 million during 2013, as compared to a decrease in deferred revenues of \$9.8 million during 2012, a net increase in working capital of \$20.9 million, mostly attributable to not offering a service prepayment discount to BFDS in 2013. Accounts receivable decreased \$4.0 million during the three months ended March 31, 2013, as compared to an increase of \$12.2 million during the same period in 2012, a net increase in working capital of \$16.2 million.

Operating cash flows during 2013 resulted principally from net income of \$93.2 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 \$33.2 million, amortization of share based compensation of \$5.9 million and equity in earnings of unconsolidated affiliates of \$5.6 million. Cash and cash equivalents were \$120.8 million and \$88.3 million at March 31, 2013 and 2012, respectively.

Investing Activities

Cash flows provided by investing activities were \$104.4 million during the three months ended March 31, 2013 as compared to cash flows used in investing activities of \$42.5 million for the three months ended March 31, 2012, an increase of \$146.9 million. The increase in net cash flows provided by investing activities during 2013 as compared to 2012 is attributable to higher net cash inflows for net investment activities (sales and purchases) and higher cash flows in 2013 from decreases in restricted cash to satisfy client fund obligations and lower capital expenditures.



Table of Contents

## Capital Expenditures

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

	Three Months Ended	
	March 31,	
	2013	2012
Financial Services Segment	\$ 15.9	\$ 18.0
Customer Communications Segment	10.0	10.8
Investments and Other Segment	1.7	1.9
	\$ 27.6	\$ 30.7

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 \$31.7 million and \$70.6 million of investments in available-for-sale securities and other investments during the three months ended March 31, 2013 and 2012, respectively. During the three months ended March 31, 2013, the Company received \$133.6 million from the sale/maturities of investments as compared to \$89.1 million during the three months ended March 31, 2012.

## Financing Activities

Cash flows used in financing activities were \$114.1 million during the three months ended March 31, 2013 as compared to cash flows provided by financing activities of \$11.1 million for the three months ended March 31, 2012, a decrease of \$125.2 million. The increase in net cash flows used in financing activities during 2013 as compared to 2012 is primarily attributable to higher net cash outflows in 2013 on client fund obligations of \$102.1 million, higher repurchases of common stock of \$47.8 million, dividends paid in 2013 of \$13.3 million and lower proceeds from the issuance of common stock of \$26.3 million and higher principal payments on debt of \$9.7 million, partially offset by higher net borrowings under the revolving credit facility of \$58.4 million and the 2012 purchase of the remaining non-controlling interest in DST Output U.K. for \$17.7 million. During the three months ended March 31, 2013, cash outflows were from common stock repurchased of \$74.1 million, client fund obligations of \$65.5 million, principal payments on debt of \$15.1 million (primarily equipment credit facilities), and payment of dividends of \$13.3 million, partially offset by net borrowings under the revolving credit facilities of \$40.5 million and proceeds from issuance of common stock of \$12.2 million. During the three months ended March 31, 2012, cash inflows were from proceeds received from the issuance of common stock of \$38.5 million and an increase in client funds obligations of \$36.6 million, which was partially offset by share repurchase activities of \$26.3 million, net repayments under the revolving credit facilities of \$17.9 million and the purchase of the remaining non-controlling interest in Output U.K. for \$17.7 million.

## Common Stock Issuances and Repurchases

The Company received proceeds of \$12.2 million and \$38.5 million from the issuance of common stock from the exercise of employee stock options during the three months ended March 31, 2013 and 2012, respectively. The Company repurchased 0.8 million shares of DST common stock for \$52.5 million during the three months ended March 31, 2013, however no shares were repurchased during the three months ended March 31, 2012 under the Company's share repurchase plan. At March 31, 2013, the Company has approximately \$200.0 million remaining for repurchase under its existing 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 \$21.6 million and \$26.3 million during the three months ended March 31, 2013 and 2012, respectively.



Table of Contents

## Dividends

DST paid a quarterly cash dividend of \$13.3 million or \$0.30 per share during the three months ended March 31, 2013. A semi-annual dividend payment of \$17.9 million or \$0.40 per share was declared during the three months ended March 31, 2012, but was paid in the subsequent quarter.

## Off Balance Sheet Obligations

As of March 31, 2013, 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 \$1,038.4 million and \$1,011.6 million of debt outstanding at March 31, 2013 and December 31, 2012, respectively, an increase of \$26.8 million during the three months ended March 31, 2013.

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

	March 31, 2013	December 31, 2012
Accounts receivable securitization program	\$ 135.0	\$ 135.0
Secured promissory notes	13.1	14.5
Equipment credit facilities		12.0
Real estate credit agreement	100.8	101.7
Term loan credit facility	125.0	125.0
Series C convertible senior debentures	91.9	90.1
Revolving credit facilities	78.6	31.1
Senior notes	370.0	370.0
Related party credit agreements	107.4	114.9
Other indebtedness	16.6	17.3
	1,038.4	1,011.6
Less current portion of debt	564.5	519.4
Long-term debt	\$473.9	\$492.2

## 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 March 31, 2013 and December 31, 2012, the outstanding amount under the program was \$135.0 million. During the three months ended March 31, 2013 and 2012, total proceeds from the accounts receivable securitization program were approximately \$226.5 million and \$222.9 million and total repayments were approximately \$226.5 million and \$222.9 million, respectively.

Series C convertible senior debentures

Holders of the Company's Series C convertible senior debentures were eligible to convert these bonds as of April 1, 2013 as a result of DST's common stock trading above 120% of the applicable conversion price for at least 20 trading days during the period of 30 consecutive trading days ended March 31, 2013. The senior debentures will continue to be convertible through June 30, 2013 and, as a result, they have been classified as a current liability as of March 31, 2013. Conversion rights, and ultimate classification as a current or non-current liability, for subsequent quarters will be a function of future DST stock prices.

## Table of Contents

Additionally, holders of unconverted bonds are eligible to receive contingent interest during the period from February 14, 2013 through August 15, 2013, as the average trading price of the Series C debentures for the applicable five trading-day reference period exceeded 120% of the accreted principal amount of the Series C debentures.

The Company has received notification of conversions during the period from April 1, 2013 through April 30, 2013, resulting in an estimated cash settlement of approximately \$39.5 million during the second quarter of 2013, of which \$29.7 million is the accreted principal and accrued interest of the bonds. Cash will be used to settle the accreted principal, accrued and unpaid interest and conversion value over the principal and accrued and unpaid interest amounts of these conversions.

### 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 \$681.9 million at March 31, 2013) and other assets, and that its longer term liquidity and 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 March 31, 2013, the Company had approximately \$649.2 million of availability under its domestic revolving credit facilities.

The following credit facilities with outstanding amounts as of March 31, 2013 are scheduled to mature in 2013: revolving line of credit with BFDS, in the amount of \$100.0 million will mature on July 1, 2013; syndicated real estate credit agreement in the amount of \$100.8 million will mature on September 16, 2013 and the term loan credit facility in the amount of \$125.0 million will mature on October 28, 2013. In addition, beginning August 15, 2013, the Company may redeem for cash all or part of the Series C senior convertible debentures, in the amount of \$91.9 million as of March 31, 2013. The Company is continuing to evaluate its option to redeem any debentures that are not yet been converted by August 15, 2013. The Company intends to utilize funds from operations, investing activities and the existing syndicated line of credit to repay the related party revolving credit facility with BFDS, the syndicated real estate credit agreement and the term loan credit facility at maturity. The Company plans to renew the \$150.0 million accounts receivable securities program in May 2013.

### Guarantees

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 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 March 31, 2013 and December 31, 2012, total borrowings on the loan were \$28.9 million and \$29.1 million, respectively, and the Company's guarantee totaled \$1.5 million at both March 31, 2013 and December 31, 2012.

The Company entered into an agreement, which became effective on January 28, 2013, for a performance guarantee up to \$5.0 million on a 20 year franchise agreement entered into by a 50% owned real estate joint venture. At March 31, 2013, the Company's liability recorded associated with the guarantee was \$0.8 million.

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

In addition to the guarantees entered into as mentioned above, 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

Table of Contents

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. Included below are examples of such indemnity obligations.

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.

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

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

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

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

In connection with the acquisition or disposition of real estate by the Company, the Company has entered into real estate contracts containing indemnification provisions, the terms of which vary depending on the negotiated terms of each respective contract, but which are generally described as follows: (i) in connection with acquisitions by the Company, the Company has agreed to indemnify the seller against third party claims made against the seller arising from the Company's on-site inspections, tests and investigations of the subject property made by the Company as part of its due diligence and against third party claims relating to the operations on the subject property after the

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

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

## Table of Contents

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.

Except for the \$0.8 million guarantee described above that has been accrued, at March 31, 2013 and December 31, 2012, 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.

### 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 March 31, 2013 was approximately \$681.9 million. The impact of a 10% change in fair value of these investments would be approximately \$42.3 million to comprehensive income. As discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations—Comprehensive Income" above, net unrealized gains and losses on the Company's investments in available-for-sale securities have had a material effect on the Company's comprehensive income (loss) and financial position.

#### Interest rate risk

The Company and certain of its joint ventures derive a certain amount of their service revenues from investment earnings related to cash balances maintained in bank accounts on which the Company is the agent for clients. The balances maintained in the bank accounts are subject to fluctuation. For the three months ended March 31, 2013, the Company and BFDS had average daily cash balances of approximately \$2.0 billion maintained in such accounts, of which approximately \$1.4 billion were maintained at BFDS. The Company estimates that a 50 basis point change in interest earnings rate would equal approximately \$3.3 million of net income (loss).

At March 31, 2013, the Company had \$1,038.4 million of debt, of which \$438.6 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 March 31, 2013, the Company's international subsidiaries had approximately \$215.2 million in total assets and for the three months ended March 31, 2013, these international subsidiaries recorded net income of approximately \$5.5 million. The Company estimates that a 10% change in exchange rates could change total consolidated assets by approximately \$21.5 million. Furthermore, a 10% change in exchange rates based upon historical earnings in international operations could change consolidated reported net income by approximately \$0.6 million for the three months ended March 31, 2013.

The Company has approximately \$100.0 million of intercompany loans as of March 31, 2013 with certain of its international subsidiaries that are expected to be repaid. Currency exchange rate fluctuations on the intercompany loans have not historically materially affected the consolidated financial results of the Company. The Company estimates a 10% change in exchange rates could change consolidated reported net income by approximately \$6.6 million for the three months ended March 31, 2013.



Table of Contents

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 March 31, 2013.

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 March 31, 2013, 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.

Table of Contents

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, 2012. The risk factors have not changed materially from the date of our periodic report on Form 10-K for the year ended December 31, 2012.

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, video and utilities, other financial service (i.e. insurance, banking, financial planning and mortgage) and other industries. A decline or lack of growth in demand for our products and services in any of the industries we serve could adversely affect our business and earnings. Demand for our products and services among companies in those industries could decline for many reasons. Consolidation or limited growth in an industry could reduce the number of our clients and potential clients.

Events that adversely affect our clients’ businesses, rates of growth or numbers of customers they serve, including decreased demand for our customers’ products and services, adverse conditions in our customers’ markets or adverse economic conditions generally could decrease demand for our products and services and the number of transactions we process. We 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.

Table of Contents

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 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.

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.

Table of Contents

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 our unconsolidated affiliates 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.

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.

Table of Contents

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, many of which contain terms and conditions based on anticipated levels of utilization of our services. We cannot unilaterally extend the terms of our client 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 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.

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.

Table of Contents

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

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

Some of our joint venture investments are subject to buy-sell agreements, which may, among other things, restrict us from selling our interests even if we were to 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. Our interests in such unconsolidated entities are subject to buy/sell arrangements, which may restrict our ability to sell our interests even if we were to determine 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 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
- the Board's authority to issue and set the terms of preferred stock

Table of Contents

• 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"). 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 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

Table of Contents

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.

## 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 March 31, 2013.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Total \$ Amount of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Amount That May Yet Be Purchased Under the Plans or Programs
January 1 — January 31	42,501	(1) \$ 60.31	41,800	\$ 2,519,110	\$ 250,000,000 (2)
February 1 — February 28	274	(1) 62.86			250,000,000 (2)
March 1 — March 31	1,025,614	(1) 69.73	716,483	50,014,300	199,985,700 (2)
Total	1,068,389	\$ 69.35	758,283	\$ 52,533,410	\$ 199,985,700 (2)

(1) For the three months ended March 31, 2013, the Company purchased, in accordance with the 2005 Equity Incentive Plan (formerly the 1995 Stock Option and Performance Award Plan), 310,106 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, 701 shares were purchased in January 2013, 274 shares were purchased in February 2013 and 309,131 shares were purchased in March 2013.

(2) On January 30, 2013, the DST Board of Directors authorized a \$250 million share repurchase plan, which replaced the Company's existing plan, under which DST had 715,700 shares available as of that date. The plan, as amended, allows, but does not require, the repurchase of common stock in open market and private transactions. 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.

Table of Contents

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.

50

---



Table of Contents

Item 6. Exhibits

(a) Exhibits:

10.1 Agreement dated January 22, 2013, by and among the Company and the Argyros Group, which is attached as Exhibit 99.2 to the Company's Current Report on Form 8-K filed January 23, 2013 (Commission File No. 1-14036) is hereby incorporated by reference as Exhibit 10.1.

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 March 31, 2013, filed with the SEC on May 7, 2013, formatted in Extensible Business Reporting Language ("XBRL"): (i) the Condensed Consolidated Balance Sheet at March 31, 2013 and December 31, 2012, (ii) the Condensed Consolidated Statement of Income for the three months ended March 31, 2013 and 2012, (iii) the Condensed Consolidated Statement of Comprehensive Income for the three months ended March 31, 2013 and 2012, (iv) the Condensed Consolidated Statement of Cash Flows for the three months ended March 31, 2013 and 2012, 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.

May 7, 2013

DST Systems, Inc.

/s/ Kenneth V. Hager

Kenneth V. Hager

Vice President, Chief Financial Officer and Treasurer  
(Principal Financial Officer)