

**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 September 30, 2004

or

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

For the transition period from _____ to _____

Commission File Number 1-14036

DST SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

43-1581814

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

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

64105
(Zip Code)

(816) 435-1000

(Registrant's telephone number, including area code)

No Changes

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

Indicate by check mark whether the Company (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 Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Number of shares outstanding of the Company's common stock as of October 29, 2004:
Common Stock \$0.01 par value – 83,766,084

DST Systems, Inc.
Form 10-Q
September 30, 2004
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The brand, service or product names or marks referred to in this Report are trademarks or services marks, registered or otherwise, of DST Systems, Inc. or its subsidiaries and affiliates or of vendors to the Company.

DST Systems, Inc.
Form 10-Q
September 30, 2004

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 for the year ended December 31, 2003.

The results of operations for the three and nine months ended September 30, 2004, are not necessarily indicative of the results to be expected for the full year 2004.

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

	<u>September 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 103.9	\$ 102.4
Transfer agency investments	127.1	63.4
Accounts receivable	415.2	399.4
Other current assets	103.1	116.6
	<u>749.3</u>	<u>681.8</u>
Investments	1,372.8	1,432.5
Transfer agency investments	149.7	
Properties	662.1	647.2
Goodwill	287.5	261.8
Intangibles	117.4	123.2
Other assets	55.2	52.1
	<u>55.2</u>	<u>52.1</u>
Total assets	<u>\$ 3,394.0</u>	<u>\$ 3,198.6</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Debt due within one year	\$ 9.4	\$ 26.9
Transfer agency deposits	276.4	63.4
Accounts payable	127.0	126.3
Accrued compensation and benefits	108.5	98.1
Deferred revenues and gains	73.2	95.0
Other liabilities	155.3	162.5
	<u>749.8</u>	<u>572.2</u>
Long-term debt	1,408.6	1,437.8
Deferred income taxes	392.2	408.5
Other liabilities	91.2	96.4
	<u>91.2</u>	<u>96.4</u>
	<u>2,641.8</u>	<u>2,514.9</u>
Commitments and contingencies (Note 6)		
Stockholders' equity		
Common stock, \$0.01 par; 300 million shares authorized, 95.3 million shares issued	1.0	1.0
Additional paid-in capital	202.7	208.8
Retained earnings	670.5	514.6
Treasury stock (11.6 million and 11.5 million shares, respectively), at cost	(458.9)	(438.4)
Accumulated other comprehensive income	336.9	397.7
	<u>752.2</u>	<u>683.7</u>
Total stockholders' equity	<u>752.2</u>	<u>683.7</u>
Total liabilities and stockholders' equity	<u>\$ 3,394.0</u>	<u>\$ 3,198.6</u>

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

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
Operating revenues	\$ 426.9	\$ 413.8	\$ 1,282.4	\$ 1,276.5
Out-of-pocket reimbursements	172.6	155.9	519.9	530.0
Total revenues	599.5	569.7	1,802.3	1,806.5
Costs and expenses	478.7	457.8	1,445.0	1,471.7
Depreciation and amortization	41.2	37.0	116.3	108.7
Income from operations	79.6	74.9	241.0	226.1
Interest expense	(14.1)	(7.8)	(40.8)	(14.3)
Other income, net	5.7	8.5	20.6	18.6
Equity in earnings of unconsolidated affiliates	5.8	4.4	16.5	7.8
Income before income taxes	77.0	80.0	237.3	238.2
Income taxes	24.5	27.1	81.4	80.9
Net income	\$ 52.5	\$ 52.9	\$ 155.9	\$ 157.3
Average common shares outstanding	83.9	115.7	84.1	117.9
Diluted shares outstanding	86.1	117.3	86.4	119.2
Basic earnings per share	\$ 0.63	\$ 0.46	\$ 1.85	\$ 1.33
Diluted earnings per share	\$ 0.61	\$ 0.45	\$ 1.80	\$ 1.32

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

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

	For the Nine Months Ended September 30,	
	2004	2003
Cash flows -- operating activities:		
Net income	\$ 155.9	\$ 157.3
Depreciation and amortization	116.3	108.7
Equity in earnings of unconsolidated affiliates	(16.5)	(7.8)
Net realized gain on investments	(9.3)	(5.5)
Deferred taxes	24.3	2.9
Changes in accounts receivable	(3.9)	42.2
Changes in other current assets	2.2	(3.3)
Changes in transfer agency investments	(213.2)	14.4
Changes in transfer agency deposits	213.2	(14.4)
Changes in accounts payable and accrued liabilities	3.0	(2.2)
Changes in deferred revenues and gains	(26.4)	5.2
Changes in accrued compensation and benefits	16.6	4.6
Other, net	1.6	(7.1)
Total adjustments to net income	107.9	137.7
Net	263.8	295.0
Cash flows -- investing activities:		
Proceeds from sale of investments	31.9	54.6
Investments and advances to unconsolidated affiliates	(21.1)	(6.4)
Investments in securities	(30.4)	(14.9)
Capital expenditures	(136.7)	(225.4)
Contingent payment for purchase of EquiServe	(25.6)	
Other, net	8.9	(1.3)
Net	(173.0)	(193.4)
Cash flows -- financing activities:		
Proceeds from issuance of common stock	31.8	4.4
Principal payments on long-term debt	(62.7)	(55.6)
Net proceeds from convertible debentures		819.0
Net increase (decrease) in revolving credit facilities and notes payable	15.9	(223.4)
Common stock repurchased	(74.3)	(142.6)
Net	(89.3)	401.8
Net increase in cash and cash equivalents	1.5	503.4
Cash and cash equivalents at beginning of period	102.4	92.3
Cash and cash equivalents at end of period	\$ 103.9	\$ 595.7

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

DST Systems, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Summary of Accounting Policies

The Condensed Consolidated Financial Statements of DST Systems, Inc. (“DST” or the “Company”) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America 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 for the year ended December 31, 2003.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal interim closing procedures) necessary to present fairly the financial position of the Company and its subsidiaries at September 30, 2004, and the results of operations for the three and nine months ended September 30, 2004 and 2003, and cash flows for the nine months ended September 30, 2004 and 2003.

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

The results of operations for the three and nine months ended September 30, 2004, are not necessarily indicative of the results to be expected for the full year 2004.

2. Agreement to Sell EquiServe

The Company announced on October 20, 2004 that it has signed a definitive agreement for Computershare Ltd. (“CPU”) to acquire, in a taxable transaction, DST’s wholly owned subsidiary, EquiServe, Inc. (“EquiServe”).

Upon closing, DST will receive U.S. \$216 million of cash plus 29.6 million shares of CPU common stock. The CPU common stock to be received represents slightly less than 5% of CPU’s total issued capital, post-transaction, and had an approximate value of U.S. \$91 million on October 19, 2004.

Under terms of the agreement, DST will continue to provide EquiServe various services, including data processing support, AWD products and services, Output Solutions services and E-Proxy services. The transaction, which has been approved by the board of directors of both companies, is expected to close in the first quarter of 2005, subject to regulatory approvals.

The following table reflects EquiServe revenues (in millions) recorded by DST:

	For the Nine Months Ended September 30,	For the Year Ended December 31,	
	2004	2003	2002
Operating Revenues	\$ 174.9	\$ 229.3	\$ 264.3
OOP Reimbursements	55.3	70.7	89.5
Total Revenues	\$ 230.2	\$ 300.0	\$ 353.8

3. Investments

Investments are as follows (in millions):

	2004 Ownership Percentage	Carrying Value	
		September 30, 2004	December 31, 2003
Available-for-sale securities:			
State Street Corporation	4%	\$ 546.3	\$ 666.2
Computer Sciences Corporation	5%	406.6	381.8
Euronet Worldwide, Inc.	6%	35.3	34.0
Transfer agency investments		149.7	
Other available-for-sale securities		105.4	97.6
		<u>1,243.3</u>	<u>1,179.6</u>
Unconsolidated affiliates:			
Boston Financial Data Services, Inc.	50%	90.4	79.1
International Financial Data Services, U.K.	50%	15.9	9.2
International Financial Data Services, Canada	50%	19.2	16.9
Unconsolidated Real Estate Affiliates		81.1	77.7
Other unconsolidated affiliates		39.2	36.5
		<u>245.8</u>	<u>219.4</u>
Other:			
Trading securities		24.7	23.1
Held-to-maturity		8.7	10.4
		<u>33.4</u>	<u>33.5</u>
Total investments		<u>\$ 1,522.5</u>	<u>\$ 1,432.5</u>

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

	September 30, 2004	December 31, 2003
Cost	\$ 712.5	\$ 551.8
Gross unrealized gains	532.0	628.4
Gross unrealized losses	(1.2)	(0.6)
Market value	<u>\$ 1,243.3</u>	<u>\$ 1,179.6</u>

The Company has a cash management service for full service mutual fund transfer agency clients, whereby end of day available client bank balances are invested overnight by and in the name of the Company into credit-quality money market funds. All invested balances are returned to the full service mutual fund transfer agency client accounts the following business day. In the first quarter of 2004, the Company initiated a similar cash management service for a portion of its corporate securities processing transfer agency accounts. The Company had \$276.8 million and \$63.4 million of transfer agency investments and deposits at September 30, 2004 and December 31, 2003, respectively. The Company will continue to evaluate implementation of this service for the remainder of its corporate securities processing transfer agency accounts, and estimates that the amount of transfer agency investments and deposits may increase by approximately \$400 million upon full implementation. Related to this service, the Company may

periodically purchase bonds issued by the US government or US government agencies with maturities of 1-5 years. Depending on differences between the current market interest rates and the coupon rates on the bonds, the bonds may be purchased at a discount or premium to the bond's face value.

Certain information related to the Company's transfer agency investments is as follows (in millions):

	<u>September 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
Current transfer agency investments	\$ 127.1	\$ 63.4
Available-for-sale securities:		
Cost	149.5	
Gross unrealized gains	0.2	
Non-current transfer agency investments	149.7	
Market value	<u>\$ 276.8</u>	<u>\$ 63.4</u>

The Company recognized \$0.3 million and \$1.6 million of investment impairments for the three and nine months ended September 30, 2004, respectively, and \$0.3 million and \$6.1 million for the three and nine months ended September 30, 2003, respectively. A decline in a security's net realizable value that is other than temporary is treated as a loss based on quoted market value and is reflected in the Other income, net line in the statement of income.

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 September 30, 2004 (in millions):

	<u>Less than 12 months</u>		<u>Greater than 12 months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized losses</u>	<u>Fair Value</u>	<u>Unrealized losses</u>	<u>Fair Value</u>	<u>Unrealized losses</u>
Common Stock	\$ 19.6	\$ 1.2	\$	\$	\$ 19.6	\$ 1.2

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

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

	For the Three Months		For the Nine Months	
	Ended September 30,		Ended September 30,	
	2004	2003	2004	2003
Boston Financial Data Services, Inc.	\$ 3.3	\$ 2.9	\$ 11.4	\$ 7.1
International Financial Data Services, U.K.	1.4	0.3	3.7	(1.9)
International Financial Data Services, Canada	1.0	0.9	2.2	1.2
Other	0.1	0.3	(0.8)	1.4
	<u>\$ 5.8</u>	<u>\$ 4.4</u>	<u>\$ 16.5</u>	<u>\$ 7.8</u>

4. Goodwill, Intangibles and Other Assets

The following table summarizes intangible assets (in millions):

	September 30, 2004		December 31, 2003	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer relationships	\$ 136.0	\$ 18.7	\$ 136.0	\$ 13.0
Other	0.2	0.1	0.3	0.1
Total	<u>\$ 136.2</u>	<u>\$ 18.8</u>	<u>\$ 136.3</u>	<u>\$ 13.1</u>

Amortization of intangible assets for the three and nine months ended September 30, 2004, was \$2.1 million and \$6.3 million, respectively. Amortization of intangible assets for the three and nine months ended September 30, 2003, was \$1.9 million and \$5.7 million, respectively. Annual amortization amounts for intangible assets recorded as of September 2004 are estimated at \$6.9 million for each of the years 2004, 2005, 2006, 2007 and \$6.8 million for 2008. Substantially all of the intangibles are tax-deductible.

The following table summarizes the changes in the carrying amount of goodwill for the nine months ended September 30, 2004, by Segment (in millions):

	December 31,	Acquisitions	Other	September 30,
	2003			2004
Financial Services	\$ 247.3	\$ 25.6	\$ 0.1	\$ 273.0
Output Solutions	9.1			9.1
Customer Management	5.4			5.4
Total	<u>\$ 261.8</u>	<u>\$ 25.6</u>	<u>\$ 0.1</u>	<u>\$ 287.5</u>

The August 2, 2002 acquisition of lock\line was accounted for as a purchase. The minimum purchase price of \$190 million was paid in cash at closing. There are provisions in the acquisition agreement that allow for additional consideration to be paid in cash if lock\line's revenues, as defined in the acquisition agreement, exceed certain targeted levels for 2003 and 2004. lock\line revenues for 2003 did not exceed targeted levels necessary to result in additional consideration. lock\line revenues for 2004 are currently estimated to exceed the targeted levels, which

would require the Company to pay additional consideration. Goodwill will be increased by the amount of additional consideration paid.

On March 30, 2001, the Company completed the acquisition of a 75% interest in EquiServe by purchasing interests held by FleetBoston Financial (“FleetBoston”) and Bank One Corporation (“Bank One”). On July 31, 2001, the Company completed the acquisition of the remaining 25%, which was owned by Boston Financial Data Services (“BFDS”), on essentially the same terms provided to FleetBoston and Bank One.

The EquiServe acquisitions were accounted for as a purchase and the results of EquiServe’s operations are included in the Company’s consolidated financial statements beginning March 30, 2001. The minimum purchase price of \$186.7 million was paid in four installments. The minimum purchase price (discounted to \$177.7 million for accounting purposes) has been allocated to the net assets acquired based upon their fair values as determined by a valuation. Three installment payments totaling \$165.1 million were made through December 31, 2003. The final purchase price installment increased pursuant to a formula that provided for additional consideration to be paid in cash if EquiServe’s revenues, as defined in the agreements, for the years ending 2000, 2001, 2002 and 2003 exceeded certain targeted levels. The final payment of \$45.8 million was paid in March 2004, including \$20.2 million for the final installment and \$25.6 million of additional consideration which was recorded as goodwill.

5. Stockholders’ Equity

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

	For the Three Months		For the Nine Months	
	Ended September 30,		Ended September 30,	
	2004	2003	2004	2003
Net income	\$ 52.5	\$ 52.9	\$ 155.9	\$ 157.3
Average common shares outstanding	83.9	115.7	84.1	117.9
Incremental shares from assumed conversions of stock options and forward purchase agreements	2.2	1.6	2.3	1.3
Diluted potential common shares	86.1	117.3	86.4	119.2
Basic earnings per share	\$ 0.63	\$ 0.46	\$ 1.85	\$ 1.33
Diluted earnings per share	\$ 0.61	\$ 0.45	\$ 1.80	\$ 1.32

Shares underlying options to purchase shares of common stock that were excluded from the diluted earnings per share calculation because they were anti-dilutive totaled 4.2 million and 6.7 million for the three months ended September 30, 2004 and 2003, respectively, and 4.2 million and 7.3 million for the nine months ended September 30, 2004 and 2003, respectively. In August 2003, the Company issued convertible senior debentures that, if converted in the future, would have a potentially dilutive effect on the Company’s stock. The Series A debentures are convertible into 11.0 million shares of common stock and the Series B debentures are convertible into 6.1 million shares of common stock, subject to adjustment. Since a cash settlement is assumed for the principal and accrued and unpaid interest and an issuance of common stock for any conversion value amount over the principal and accrued and unpaid interest amounts, the impact has been excluded from earnings per share.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income	\$ 52.5	\$ 52.9	\$ 155.9	\$ 157.3
Other comprehensive income (loss):				
Unrealized gains (losses) on investments:				
Unrealized holding gains (losses) arising during the period	(90.4)	69.7	(98.7)	122.8
Less reclassification adjustments for net gains (losses) included in net income	(0.5)	(3.5)	(8.1)	(2.4)
Foreign currency translation adjustments	(0.1)	4.7	4.5	7.3
Deferred income taxes	35.2	(25.8)	41.3	(47.0)
Other comprehensive income (loss)	(55.8)	45.1	(61.0)	80.7
Comprehensive income	\$ (3.3)	\$ 98.0	\$ 94.9	\$ 238.0

Stock repurchases. On October 19, 2004, DST’s Board of Directors authorized an additional 5.5 million share repurchase to the 6.0 million share repurchase plan authorized on February 26, 2004. The plan allows, but does not require, the repurchase of common stock in open market and private transactions through February 28, 2007. In the third quarter of 2004, 0.6 million shares were purchased for an average price of \$45.45 per share. At September 30, 2004, the Company had purchased 1.5 million shares at an average price of \$45.85 per share since the program commenced. As of October 19, 2004 the Company had approximately 10.0 million shares remaining to be purchased under this program.

Stock-based compensation. The Company has stock-based compensation plans. The Company accounts for stock-based compensation in accordance with Accounting Principles Board Opinion (“APBO”) No. 25, “Accounting for Stock Issued to Employees,” and related interpretations and has presented the required Statement of Financial Accounting Standards (“SFAS”) No. 123 “Accounting for Stock-Based Compensation,” as amended by SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure,” pro forma disclosure in the table below.

The Company applies APBO No. 25 and related interpretations in accounting for its plans, and accordingly, no compensation cost has been recognized for the Company’s fixed stock-based compensation. Had compensation cost been determined consistent with SFAS No. 123, as amended by SFAS No. 148, the Company's net income would have been reduced to the following pro forma amounts:

		For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
		2004	2003	2004	2003
Net income (millions):	As reported	\$ 52.5	\$ 52.9	\$ 155.9	\$ 157.3
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		<u>(4.0)</u>	<u>(7.3)</u>	<u>(14.0)</u>	<u>(24.8)</u>
Net Income	Pro forma	<u>\$ 48.5</u>	<u>\$ 45.6</u>	<u>\$ 141.9</u>	<u>\$ 132.5</u>
Basic earnings per share:	As reported	\$ 0.63	\$ 0.46	\$ 1.85	\$ 1.33
	Pro forma	\$ 0.58	\$ 0.39	\$ 1.69	\$ 1.12
Diluted earnings per share:	As reported	\$ 0.61	\$ 0.45	\$ 1.80	\$ 1.32
	Pro forma	\$ 0.57	\$ 0.39	\$ 1.67	\$ 1.11

The Company uses the Black-Scholes option pricing model which requires the Company to make certain assumptions in order to estimate fair value.

On October 29, 2004 the Compensation Committee of the Board of Directors of the Company voted to grant as of November 10, 2004, approximately 2.8 million shares of restricted common stock of the Company to officers and certain other participants in the Stock Option and Performance Award Plan. For ten senior executive officers, the restricted shares are subject to the earnings per share goal that must be met as an additional condition to the lapse of restrictions on January 31, 2010. Subject to early lapsing and forfeiture provisions, the restrictions on the shares granted to all other officers and participants lapse on November 10, 2009. The restricted stock grants cover the five-year period of 2005 through 2009 and are intended to be the only restricted stock grants for such periods other than for new hires or promotions, for special employee recognition purposes, and, in accordance with past practice, for the portion of each annual incentive bonus the executive officers are required to take in the form of equity compensation. The Compensation Committee made the grant after evaluating the Company's equity compensation practices, particularly in light of pending changes in the accounting rules applicable to stock options.

The Company estimates that the impact on amortized compensation expense attributable to the grant for each year covered by the grant based upon the average of the high and low trading prices for the Company's shares on October 28, 2004 will be approximately \$4.3 million in 2004, \$25.5 million for the years 2005 through 2008 and \$21.3 million in 2009. These estimates assume that all shares will be vested and all performance criteria will be met.

6. Commitments and Contingencies

The Company is a 50% partner in a limited purpose real estate joint venture. The real estate joint venture will develop approximately 1.1 million square feet of office space that will be leased to an unrelated third party. The project is estimated to cost approximately \$362 million and has been financed with \$315 million of non-recourse insured bonds (issued June 2004) with the remainder in the form of equal equity contributions from the real estate joint venture partners (totaling approximately \$22 million at September 30, 2004). The real estate joint venture partners have committed aggregate additional equity investments of approximately \$25 million to complete the financing and up to \$33 million of equity investments in the aggregate in the event of delays in construction or lease commencement. The remaining equity contributions of \$25 million to \$58 million have been secured through \$58 million of letters of credit that will expire beginning in 2007 through 2008. The Company is responsible for \$29 million of the letters of credit. At September 30, 2004, there were no outstanding borrowings against the letters of credit.

The Company has entered into an agreement to guarantee 50% of a \$0.9 million construction loan of a 50% owned joint venture. The construction loan expires in June 2005.

The Company has entered into an agreement to guarantee 49% of a \$2.2 million mortgage loan of a 50% owned real estate joint venture. The mortgage loan expires in February 2005.

The Company has entered into an agreement to guarantee on a joint and several basis, up to \$10.0 million of a \$60.0 million construction loan for a 50% owned real estate joint venture. The \$60 million loan expires on December 31, 2005. At September 30, 2004, total borrowings on the loan were \$18.2 million.

The Company and State Street Corporation (“State Street”) have each guaranteed 50% of a lease obligation of International Financial Data Services, U.K. Limited (“IFDS U.K.”), which requires IFDS U.K. to make annual rent payments of approximately \$3.7 million through 2017, for its use of a commercial office building. The commercial office building is owned by a wholly owned affiliate of International Financial Data Services, (Canada) Limited (“IFDS Canada”) and was financed with a \$19.5 million mortgage from a bank. The loan has a floating interest rate based upon LIBOR and fully amortizes over the 15 year term. To fix the rate of borrowing costs, the IFDS Canada affiliate entered into a 15 year interest rate hedge agreement with the same bank. The interest rate hedge, which has an initial notional amount value of approximately \$19.5 million and scheduled reductions that coincide with the scheduled principal payments for the mortgage loan, was entered into for the purpose of fixing the borrowing costs of the mortgage at approximately 6.3%. The Company and State Street have each guaranteed 50% of the amounts of the interest rate hedge obligations. Under this guarantee, the Company would pay 50% of the total amount to close out of the hedge, which is approximately \$0.1 million.

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

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

FIN 45

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

In certain instances in which the Company licenses proprietary systems to customers, the Company gives certain indemnities (including infringement indemnities) and warranties to the licensee, the terms of which vary depending on the negotiated terms of each respective license agreement. Such warranties 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 obligations may be subject to time and materiality limitations, monetary caps and other conditions and defenses.

From time to time, the Company enters into service agreements and other agreements with unaffiliated parties containing indemnification provisions, the terms of which vary depending on the negotiated terms of each respective agreement. The amount of such obligations is not stated in the agreements. The Company’s liability under such

indemnification provisions may be subject to time and materiality limitations, monetary caps and other conditions and defenses. Such indemnity obligations include those described herein.

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 subject to certain limitations, due to the buyer's reliance on representations and warranties relating to the subject subsidiary, operating unit or business assets in the disposition agreement if such representations or warranties were untrue when made, or due to any breach of the representations, warranties, agreements or covenants contained in the agreement.

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

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

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

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

At September 30, 2004, the Company had not accrued any liability on the aforementioned guarantees or indemnifications as they relate to future performance criteria or indirect indebtedness of others in accordance with FIN 45.

FIN 46

Interpretation No. 46 (“FIN 46”), “Consolidation of Variable Interest Entities, an interpretation of ARB No. 51” requires the consolidation of certain types of entities in which the Company absorbs a majority of another entity’s expected losses, receives a majority of the other entity’s expected residual returns, or both, as a result of ownership, contractual or other financial interests in the other entity. These entities are called “variable interest entities.” The principal characteristics of variable interest entities are (1) an insufficient amount of equity to absorb the entity’s expected losses, (2) equity owners as a group are not able to make decisions about the entity’s activities, or (3) equity that does not absorb the entity’s losses or receive the entity’s residual returns. “Variable interests” are contractual, ownership or other monetary interests in an entity that change with fluctuations in the entity’s net asset value. As a result, variable interest entities can arise from items such as joint ventures, lease agreements, loan arrangements, guarantees or service contracts.

If an entity is determined to be a “variable interest entity,” the “primary beneficiary” must consolidate the entity. The primary beneficiary is the holder of the variable interests that absorb a majority of the variable interest entity’s expected losses or receive a majority of the entity’s residual returns in the event no holder has a majority of the expected losses. There is no primary beneficiary in cases where no single holder absorbs the majority of the expected losses or receives a majority of the residual returns. The determination of the primary beneficiary is based on projected cash flows at the inception of the variable interests.

With regard to real estate, the Company is the lessee in a series of operating leases covering a large portion of its Kansas City based leased office facilities. The lessors are generally joint ventures (in which the Company has a 50% ownership) that have been established specifically to purchase, finance and engage in leasing activities with the joint venture partners and unrelated third parties. Two of the real estate joint ventures have entered into financing arrangements with the Company’s wholly owned captive insurance company. In each case, the other joint venture partner has guaranteed at least 50% of the joint venture’s borrowings (\$38.5 million at September 30, 2004) from the Company’s captive insurance company. The Company is generally not the primary beneficiary of the joint ventures if the lease terms are consistent with market terms at the inception of the lease and do not include a residual value guarantee, fixed-price purchase options or similar features that disproportionately obligate it to absorb decreases in value or entitle it to participate in increases in the value of the real estate. The Company has finalized analyses of its real estate joint ventures and determined that a large portion of the real estate joint ventures are variable interest entities, however the real estate joint ventures do not need to be consolidated because the Company is not the primary beneficiary. The Company entered into two real estate joint ventures during the first quarter of 2004. The Company has determined that these ventures are not variable interest entities. The Company did not enter into any new real estate joint ventures during the second and third quarters of 2004.

With regard to operating joint ventures, the Company has formed or entered into operating joint ventures to enter into or expand its presence in target markets. The Company has three significant operating joint ventures; BFDS; IFDS (includes IFDS U.K., IFDS Canada and International Financial Data Services, Luxembourg); and Argus Health Systems. Each of these operating joint ventures was formed prior to February 1, 2003. The Company has finalized its FIN 46 analyses of these operating joint ventures, and its assessment is that none qualify as variable interest entities due to meeting the criteria for the operating joint venture exception in FIN 46.

7. Recently Issued Accounting Standards

In August 2003, the Company issued \$840 million aggregate principal amount of convertible senior debentures, consisting of \$540 million of 4.125% Series A convertible senior debentures due 2023 and \$300 million aggregate principal amount of 3.625% Series B convertible senior debentures due 2023. The debentures are convertible under specified circumstances into shares of the Company’s common stock at a conversion rate of 20.3732 shares per \$1,000 principal amount of debentures (which is equal to an initial conversion price of \$49.08 per share), subject to adjustment.

The debentures are contingently convertible into shares of the Company's common stock during any calendar quarter (and only during such calendar quarter) if the closing price of the Company's common stock, for at least 20 trading days during a period of 30 consecutive trading days ending on the last trading day of the previous calendar quarter, is greater than or equal to 120% of the applicable conversion price (\$58.90 per share).

Upon conversion, the Company will have the right to deliver, in lieu of shares of its common stock, cash or a combination of cash and shares of common stock. If all \$840 million of convertible senior debentures were converted into common stock, the Company would need to issue approximately 17.1 million shares of common stock, subject to adjustment. The Company intends to settle the conversions with cash for the principal and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amounts.

Under current generally accepted accounting principles, the Company's calculation of diluted earnings per share would not include any incremental shares from assumed conversions of the convertible debentures until such time that the Company's common stock exceeded the contingent conversion price of \$58.90 per share for the time periods specified above. At that point, the Company would include incremental shares assumed to be issued for the conversion value of the bonds (value over \$49.08 per share) in the calculation of diluted earnings per share. This is commonly referred to as the "net share settlement method" of accounting for the conversion spread.

There are two proposed accounting standards that can impact the way the Company calculates diluted earnings per share regarding incremental shares to be issued from the assumed conversion of the convertible debentures. The first proposed standard is EITF Topic 04-08, "Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share." Under EITF 04-08, a company would need to include the effects of contingently convertible bonds in diluted earnings per share from the date of issuance, without considering the impact of the conversion price. Under EITF 04-08, the Company can still utilize the "net share settlement method" of calculating shares for the conversion premium if it intends to settle the principal amount of the bonds in cash and any excess value with shares of its common stock. The impact of EITF 04-08 to DST is that the calculation of diluted earnings per share would begin to include an incremental amount of shares assumed to be issued for the conversion spread if the Company's stock price at the end of a quarter exceeds \$49.08 per share. EITF 04-08 is expected to be issued in final form in the latter part of 2004, with a fourth quarter effective date. The Company does not believe EITF 04-08 would have impacted the Company's calculated diluted earnings per share for any historical periods. EITF 04-08 will affect the Company's calculation of diluted earnings per share if the Company's share price is between \$49.08 and \$58.90 per share.

The second proposed standard involves an amendment to SFAS 128, "Earnings per Share." The proposed amendment, which is designed for convergence with international accounting standards, would require the use of the "if-converted" method from the date of issuance of the convertible bond. The proposed amendment will remove the ability of a company to overcome the presumption that the convertible securities will be satisfied by full conversion into shares of common stock. Accordingly, the Company's intention to settle the conversions with cash for the principal and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amounts, would no longer be accepted under SFAS 128. The proposed amendment to SFAS 128 is expected to become effective in the fourth quarter of 2004, and would require retroactive restatement of a company's diluted earnings per share calculations. Under the proposed amended SFAS 128 "if converted" method, in calculating diluted earnings per share, the Company will need to increase net income for the interest expense associated with the convertible debentures, net of tax, and increase the incremental shares assumed to be issued upon conversion to 17.1 million shares. Under this method, diluted earnings per share would have been \$0.57 and \$1.68 for the three and nine months ended September 30, 2004. Diluted earnings per share would have been \$2.69 for the year ended December 31, 2003 as compared to the reported amount of \$2.77.

At a recent meeting, the FASB unanimously voted for proposed accounting standards relating to equity-based compensation to be effective for fiscal periods beginning after June 15, 2005 (July 1, 2005 for the Company). An exposure draft was released in the first quarter of 2004, and the final standard is expected to be issued in 2004. The accounting standard is expected to require all companies to utilize the fair value method of accounting for equity-

based compensation in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation." Companies can currently voluntarily adopt SFAS No. 123, using a variety of adoption methods. DST is currently evaluating the impact of the proposed accounting standards and the adoption alternatives provided under both the current standards and the proposed standards. DST discloses the pro forma impact of stock based compensation on its earnings in its notes to financial statements.

8. Segment Information

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

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

	<u>September 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
Financial Services	\$ 2,445.9	\$ 2,175.9
Output Solutions	335.4	313.7
Customer Management	128.2	132.0
Investments and Other	1,298.0	1,393.6
Eliminations	(813.5)	(816.6)
	<u>\$ 3,394.0</u>	<u>\$ 3,198.6</u>

The Company evaluates the performance of its Segments based on income before income taxes and interest expense, adjusted for certain items that are not necessarily ongoing in nature, do not have a high level of predictability associated with them or are non-operational in nature. Generally, these items include net gains (losses) associated with securities, restructuring costs and other similar items. Management believes the exclusion of these items provides a better basis for evaluating underlying business unit performance. Intersegment revenues are reflected at rates prescribed by the Company and may not be reflective of market rates.

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

Three Months Ended September 30, 2004

	<u>Financial Services</u>	<u>Output Solutions</u>	<u>Customer Management</u>	<u>Investments/ Other</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Operating revenues	\$ 279.3	\$ 95.4	\$ 49.1	\$ 3.1	\$	\$ 426.9
Intersegment operating revenues	2.2	13.1		14.0	(29.3)	
Out-of-pocket reimbursements	38.9	141.1	13.4	0.1	(20.9)	172.6
	<u>320.4</u>	<u>249.6</u>	<u>62.5</u>	<u>17.2</u>	<u>(50.2)</u>	<u>599.5</u>
Costs and expenses	229.8	238.6	51.0	9.5	(50.2)	478.7
Depreciation and amortization	28.3	6.5	2.2	4.2		41.2
Income from operations	62.3	4.5	9.3	3.5		79.6
Other income, net	2.5			3.3		5.8
Equity in earnings of unconsolidated affiliates	5.5			0.3		5.8
Income before interest and income taxes	<u>\$ 70.3</u>	<u>\$ 4.5</u>	<u>\$ 9.3</u>	<u>\$ 7.1</u>	<u>\$</u>	<u>\$ 91.2</u>

Three Months Ended September 30, 2003

	<u>Financial Services</u>	<u>Output Solutions</u>	<u>Customer Management</u>	<u>Investments/ Other</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Operating revenues	\$ 251.9	\$ 115.6	\$ 45.8	\$ 0.5	\$	\$ 413.8
Intersegment operating revenues	2.6	11.5		14.6	(28.7)	
Out-of-pocket reimbursements	26.0	134.7	14.8	0.1	(19.7)	155.9
	<u>280.5</u>	<u>261.8</u>	<u>60.6</u>	<u>15.2</u>	<u>(48.4)</u>	<u>569.7</u>
Costs and expenses	191.5	255.5	50.5	8.7	(48.4)	457.8
Depreciation and amortization	23.6	8.8	1.5	3.1		37.0
Income from operations	65.4	(2.5)	8.6	3.4		74.9
Other income, net	2.1			6.4		8.5
Equity in earnings of unconsolidated affiliates	4.4					4.4
Income before interest and income taxes	<u>\$ 71.9</u>	<u>\$ (2.5)</u>	<u>\$ 8.6</u>	<u>\$ 9.8</u>	<u>\$</u>	<u>\$ 87.8</u>

Nine Months Ended September 30, 2004

	<u>Financial Services</u>	<u>Output Solutions</u>	<u>Customer Management</u>	<u>Investments/ Other</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Operating revenues	\$ 826.2	\$ 300.9	\$ 145.7	\$ 9.6	\$	\$ 1,282.4
Intersegment operating revenues	6.9	39.1		39.2	(85.2)	
Out-of-pocket reimbursements	115.7	426.0	40.9	0.3	(63.0)	519.9
	<u>948.8</u>	<u>766.0</u>	<u>186.6</u>	<u>49.1</u>	<u>(148.2)</u>	<u>1,802.3</u>
Costs and expenses	683.8	727.6	154.5	27.3	(148.2)	1,445.0
Depreciation and amortization	79.9	20.7	4.9	10.8		116.3
Income from operations	185.1	17.7	27.2	11.0		241.0
Other income, net	7.9			12.7		20.6
Equity in earnings (losses) of unconsolidated affiliates	17.6			(1.1)		16.5
Income before interest and income taxes	<u>\$ 210.6</u>	<u>\$ 17.7</u>	<u>\$ 27.2</u>	<u>\$ 22.6</u>	<u>\$</u>	<u>\$ 278.1</u>

Nine Months Ended September 30, 2003

	<u>Financial Services</u>	<u>Output Solutions</u>	<u>Customer Management</u>	<u>Investments/ Other</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Operating revenues	\$ 763.8	\$ 368.7	\$ 135.7	\$ 8.3	\$	\$ 1,276.5
Intersegment operating revenues	8.1	37.4		36.3	(81.8)	
Out-of-pocket reimbursements	102.5	448.6	46.9	0.3	(68.3)	530.0
	<u>874.4</u>	<u>854.7</u>	<u>182.6</u>	<u>44.9</u>	<u>(150.1)</u>	<u>1,806.5</u>
Costs and expenses	625.3	815.6	153.6	27.3	(150.1)	1,471.7
Depreciation and amortization	68.3	26.4	4.8	9.2		108.7
Income from operations	180.8	12.7	24.2	8.4		226.1
Other income, net	4.9	4.5		9.2		18.6
Equity in earnings of unconsolidated affiliates	7.4			0.4		7.8
Income before interest and income taxes	<u>\$ 193.1</u>	<u>\$ 17.2</u>	<u>\$ 24.2</u>	<u>\$ 18.0</u>	<u>\$</u>	<u>\$ 252.5</u>

The consolidated total income before interest and income taxes as shown in the segment reporting information above less interest expense of \$14.1 million and \$40.8 million for the three and nine months ended September 30, 2004, respectively, and \$7.8 million and \$14.3 million for the three and nine months ended September 30, 2003, respectively, is equal to the Company's income before income taxes on a consolidated basis for the corresponding periods.

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

The discussions set forth in this Quarterly Report on Form 10-Q contain statements concerning potential future events. Such forward-looking statements are based upon assumptions by the Company's management, as of the date of this Quarterly Report, including assumptions about risks and uncertainties faced by the Company. In addition, management may make forward-looking statements orally or in other writings, including, but not limited to, in press releases, in the annual report to shareholders and in the Company's other filings with the Securities and Exchange Commission ("SEC"). Readers can identify these forward-looking statements by the use of such verbs as expects, anticipates, believes or similar verbs or conjugations of such verbs. If any of management's assumptions prove incorrect or should unanticipated circumstances arise, the Company's actual results could materially differ from those anticipated by such forward-looking statements. The differences could be caused by a number of factors or combination of factors including, but not limited to, those factors identified below in "Company-Specific Trends and Risks." Readers are strongly encouraged to consider the factors listed in such section and any amendments or modifications thereof when evaluating any forward-looking statements concerning the Company. The Company's reports filed with or furnished to the SEC on Form 8-K, Form 10-K, Form 10-Q and other forms and any amendments to those reports, may be obtained by contacting the SEC's Public Reference Branch at 1-800-SEC-0330 or by accessing the forms electronically, free of charge, through the SEC's Internet website at <http://www.sec.gov> or through the Company's Internet website, as soon as reasonably practicable after filing with the SEC, at <http://www.dstsystems.com>. The Company will not update any forward-looking statements in this Quarterly Report to reflect future events or developments.

The information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto included in this Form 10-Q and the audited financial statements and notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

INTRODUCTION

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

Financial Services

The Financial Services Segment provides sophisticated information processing and computer software services and products primarily to mutual funds, investment managers, corporations, insurance companies, banks, brokers and financial planners. The Segment also provides design, management and transaction processing services for customized consumer equipment maintenance and debt protection programs.

Output Solutions

The Output Solutions Segment provides single source, integrated print and electronic communications solutions, including customized and personalized bill and statement processing services and electronic bill payment and presentment solutions, and computer output archival solutions.

Customer Management

The Customer Management Segment provides customer management, billing and marketing solutions to the video/broadband, direct broadcast satellite, wire-line and Internet Protocol telephony, Internet and utility markets.

Investments and Other

The Investments and Other Segment holds investments in equity securities and certain financial interests and the Company's real estate subsidiaries and affiliates.

RESULTS OF OPERATIONS

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

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	2004	2003	2004	2003
Revenues				
Operating revenues				
Financial Services	\$ 281.5	\$ 254.5	\$ 833.1	\$ 771.9
Output Solutions	108.5	127.1	340.0	406.1
Customer Management	49.1	45.8	145.7	135.7
Investments and Other	17.1	15.1	48.8	44.6
Eliminations	(29.3)	(28.7)	(85.2)	(81.8)
	<u>\$ 426.9</u>	<u>\$ 413.8</u>	<u>\$ 1,282.4</u>	<u>\$ 1,276.5</u>
% change from prior year period	3.2%		0.5%	
Out-of-pocket reimbursements				
Financial Services	\$ 38.9	\$ 26.0	\$ 115.7	\$ 102.5
Output Solutions	141.1	134.7	426.0	448.6
Customer Management	13.4	14.8	40.9	46.9
Investments and Other	0.1	0.1	0.3	0.3
Eliminations	(20.9)	(19.7)	(63.0)	(68.3)
	<u>\$ 172.6</u>	<u>\$ 155.9</u>	<u>\$ 519.9</u>	<u>\$ 530.0</u>
% change from prior year period	10.7%		(1.9%)	
Total revenues	<u>\$ 599.5</u>	<u>\$ 569.7</u>	<u>\$ 1,802.3</u>	<u>\$ 1,806.5</u>
% change from prior year period	5.2%		(0.2%)	
Income (loss) from operations				
Financial Services	\$ 62.3	\$ 65.4	\$ 185.1	\$ 180.8
Output Solutions	4.5	(2.5)	17.7	12.7
Customer Management	9.3	8.6	27.2	24.2
Investments and Other	3.5	3.4	11.0	8.4
	<u>79.6</u>	<u>74.9</u>	<u>241.0</u>	<u>226.1</u>
Interest expense	(14.1)	(7.8)	(40.8)	(14.3)
Other income, net	5.7	8.5	20.6	18.6
Equity in earnings of unconsolidated affiliates, net of income taxes	5.8	4.4	16.5	7.8
	<u>77.0</u>	<u>80.0</u>	<u>237.3</u>	<u>238.2</u>
Income before income taxes	<u>77.0</u>	<u>80.0</u>	<u>237.3</u>	<u>238.2</u>
Provision for income taxes	24.5	27.1	81.4	80.9
	<u>\$ 52.5</u>	<u>\$ 52.9</u>	<u>\$ 155.9</u>	<u>\$ 157.3</u>
Net income	<u>\$ 52.5</u>	<u>\$ 52.9</u>	<u>\$ 155.9</u>	<u>\$ 157.3</u>
Basic earnings per share	\$ 0.63	\$ 0.46	\$ 1.85	\$ 1.33
Diluted earnings per share	\$ 0.61	\$ 0.45	\$ 1.80	\$ 1.32

Consolidated revenues

Consolidated total revenues (including Out-of-Pocket (“OOP”) reimbursements) for the three and nine months ended September 30, 2004, increased \$29.8 million or 5.2% and decreased \$4.2 million or 0.2%, respectively, over the same periods in 2003. Consolidated operating revenues for the three and nine months ended September 30, 2004, increased \$13.1 million or 3.2% over the prior year quarter and \$5.9 million or 0.5% over the prior year nine month period. U.S. operating revenues for the three and nine months ended September 30, 2004, were \$382.6 million and \$1,137.1 million, respectively, an increase of 3.0% and a decrease of 1.5%, respectively, over the same periods in 2003. International operating revenues for the three and nine months ended September 30, 2004, were \$44.3 million and \$145.3 million, respectively, an increase of 4.2% and 18.7% over the same periods in 2003.

Financial Services Segment total revenues for the three and nine months ended September 30, 2004, increased \$39.9 million or 14.2% and \$74.4 million or 8.5%, respectively, over the same periods in 2003. Financial Services operating revenues for the three and nine months ended September 30, 2004, increased \$27.0 million or 10.6% and \$61.2 million or 7.9%, respectively, over the same periods in 2003. U.S. Financial Services Segment operating revenues for the three and nine months ended September 30, 2004, increased \$24.3 million or 10.6% and \$41.7 million or 6.0%, respectively, over the same periods in 2003. The increase in U.S. Financial Services Segment operating revenues for the three months ended September 30, 2004, resulted primarily from higher EquiServe corporate action servicing revenues of \$11.7 million, higher U.S. mutual fund servicing revenues of \$8.0 million and higher lock\line related revenues from increases in supported customers and expanded service offerings of \$10.2 million. The increase in U.S. Financial Services Segment operating revenues for the nine months ended September 30, 2004, resulted primarily from higher U.S. mutual fund servicing revenues of \$23.0 million and higher lock\line related revenues from increases in supported customers and expanded service offerings of \$21.6 million. U.S. mutual fund servicing revenues increased as U.S. mutual fund open shareowner accounts processed totaled 91.0 million at September 30, 2004, an increase of 3.1 million or 3.5% from the 87.9 million serviced at December 31, 2003, and an increase of 4.1 million or 4.7% from the 86.9 million serviced at September 30, 2003. Financial Services Segment international operating revenues for the three and nine months ended September 30, 2004, were \$28.7 million and \$95.1 million, respectively, an increase of \$2.7 million or 10.4% and \$19.5 million or 25.8%, respectively, over the same periods in 2003. The increase for the three months ended September 30, 2004 compared to the same period in the prior year is primarily from an increase in the value of the British pound versus the U.S. dollar. The increase for the nine months ended September 30, 2004 compared to the same period in the prior year is a result of increased license fee revenues and an increase in the value of the British pound versus the U.S. dollar.

Output Solutions Segment total revenues for the three and nine months ended September 30, 2004, decreased \$12.2 million or 4.7% and \$88.7 million or 10.4%, respectively, over the same periods in 2003. Output Solutions Segment operating revenues for the three and nine months ended September 30, 2004 decreased \$18.6 million or 14.6% and \$66.1 million or 16.3%, respectively, over the same periods in 2003. The operating revenue decline resulted principally from the absence of DST Output Marketing Services, Inc. (“OMS”) revenues as a result of the exchange transaction with Janus Capital Group Inc. (“Janus Exchange”) (\$20.8 million of OMS revenues were recorded in the third quarter of 2003 and \$54.1 million of OMS revenues were recorded for the first nine months of 2003) and lower revenues from the loss of a telecommunications client. These operating revenue decreases were partially offset by increased revenues of \$3.5 million and \$1.0 million in the banking and transportation industries, respectively for the three months ended September 30, 2004 compared to the same period last year, and increased revenues of \$7.7 million in the transportation industry for the nine months ended September 30, 2004 compared to the same period last year. Output Solutions Segment images produced for the three and nine months ended September 30, 2004, decreased 4.3% to 2.2 billion and 5.9% to 6.4 billion, respectively, and items mailed decreased 3.8% to 401 million and 4.4% to 1,225 million, respectively, compared to the same periods in 2003.

Customer Management Segment total revenues for the three and nine months ended September 30, 2004 increased \$1.9 million or 3.1% and \$4.0 million or 2.2%, respectively, over the same periods in 2003. Customer Management Segment operating revenues for the three and nine months ended September 30, 2004 increased \$3.3 million or 7.2% and \$10.0 million or 7.4%, respectively, over the same periods in 2003. The increase for the quarter ended September 30, 2004 was a result of an increase in processing and software service revenues of \$2.7 million primarily from higher software development revenues and a \$0.6 million increase in equipment sales compared to third quarter 2003. The

increase for the nine months ended September 30, 2004 was primarily a result of an increase in processing and software service revenues of \$5.6 million primarily from higher software development revenues and a \$4.4 million increase in equipment sales compared to the same period in 2003.

Investments and Other Segment total revenues increased \$2.0 million or 13.2% and \$4.2 million or 9.4% for the three and nine months ended September 30, 2004, respectively, as compared to the same periods in 2003. Investments and Other Segment operating revenues increased \$2.0 million or 13.2% and \$4.2 million or 9.4% for the three and nine months ended September 30, 2004, respectively, as compared to the same periods in 2003. The increase was primarily from increased real estate leasing activity. Segment revenues are primarily rental income for facilities leased to the Company's operating segments.

Income from operations

Consolidated income from operations for the three and nine months ended September 30, 2004 was \$79.6 million and \$241.0 million, an increase of \$4.7 million or 6.3% and \$14.9 million or 6.6%, respectively, over the same periods in 2003.

Financial Services Segment income from operations for the three and nine months ended September 30, 2004 was \$62.3 million and \$185.1 million, a decrease of \$3.1 million or 4.7% and an increase of \$4.3 million or 2.4%, respectively, over the same periods in 2003. Income from operations for the three months ended September 30, 2004 decreased due to an increase in costs and expenses of \$38.3 million or 20.0% compared to the prior year quarter, primarily from increased personnel costs of \$17.9 million to support new product development and increased lock\line related revenues, increased OOP expenses of \$13.0 million resulting from higher OOP revenues and increased occupancy costs of \$3.7 million which included a charge of \$1.7 million for early termination of a lease, partially offset by an increase in total revenues of \$39.9 million. In addition, depreciation and amortization increased \$4.7 million, primarily attributable to depreciation of capital costs for DST's recovery data center, which became operational during the fourth quarter of 2003. Income from operations for the nine months ended September 30, 2004 increased as higher total revenues of \$74.4 million were partially offset by an increase in costs and expenses of \$58.5 million or 9.4% compared to the prior year period, primarily from increased personnel costs of \$33.7 million to support new product development and increased lock\line related revenues, increased OOP expenses of \$13.3 million resulting from higher OOP revenues and increased occupancy costs of \$5.8 million which included a charge of \$1.7 million for early termination of a lease. In addition, depreciation and amortization increased \$11.6 million, primarily attributable to depreciation of capital costs for DST's recovery data center.

Output Solutions Segment income from operations for the three and nine months ended September 30, 2004, was \$4.5 million and \$17.7 million, respectively, an increase of \$7.0 million from the loss from operations of \$2.5 million recorded for the same three month period in 2003 and an increase of \$5.0 million or 39.4% over the same nine month period in 2003. The increase for the three months ended September 30, 2004 compared to the same period in the prior year related to an increase of operating revenues of \$2.2 million, excluding OMS revenue in 2003, and lower costs and expenses. Costs and expenses decreased \$16.9 million or 6.6% from the third quarter 2003, reflecting the absence of OMS costs and expenses of \$24.5 million, cost containment activities and lower OOP expenses. Depreciation and amortization for the three and nine months ended September 30, 2004 decreased \$2.3 million and \$5.7 million, respectively, compared to the prior year periods, reflecting the exclusion of OMS and lower capital expenditures. The increase in income from operations for the nine months ended September 30, 2004 compared to the same period in the prior year related primarily to lower costs and expenses. Costs and expenses decreased \$88.0 million or 10.8% from the same period in 2003, reflecting the absence of OMS costs and expenses of \$64.7 million and cost containment activities.

Customer Management Segment income from operations totaled \$9.3 million and \$27.2 million for the three and nine months ended September 30, 2004, an increase of \$0.7 million or 8.1% and \$3.0 million or 12.4%, respectively, over the same periods in 2003. Costs and expenses increased 1.0% and 0.6% respectively, for the three and nine month periods ending September 30, 2004 compared to the same periods in 2003. Depreciation and amortization increased \$0.7 million compared to the prior year quarter, primarily from the initial amortization of capitalized software for the first operational components of Collabrent (formerly Concorde).

Investments and Other Segment income from operations for the three and nine months ended September 30, 2004, increased \$0.1 million or 2.9% and \$2.6 million or 31.0%, respectively, over the same periods in 2003. The increase is primarily due to increased real estate leasing activity.

Interest expense

Interest expense was \$14.1 million for the quarter ended September 30, 2004 compared to \$7.8 million in the prior year quarter, principally from increased interest expense of \$9.1 million associated with the \$840 million of convertible debentures issued in August 2003.

Interest expense was \$40.8 million for the nine months ended September 30, 2004 compared to \$14.3 million in the prior year period, principally from increased interest expense of \$27.4 million associated with the \$840 million of convertible debentures issued in August 2003. Average debt balances were higher in 2004 compared to 2003, primarily as a result of the convertible debentures and higher borrowings on the syndicated line of credit facility primarily to finance the Janus Exchange.

Other income, net

Other income was \$5.7 million for the quarter ended September 30, 2004 compared to \$8.5 million recorded in the prior year quarter. Third quarter 2004 results include \$4.5 million primarily related to interest and dividend income and \$0.5 million primarily in net gains on securities. Third quarter 2003 results include \$4.2 million primarily related to interest and dividend income and \$3.5 million primarily in net gains on securities.

Other income was \$20.6 million for the nine months ended September 30, 2004 compared to \$18.6 million for the prior year period. Year to date 2004 results include \$12.3 million primarily related to interest and dividend income and \$6.2 million primarily related to net gains on securities. Year to date 2003 results include \$10.8 million primarily related to interest and dividend income and \$5.5 million primarily related to net gains on securities.

Equity in earnings of unconsolidated affiliates

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2004	2003	2004	2003
BFDS	\$ 3.3	\$ 2.9	\$ 11.4	\$ 7.1
IFDS U.K.	1.4	0.3	3.7	(1.9)
IFDS Canada	1.0	0.9	2.2	1.2
Other	0.1	0.3	(0.8)	1.4
	<u>\$ 5.8</u>	<u>\$ 4.4</u>	<u>\$ 16.5</u>	<u>\$ 7.8</u>

Equity in earnings of unconsolidated affiliates totaled \$5.8 million and \$16.5 million, respectively, for the three and nine months ended September 30, 2004, as compared to \$4.4 million and \$7.8 million, respectively, for the three and nine months ended September 30, 2003. Boston Financial Data Services ("BFDS") earnings increased \$0.4 million and \$4.3 million, respectively, for the three and nine months ended September 30, 2004, compared to the same periods in 2003, primarily from higher revenues from client additions, partially offset by increased costs from higher levels of accounts serviced. On July 1, 2004, BFDS began performing transfer agency services for a client which was previously a remote client of DST. This change did not result in an increase in DST's mutual fund shareowner accounts processed. International Financial Data Services (U.K.) Limited ("IFDS U.K.") results increased \$1.1 million and \$5.6 million, respectively, for the three and nine months ended September 30, 2004, compared to the same

periods in 2003, primarily due to higher levels of accounts serviced and the favorable finalization of certain leasehold obligations originally established at the time of property abandonment. Accounts serviced by IFDS U.K. were 4.7 million at September 30, 2004, a decrease of 0.1 million or 2.2% from year end 2003 levels and an increase of 0.8 million or 20.5% over September 30, 2003 levels, due primarily to new client conversions for the nine month period ending September 30, 2004. An additional 750,000 accounts are scheduled to convert during the fourth quarter of 2004. Accounts serviced by International Financial Data Services (Canada) Limited (“IFDS Canada”) were 3.0 million at September 30, 2004, an increase of 0.2 million or 11.1% from year end 2003 levels, and a decrease of 0.5 million or 14.3% from September 30, 2003 levels. The reduction in year to date earnings from Other unconsolidated affiliates is principally related to pre-operating costs associated with the formation of a real estate joint venture.

Income taxes

The Company provides income taxes during interim periods based on its best estimate of the full year’s effective tax rate. The Company’s effective tax rate was 31.8% for the quarter and 34.3% for the nine months ended September 30, 2004, compared to 34.0% for the quarter and nine months ended September 30, 2003. The Company estimates its effective tax rate will be 34.3% for the year ending December 31, 2004, and, on this basis, has provided income taxes at this rate for the three and nine months ended September 30, 2004, which compares with 34.0% for the three and nine months ended September 30, 2003. The reduction in the year to date tax rate from 35.5% to 34.3% is primarily the result of certain real estate related tax credits being finalized. Excluding the effect of the real estate related tax credits, the Company believes its tax rate for the full year 2004 would be approximately 35%. The 2004 and 2003 tax rates were affected by tax aspects of certain international operations and state tax income apportionment rules. The 2003 income tax rate was lower than the 2004 anticipated rate primarily as a result of real estate related tax credits realized in 2003. The full year 2004 effective tax rate can be affected as a result of variances among the estimates and amounts of full year sources of taxable income (e.g. domestic consolidated, joint venture and/or international), the realization of tax credits (e.g. historic rehabilitation, research and experimental and state incentive) and adjustments which may arise from the resolution of tax matters under review.

Business Segment Comparisons

FINANCIAL SERVICES SEGMENT

Revenues

Financial Services Segment total revenues for the three and nine months ended September 30, 2004, increased 14.2% and 8.5%, respectively, over the same periods in 2003 to \$320.4 million and \$948.8 million, respectively. Financial Services Segment operating revenues for the three and nine months ended September 30, 2004 were \$281.5 million and \$833.1 million, respectively, an increase of \$27.0 million or 10.6% and \$61.2 million or 7.9%, respectively, over the same periods in 2003. U.S. Financial Services Segment operating revenue increased 10.6% to \$252.8 million and 6.0% to \$738.0 million, respectively, for the three and nine months ended September 30, 2004. The increase in U.S. Financial Services Segment operating revenues for the quarter ended September 30, 2004, resulted primarily from higher EquiServe corporate action servicing revenues of \$11.7 million, higher U.S. mutual fund servicing revenues of \$8.0 million and higher lock\line related revenues from increases in supported customers and expanded service offerings of \$10.2 million. The increase in U.S. Financial Services Segment operating revenues for the nine months ended September 30, 2004 resulted primarily from higher U.S. mutual fund servicing revenues of \$23.0 million and higher lock\line related revenues from increases in supported customers and expanded service offerings of \$21.6 million. U.S. mutual fund servicing revenues increased as U.S. mutual fund open shareowner accounts processed increased 4.7% from 86.9 million at September 30, 2003 to 91.0 million at September 30, 2004. Financial Services Segment operating revenues from international operations for the three and nine months ended September 30, 2004 increased 10.4% to \$28.7 million and 25.8% to \$95.1 million, respectively, over the same periods in 2003. The increase for the three months ended September 30, 2004 compared to the same period in the prior year is primarily from an increase in the value of the British pound versus the U.S. dollar. The increase for the nine months ended September 30, 2004 compared to same period in the prior year is a result of increased license fee revenues and an increase in the value of the British pound versus the U.S. dollar.

During the third quarter of 2004, DST obtained commitments from two additional prospective clients with a total of 1.1 million shareowner accounts and 200,000 401(k) plan participants. The Company currently has commitments from a total of four clients with a combined total of 6.6 million shareowner accounts and 200,000 401(k) plan participants. It is expected that the conversion schedule will be such that significant revenues from these conversions will not be recognized until the second quarter of 2005. The Company is also pursuing a number of potential new clients for mutual fund processing services.

Costs and expenses

Segment costs and expenses for the three and nine months ended September 30, 2004 increased 20.0% to \$229.8 million and 9.4% to \$683.8 million, respectively, over the same periods in 2003. Personnel costs for the three and nine months ended September 30, 2004 increased \$17.9 million or 14.0% and \$33.7 million or 8.3%, respectively, over the same periods in 2003, primarily to support new product development and increased lock\line related revenues. OOP expenses increased \$13.0 million and \$13.3 million for the three and nine months ended September 30, 2004, respectively, resulting from higher OOP revenues. Occupancy costs increased \$3.7 million and \$5.8 million for the three and nine months ended September 30, 2004, respectively, and a charge of \$1.7 million was taken during the third quarter of 2004 for early termination of a lease.

Segment costs and expenses continue to include costs associated with the development of Fairway, the Company's new securities transfer system, and Managed Asset Platform ("MAP") and Open Platform for Advisors ("OpenPFA"), the Company's Wealth Management and Advisor products. Client accounts are currently being converted to the Fairway system from older systems and there are certain costs involved in these conversions. The Company will continue to incur development and conversion costs related to MAP and OpenPFA.

Depreciation and amortization

Segment depreciation and amortization increased 19.9% or \$4.7 million and 17.0% or \$11.6 million, respectively, for the three and nine months ended September 30, 2004 over the same periods in 2003, primarily attributable to depreciation of capital costs for DST's recovery data center, which became operational during the fourth quarter of 2003.

The Segment also continues to incur amortization for capitalized costs related to the new Fairway system. As additional work is completed and more costs are capitalized, depreciation will increase as it relates to Fairway. The Company has assigned a 10 year life to Fairway for amortization purposes.

Income from operations

Segment income from operations for the three and nine months ended September 30, 2004 decreased 4.7% to \$62.3 million and increased 2.4% to \$185.1 million, respectively, over the same periods in 2003. The decrease for the three month period ended September 30, 2004 compared to the same period in 2003 resulted primarily from increased costs and expenses and increased depreciation and amortization expense, partially offset by higher EquiServe corporate action servicing revenues, higher mutual fund servicing revenues and higher lock\line related revenues from increases in supported customers and expanded service offerings.

OUTPUT SOLUTIONS SEGMENT

Revenues

Output Solutions Segment total revenues for the three and nine months ended September 30, 2004 decreased 4.7% to \$249.6 million and 10.4% to \$766.0 million, respectively, compared to the same periods in 2003. Output Solutions Segment operating revenues for the three and nine months ended September 30, 2004 decreased 14.6% to \$108.5 million and 16.3% to \$340.0 million, respectively, compared to the same periods in 2003. The operating revenue decline for the three and nine months ended September 30, 2004 resulted principally from the absence of OMS revenues as a result of the Janus Exchange (\$20.8 million and \$54.1 million, respectively, of OMS revenues were recorded over the same periods in 2003) and lower revenues from the loss of a telecommunications client. These operating revenue decreases were partially offset by increased revenues of \$3.5 million and \$1.0 million in the banking and transportation industries, respectively, for the three months ended September 30, 2004 compared to the same period last year, and increased revenues of \$7.7 million in the transportation industry for the nine months ended

September 30, 2004 compared to the same period last year.

Costs and expenses

Segment costs and expenses for the three and nine months ended September 30, 2004 decreased 6.6% to \$238.6 million and 10.8% to \$727.6 million, respectively, over the same periods in 2003. The decline resulted from the absence of OMS costs and expenses of \$24.5 million and \$64.7 million for the three and nine month periods ending September 30, 2004, respectively, over the same periods in 2003 as well as lower costs due to cost containment activities and lower OOP expenses. For the three and nine months ended September 30, 2003, Segment results include \$0.9 million and \$2.4 million, respectively, of costs associated with previously announced facility and other consolidations. Personnel costs for the three and nine months ended September 30, 2004 decreased 16.8% and 14.6%, respectively, over the same periods in 2003 primarily due to facility consolidations and other cost containment activities.

Depreciation and amortization

Segment depreciation and amortization decreased 26.1% to \$6.5 million and 21.6% to \$20.7 million for the three and nine months ended September 30, 2004, respectively, compared to the same periods in 2003, primarily from the exclusion of OMS depreciation and amortization of \$0.9 million and \$2.5 million, respectively, and from lower capital expenditures.

Income from operations

Segment income from operations for the three and nine months ended September 30, 2004 increased from a net loss of \$2.5 million to net income of \$4.5 million and increased \$5.0 million to net income of \$17.7 million, respectively, over the same periods in 2003. The increases related primarily to lower costs and expenses. Segment results for the three and nine months ended September 30, 2003 include \$0.9 million and \$2.4 million, respectively, of costs associated with previously announced facility and other consolidations.

CUSTOMER MANAGEMENT SEGMENT

Revenues

Customer Management Segment total revenues for the three and nine months ended September 30, 2004 increased 3.1% to \$62.5 million and 2.2% to \$186.6 million, respectively, as compared to the same periods in 2003. Customer Management Segment operating revenues for the three and nine months ended September 30, 2004 were \$49.1 million, an increase of \$3.3 million or 7.2%, and \$145.7 million, an increase of \$10.0 million or 7.4%, respectively, over the same periods in 2003. Processing and software service revenues increased \$2.7 million to \$47.9 million and \$5.6 million to \$139.0 million, respectively, for the three and nine months ended September 30, 2004 from \$45.2 million and \$133.4 million, respectively, for the three and nine months ended September 30, 2003. Processing and software service revenues increased primarily from higher software development revenues. Equipment sales increased to \$1.2 million and \$6.7 million, respectively, for the three and nine months ended September 30, 2004 from \$0.6 million and \$2.3 million, respectively, for the three and nine months ended September 30, 2003. Total cable and satellite subscribers serviced were 37.2 million at September 30, 2004, a decrease of 5.3% compared to year end 2003 levels, principally from a net decrease in international cable subscribers serviced.

Costs and expenses

Segment costs and expenses for the three and nine months ended September 30, 2004, increased \$0.5 million or 1.0% and \$0.9 million or 0.6%, respectively, compared to the same periods in 2003, primarily attributable to increased personnel costs offset by cost containment efforts.

Segment costs and expenses continue to include costs associated with the development of Collabrent, the Company's new billing and customer care solution that has been designed as a fully integrated modular system to support the broadband, satellite, wire-line and voice over Internet Protocol telephony markets. Subscriber accounts are expected to begin conversion to the new Collabrent system in the future and the Company expects to incur additional costs on these conversions. Development and conversion costs are expected to continue at the current rate until the majority of subscriber accounts are converted onto Collabrent, however the amount that qualifies for capitalization of internally developed software costs will decrease.

Depreciation and amortization

Segment depreciation and amortization for the three and nine months ended September 30, 2004 increased \$0.7 million to \$2.2 million and \$0.1 million to \$4.9 million, respectively, compared to the same periods in 2003, primarily from lower capital expenditures.

The first components of Collabrent were placed into production in July 2004 and accordingly, amortization of the capitalized costs for those components commenced at that time. The Company has assigned a 7 year life to Collabrent for amortization purposes.

Income from operations

Customer Management Segment income from operations for the three and nine months ended September 30, 2004 increased \$0.7 million to \$9.3 million and \$3.0 million to \$27.2 million, respectively, compared to the same periods in 2003. The increase is primarily attributable to higher operating revenues.

INVESTMENTS AND OTHER SEGMENT**Revenues**

Investments and Other Segment operating revenues were \$17.1 million and \$48.8 million, respectively, for the three and nine months ended September 30, 2004, an increase of \$2.0 million and \$4.2 million, respectively, as compared to the same periods in 2003. The increase is primarily attributable to increased real estate leasing activity.

Costs and expenses

Segment costs and expenses increased \$0.8 million to \$9.5 million for the three months ended September 30, 2004 compared to the prior year quarter. Segment costs and expenses for the nine months ended September 30, 2004 were \$27.3 million, unchanged compared to the same period in 2003.

Depreciation and amortization

Segment depreciation and amortization increased \$1.1 million to \$4.2 million and \$1.6 million to \$10.8 million, respectively, for the three and nine months ended September 30, 2004, as compared to the same periods in 2003.

Income from operations

Segment income from operations totaled \$3.5 million and \$11.0 million, respectively, for the three and nine months ended September 30, 2004, as compared to \$3.4 million and \$8.4 million, respectively, for the three and nine months ended September 30, 2003, primarily due to higher real estate revenues.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash flow from operating activities totaled \$263.8 million for the nine months ended September 30, 2004. Operating cash flows primarily resulted from net income of \$155.9 million, depreciation and amortization of \$116.3 million, an increase in the deferred tax liability of \$24.3 million and an increase in accrued compensation and benefits of \$16.6 million partially offset by decreases in deferred revenues and gains of \$26.4 million.

The Company has a cash management service for full service mutual fund transfer agency clients, whereby end of day available client bank balances are invested overnight by and in the name of the Company into credit-quality money market funds. All invested balances are returned to the full service mutual fund transfer agency client accounts the following business day. In the first quarter of 2004, the Company initiated a similar cash management service for a portion of its corporate securities processing transfer agency accounts. The Company had \$276.8 million and \$63.4 million of transfer agency investments and deposits at September 30, 2004 and December 31, 2003, respectively. The Company will continue to evaluate implementation of this service for the remainder of its corporate securities processing transfer agency accounts, and estimates that the amount of transfer agency investments and deposits may increase by approximately \$400 million upon full implementation. Related to this service, the Company may periodically purchase bonds issued by the US government or US government agencies with maturities of 1-5 years.

Depending on differences between the current market interest rates and the coupon rates on the bonds, the bonds may be purchased at a discount or premium to the bond's face value.

The Company collects from its clients and remits to the U.S. Postal Service a significant amount of postage. A significant number of contracts allow the Company to pre-bill and/or require deposits to allow pre-funding.

Cash flows used in investing activities totaled \$173.0 million for the nine months ended September 30, 2004. The Company expended \$136.7 million during the nine months ended September 30, 2004 for capital additions, of which \$96.0 million related to the Financial Services, Output Solutions and Customer Management Segments and \$40.7 million related to the Investments and Other Segment, which primarily related to acquisitions of buildings and building improvements. The Company had \$30.4 million of investments in available-for-sale securities and expended \$21.1 million for advances to affiliates and other investments. During the nine months ended September 30, 2004, the Company received \$29.0 million from the sale and maturities of investments in available-for-sale securities and \$2.9 million primarily from the sale of other investments.

The Company is a 50% partner in a limited purpose real estate joint venture. The real estate joint venture will develop approximately 1.1 million square feet of office space that will be leased to the U.S. government. The project is estimated to cost approximately \$362 million and has been financed with \$315 million of non-recourse insured bonds (issued June 2004) with the remainder in the form of equal equity contributions from the real estate joint venture partners (totaling approximately \$22 million at September 30, 2004). The real estate joint venture partners have committed aggregate additional equity investments of approximately \$25 million to complete the financing and up to \$33 million of equity investments in the aggregate in the event of delays in construction or lease commencement. The remaining equity contributions of \$25 million to \$58 million have been secured through \$58 million of letters of credit that expire beginning in 2007 through 2008. The Company is responsible for \$29 million of the letters of credit. At September 30, 2004, there were no outstanding borrowings against the letters of credit.

The August 2, 2002 acquisition of lock\line was accounted for as a purchase. The minimum purchase price of \$190 million was paid in cash at closing. There are provisions in the acquisition agreement that allow for additional consideration to be paid in cash if lock\line's revenues, as defined in the acquisition agreement, exceed certain targeted levels for 2003 and 2004. lock\line revenues for 2003 did not exceed targeted levels necessary to result in additional consideration. lock\line revenues for 2004 are currently estimated to exceed the targeted levels, which would require the Company to pay additional consideration. Goodwill will be increased by the amount of additional consideration paid.

On March 30, 2001, the Company completed the acquisition of a 75% interest in EquiServe, Inc. ("EquiServe") by purchasing interests held by FleetBoston Financial ("FleetBoston") and Bank One Corporation ("Bank One"). On July 31, 2001, the Company completed the acquisition of the remaining 25%, which was owned by BFDS, on essentially the same terms provided to FleetBoston and Bank One.

The EquiServe acquisitions were accounted for as a purchase and the results of EquiServe's operations are included in the Company's consolidated financial statements beginning March 30, 2001. The minimum purchase price of \$186.7 million was paid in four installments. The minimum purchase price (discounted to \$177.7 million for accounting purposes) has been allocated to the net assets acquired based upon their fair values as determined by a valuation. Three installment payments totaling \$165.1 million were made through December 31, 2003. The final installment payment was \$45.8 million and was paid in March 2004. The final purchase price installment increased pursuant to a formula that provided for additional consideration to be paid in cash if EquiServe's revenues, as defined in the agreements, for the years ending 2000, 2001, 2002 and 2003 exceeded certain targeted levels. Goodwill was increased by \$25.6 million, the amount of contingent consideration paid during the first quarter of 2004.

The Company announced on October 20, 2004 that it has signed a definitive agreement for Computershare Ltd. ("CPU") to acquire, in a taxable transaction, DST's wholly owned subsidiary, EquiServe. Upon closing, DST will receive U.S. \$216 million of cash plus 29.6 million shares of CPU common stock. The CPU common stock to be received represents slightly less than 5% of CPU's total issued capital, post-transaction, and had an approximate value of U.S. \$91 million on October 19, 2004. Under terms of the agreement, DST will continue to provide EquiServe various services, including

data processing support, AWD products and services, Output Solutions services and E-Proxy services. The transaction, which has been approved by the board of directors of both companies, is expected to close in the first quarter of 2005, subject to regulatory approvals. The Company recorded EquiServe operating revenues of \$174.9 million and OOP reimbursements of \$55.3 million for the nine months ended September 30, 2004. For the years ended December 31, 2003 and 2002, the Company recorded EquiServe operating revenues of \$229.3 million and \$264.3 million, respectively, and OOP reimbursements of \$70.7 million and \$89.5 million, respectively.

DST expects to record a one-time after-tax gain of \$30-\$50 million associated with the transaction. DST estimates that it will receive approximately \$165 million of after-tax cash proceeds associated with the transaction that may be used to reduce debt or repurchase shares of DST common stock. DST believes that the transaction will be slightly dilutive to diluted earnings per share.

Cash flows used in financing activities totaled \$89.3 million for the nine months ended September 30, 2004. For the nine months ended September 30, 2004, the Company repurchased \$74.3 million of common stock. The Company had payments of \$62.7 million for the nine months ended September 30, 2004 on its long-term debt, which was partially comprised of the final purchase price installment for EquiServe. Net borrowings totaled \$15.9 million on the Company's revolving credit facility, which brought the outstanding balance to \$454.2 million at September 30, 2004.

The Company has approximately \$87.5 million of scheduled debt payments due on or before September 30, 2005, however the Company has classified these amounts as long-term debt due to the Company's ability and intent to refinance the debt under its existing line of credit agreements.

On October 19, 2004, DST's Board of Directors authorized an additional 5.5 million share repurchase to the six million share repurchase plan authorized on February 26, 2004. The plan allows, but does not require, the repurchase of common stock in open market and private transactions through February 28, 2007. In the third quarter of 2004, 0.6 million shares were purchased for an average price of \$45.45 per share. At September 30, 2004, the Company had purchased 1.5 million shares at an average price of \$45.85 per share since the program commenced. As of October 19, 2004 the Company had approximately 10.0 million shares remaining to be purchased under this program.

On October 29, 2004 the Compensation Committee of the Board of Directors of the Company voted to grant as of November 10, 2004, approximately 2.8 million shares of restricted common stock of the Company to officers and certain other participants in the Stock Option and Performance Award Plan. For ten senior executive officers, the restricted shares are subject to the earnings per share goal that must be met as an additional condition to the lapse of restrictions on January 31, 2010. Subject to early lapsing and forfeiture provisions, the restrictions on the shares granted to all other officers and participants lapse on November 10, 2009. The restricted stock grants cover the five-year period of 2005 through 2009 and are intended to be the only restricted stock grants for such periods other than for new hires or promotions, for special employee recognition purposes, and, in accordance with past practice, for the portion of each annual incentive bonus the executive officers are required to take in the form of equity compensation. The Compensation Committee made the grant after evaluating the Company's equity compensation practices, particularly in light of pending changes in the accounting rules applicable to stock options.

The Company estimates that the impact on amortized compensation expense attributable to the grant for each year covered by the grant based upon the average of the high and low trading prices for the Company's shares on October 28, 2004 will be approximately \$4.3 million in 2004, \$25.5 million for the years 2005 through 2008 and \$21.3 million in 2009. These estimates assume that all shares will be vested and all performance criteria will be met.

The Company believes that its existing cash balances and other current assets, together with cash provided by operating activities and, as necessary, the Company's bank and revolving credit facilities, will suffice to meet the Company's operating and debt service requirements and other current liabilities for at least the next 12 months. Further, the Company believes that its longer term liquidity and capital requirements will also be met through cash provided by operating activities and bank credit facilities.

FIN 45

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

In certain instances in which the Company licenses proprietary systems to customers, the Company gives certain indemnities (including infringement indemnities) and warranties to the licensee, the terms of which vary depending on the negotiated terms of each respective license agreement. Such warranties 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 obligations may be subject to time and materiality limitations, monetary caps and other conditions and defenses.

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

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 subject to certain limitations, due to the buyer's reliance on representations and warranties relating to the subject subsidiary, operating unit or business assets in the disposition agreement if such representations or warranties were untrue when made, or due to any breach of the representations, warranties, agreements or covenants contained in the agreement.

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

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

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

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

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

At September 30, 2004, the Company had not accrued any liability on the aforementioned guarantees or indemnifications as they relate to future performance criteria or indirect indebtedness of others in accordance with FIN 45.

FIN 46

Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51" requires the consolidation of certain types of entities in which the Company absorbs a majority of another entity's expected losses, receives a majority of the other entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the other entity. These entities are called "variable interest entities." The principal characteristics of variable interest entities are (1) an insufficient amount of equity to absorb the entity's expected losses, (2) equity owners as a group are not able to make decisions about the entity's activities, or (3) equity that does not absorb the entity's losses or receive the entity's residual returns. "Variable interests" are contractual, ownership or other monetary interests in an entity that change with fluctuations in the entity's net asset value. As a result, variable interest entities can arise from items such as joint ventures, lease agreements, loan arrangements, guarantees or service contracts.

If an entity is determined to be a "variable interest entity," the "primary beneficiary" must consolidate the entity. The primary beneficiary is the holder of the variable interests that absorb a majority of the variable interest entity's expected losses or receive a majority of the entity's residual returns in the event no holder has a majority of the expected losses. There is no primary beneficiary in cases where no single holder absorbs the majority of the expected losses or receives a majority of the residual returns. The determination of the primary beneficiary is based on projected cash flows at the inception of the variable interests.

With regard to real estate, the Company is the lessee in a series of operating leases covering a large portion of its Kansas City based leased office facilities. The lessors are generally joint ventures (in which the Company has a 50% ownership) that have been established specifically to purchase, finance and engage in leasing activities with the joint venture partners and unrelated third parties. Two of the real estate joint ventures have entered into financing arrangements with the Company's wholly owned captive insurance company. In each case, the other joint venture partner has guaranteed at least 50% of the joint venture's borrowings (\$38.5 million at September 30, 2004) from the Company's captive insurance company. The Company is generally not the primary beneficiary of the joint ventures if the lease terms are consistent with market terms at the inception of the lease and do not include a residual value guarantee, fixed-price purchase options or similar features that disproportionately obligate it to absorb decreases in value or entitle it to participate in increases in the value of the real estate. The Company has finalized analyses of its real estate joint ventures and determined that a large portion of the real estate joint ventures are variable interest entities, however the real estate joint ventures do not need to be consolidated because the Company is not the primary beneficiary. The Company entered into two real estate joint ventures during the first quarter of 2004. The Company has determined that these ventures are not variable interest entities. The Company did not enter into any new real estate joint ventures during the second and third quarters of 2004.

With regard to operating joint ventures, the Company has formed or entered into operating joint ventures to enter into or expand its presence in target markets. The Company has three significant operating joint ventures; BFDS; IFDS (includes IFDS U.K., IFDS Canada and International Financial Data Services, Luxembourg); and Argus Health Systems. Each of these operating joint ventures was formed prior to February 1, 2003. The Company has finalized its FIN 46 analyses of these operating joint ventures, and its assessment is that none qualify as variable interest entities due to meeting the criteria for the operating joint venture exception in FIN 46.

OTHER

Comprehensive income (loss). The Company's comprehensive income (loss) totaled \$(3.3) million and \$98.0 million for the three and nine months ended September 30, 2004, respectively, compared to \$94.9 million and \$238.0 million for the comparable periods in 2003. Comprehensive income (loss) consists of net income of \$52.5 million and \$155.9 million and other comprehensive (loss) of \$(55.8) million and \$(61.0) million for the three and nine months ended September 30, 2004, respectively, and net income of \$52.9 million and \$157.3 million and other comprehensive income of \$45.1 million and \$80.7 million for the three and nine months ended September 30, 2003, respectively. Other comprehensive income consists of unrealized gains (losses) on available-for-sale securities, net of deferred taxes, reclassifications for net gains included in net income and foreign currency translation adjustments. The principal difference between net income and comprehensive net income is the net change in unrealized gains (losses) on available-for-sale securities.

Other than temporary impairments. At September 30, 2004, the Company's available-for-sale securities had unrealized losses of \$1.2 million. If it is determined that a security's net realizable value is other than temporary, a realized loss will be recognized in the statement of operations and the cost basis of the security reduced to its estimated fair value. The Company does not believe that the unrealized losses recorded at September 30, 2004 are other than temporary.

The Company recognized investment impairments of \$0.3 million and \$1.6 million for the three and nine months ended September 30, 2004, respectively, and \$0.3 million and \$6.1 million for the three and nine months ended September 30, 2003, respectively, which the Company believed were other than temporary. The impairments related primarily to investments available for sale in the Investment and Other Segment. A decline in a security's net realizable value that is other than temporary is treated as a loss based on quoted market value and is reflected in the Other income, net line in the statement of income.

Seasonality. Generally, the Company does not have significant seasonal fluctuations in its business operations. Processing and output solutions volumes for mutual fund and corporate securities transfer processing customers are usually highest during the quarter 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.

Recently Issued Accounting Standards

In August 2003, the Company issued \$840 million aggregate principal amount of convertible senior debentures, consisting of \$540 million of 4.125% Series A convertible senior debentures due 2023 and \$300 million aggregate principal amount of 3.625% Series B convertible senior debentures due 2023. The debentures are convertible under specified circumstances into shares of the Company's common stock at a conversion rate of 20.3732 shares per \$1,000 principal amount of debentures (which is equal to an initial conversion price of \$49.08 per share), subject to adjustment.

The debentures are contingently convertible into shares of the Company's common stock during any calendar quarter (and only during such calendar quarter) if the closing price of the Company's common stock, for at least 20 trading days during a period of 30 consecutive trading days ending on the last trading day of the previous calendar quarter, is greater than or equal to 120% of the applicable conversion price (\$58.90 per share).

Upon conversion, the Company will have the right to deliver, in lieu of shares of its common stock, cash or a combination of cash and shares of common stock. If all \$840 million of convertible senior debentures were converted into common stock, the Company would need to issue approximately 17.1 million shares of common stock, subject to adjustment. The Company intends to settle the conversions with cash for the principal and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amounts.

Under current generally accepted accounting principles, the Company's calculation of diluted earnings per share would not include any incremental shares from assumed conversions of the convertible debentures until such time that the Company's common stock exceeded the contingent conversion price of \$58.90 per share for the time periods specified above. At that point, the Company would include incremental shares assumed to be issued for the conversion value of the bonds (value over \$49.08 per share) in the calculation of diluted earnings per share. This is commonly referred to as the "net share settlement method" of accounting for the conversion spread.

There are two proposed accounting standards that can impact the way the Company calculates diluted earnings per share regarding incremental shares to be issued from the assumed conversion of the convertible debentures. The first proposed standard is EITF Topic 04-08, "Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share." Under EITF 04-08, a company would need to include the effects of contingently convertible bonds in diluted earnings per share from the date of issuance, without considering the impact of the conversion price. Under EITF 04-08, the Company can still utilize the "net share settlement method" of calculating shares for the conversion premium if it intends to settle the principal amount of the bonds in cash and any excess value with shares of its common stock. The impact of EITF 04-08 to DST is that the calculation of diluted earnings per share would begin to include an incremental amount of shares assumed to be issued for the conversion spread if the Company's stock price at the end of a quarter exceeds \$49.08 per share. EITF 04-08 is expected to be issued in final form in the latter part of 2004, with a fourth quarter effective date. The Company does not believe EITF 04-08 would have impacted the Company's calculated diluted earnings per share for any historical periods. EITF 04-08 will affect the Company's calculation of diluted earnings per share if the Company's share price is between \$49.08 and \$58.90 per share.

The second proposed standard involves an amendment to SFAS 128, "Earnings per Share." The proposed amendment, which is designed for convergence with international accounting standards, would require the use of the "if-converted" method from the date of issuance of the convertible bond. The proposed amendment will remove the ability of a company to overcome the presumption that the convertible securities will be satisfied by full conversion into shares of common stock. Accordingly, the Company's intention to settle the conversions with cash for the principal and accrued and unpaid interest and issue common stock for any conversion value amount over the principal and accrued and unpaid interest amounts, would no longer be accepted under SFAS 128. The proposed amendment to SFAS 128 is expected to become effective in the fourth quarter of 2004, and would require retroactive restatement of a company's diluted earnings per share calculations. Under the proposed amended SFAS 128 "if converted" method, in calculating diluted earnings per share, the Company will need to increase net income for the interest expense associated with the convertible debentures, net of tax, and increase the incremental shares assumed to be issued upon conversion to 17.1 million shares. Under this method, diluted earnings per share would have been \$0.57 and \$1.68 for the three and nine months ended September 30, 2004. Diluted earnings per share would have been \$2.69 for the year ended December 31, 2003 as compared to the reported amount of \$2.77.

At a recent meeting, the FASB unanimously voted for proposed accounting standards relating to equity-based compensation to be effective for fiscal periods beginning after June 15, 2005 (July 1, 2005 for the Company). An exposure draft was released in the first quarter of 2004 and the final standard is expected to be issued in 2004. The accounting standard is expected to require all companies to utilize the fair value method of accounting for equity-based compensation in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation." Companies can currently voluntarily adopt SFAS No. 123, using a variety of adoption methods. DST is currently evaluating the impact of the proposed accounting standards and the adoption alternatives provided under both the current standards and the proposed standards. DST discloses the pro forma impact of stock based compensation on its earnings in its notes to financial statements.

In December 2003, the FASB issued an exposure draft that would amend the computational guidance in SFAS No. 128, "Earnings per Share," for calculating the number of incremental shares included in diluted shares when applying the treasury stock method. Also, this proposed Statement would eliminate the provisions of SFAS No. 128 that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock. In addition, this proposed Statement would require that shares that will be issued upon conversion of a mandatorily convertible security be included in the weighted-average number of ordinary shares outstanding used in computing basic earnings per share from the date when conversion becomes mandatory. This Statement will be effective for fiscal periods beginning after December 15, 2004 (January 1, 2005 for the Company). After the effective date, all prior-period earnings per share data presented shall be adjusted retrospectively (including interim financial statements, summaries of earnings and selected financial data) to conform with the provisions of this Statement. At this time, DST does not believe any prior period adjustments will result from the exposure draft. If this Statement is finalized in its current form, DST will be required to include the shares from the convertible debentures as dilutive in its calculation of earnings per share.

Company-Specific Trends and Risks

Dependence on Certain Industries

The Company derives a substantial proportion of its consolidated revenues from the delivery of services and products to clients that are publicly traded corporations, mutual funds, investment managers, insurance companies, banks, brokers, or financial planners or are in the video/broadband, direct broadcast satellite, wire-line, wireless and cellular, debt protection, Internet protocol telephony, Internet, utility and other businesses. Consolidations which would decrease the number of potential clients in such businesses, events which would reduce the rate of growth in or negatively impact such businesses, or significant declines in the number of accounts or subscribers serviced by clients in such businesses could have a material adverse effect on the financial condition and results of operations of the Company.

Development of Technology

The Company is implementing and enhancing (a) a new stock transfer system ("Fairway") that will replace the existing systems used by its wholly-owned subsidiary EquiServe, Inc. to maintain corporate stock transfer records, (b) a new subscriber management system, Collabrent, that will replace the existing systems used by its wholly-owned subsidiaries DST Interactive, Inc. and DST Innovis, Inc. to maintain cable and satellite TV subscriber records and (c) new proprietary systems for MAP and OpenPFA that are designed to facilitate the distribution, investment management, trading, reconciliation and reporting for managed accounts. Failure to successfully complete development and implementation of Fairway, Collabrent, MAP or OpenPFA, to successfully convert new or existing clients to such systems, or to successfully complete and implement various other current technology projects could have a material adverse effect on the financial condition and results of operations of the Company.

Impact of Technological and Market Changes

The Company's clients use computer technology-based products and services in the complex and rapidly changing markets in which they operate. The technology available to the Company's clients, such as methods for the electronic dissemination of documents, is expanding. The Company's future success depends in part on its ability to continue to develop and adapt its technology, on a timely and cost effective basis, to meet clients' needs and demands for the latest technology. There can be no assurance that the Company will be able to respond adequately and in advance of its competitors to these technological demands or that more advanced technology, including technology for the electronic dissemination of documents, will not reduce or replace the need for certain of the Company's products and services.

Similarly, certain of the Company's clients provide services related to communications devices and/or the communications industry. The communications industry, and wireless communication devices in particular, are rapidly evolving. The future success of the Company's business of providing administrative services to clients in the

communications industry depends in part on the Company's ability to continue to develop and adapt its services, on a timely and cost effective basis, to meet clients' needs and demands for administrative services appropriate to the latest communications technology.

The Company has expended considerable funds to develop products to serve new and rapidly changing markets. If such markets grow or converge more slowly than anticipated or the Company's products and services fail to achieve market acceptance, there could be a material adverse effect on the financial condition and results of operations of the Company.

The Company significantly invests in available-for-sale equity securities of other companies. The value of such securities depends on the market for such securities and on changes in the markets in which such other companies operate. Any significant decline in the value of the Company's equity investments could have a material adverse effect on the financial condition and results of operations of the Company.

Reliance on Facilities

The Company's processing services are primarily dependent on facilities housing central computer operations or in which information, image or bill and statement processing occur. The Company's mutual fund full service, corporate stock transfer and insurance, warranty and debt protection administrative service businesses are dependent on call centers in various locations. The Company owns, leases and manages real estate. A natural disaster, terrorist act or other calamity that causes long-term damage to the Company's facilities, or economic or other events impacting the real estate markets in which the Company owns, leases or manages real estate, could have a material adverse effect on the financial condition and results of operation of the Company.

Reliance on Insurers

Currently, the Company's business of providing administrative services in connection with the insurance, warranty, and debt protection services of its clients significantly depends upon its business relationships with one or more insurance companies that provide coverage necessary for the clients' products and services. Termination of the business relationships with these insurance companies could have a material adverse effect on the financial condition and results of operations of the Company if the Company were unable to arrange alternative sources of coverage.

Importance of Key Personnel

The Company's operations and the continuing implementation of its business strategy depend upon the efforts of its technical personnel and senior management. Recruiting and retaining capable personnel, particularly those with expertise in the types of computer hardware and software utilized by the Company, are vital to the Company's success. There is substantial competition for qualified technical and management personnel, and there can be no assurance that the Company will be able to attract or keep the qualified personnel it requires. The loss of key personnel or the failure to hire qualified personnel could have a material adverse effect on the financial condition and results of operations of the Company.

Lack of Control of Joint Ventures

The Company's business strategy for growth and expansion includes reliance on joint ventures. The Company derives part of its net income from its pro rata share in the earnings of these unconsolidated companies. Although the Company owns significant equity interests in such companies and has representation on their Boards of Directors or governance structures, the Company is not in a position to exercise control over their operations, strategies or financial decisions without the concurrence of its equity partners. The Company's equity interests in BFDS, Argus Health Systems, Inc., and International Financial Data Services Limited Partnership and International Financial Data Services Limited (collectively, "IFDS") are subject to contractual buy/sell arrangements that may restrict the Company's ability to fully dispose of its interest in these companies and that under certain circumstances permit such companies to purchase the Company's interest.

The other parties to the Company's current and future joint venture arrangements may at any time have economic, business or legal interests or goals that are inconsistent with those of the joint venture or of the Company. In addition, if such other parties were unable to meet their economic or other obligations to such ventures, it could, depending upon the nature of such obligations, adversely affect the financial condition and results of operations of the Company.

Significant Competition from Other Providers

The Company and its subsidiaries and joint ventures encounter significant competition for the Company's services and products from other third-party providers of similar services and products and from potential clients who have chosen not to outsource certain services the Company could provide. The Company's ability to compete effectively depends, in part, on the availability of capital and other resources, and some of these competitors have greater resources and greater access to capital than the Company. The Company also competes for shareowner accounting services with brokerage firms that perform sub-accounting services for the brokerage firms' customers who purchase or sell shares of mutual funds for which the Company serves as transfer agent. Such brokerage firms maintain only an "omnibus" account with the Company representing the aggregate number of shares of a mutual fund owned by the brokerage firms' customers, thus resulting in fewer mutual fund shareowner accounts being maintained by the Company. Any of these events could have a material adverse effect on the financial condition and results of operations, including gross profit margins, of the Company. In addition, competitive factors could influence or alter the Company's overall revenue mix between the various business Segments.

Regulation

As registered transfer agents, the Company, its subsidiary EquiServe, its indirect subsidiary, EquiServe Trust Company, N.A. ("EquiServe Trust"), its joint venture BFDS and BFDS' subsidiary National Financial Data Services, Inc. (collectively, "Domestic Transfer Agent Businesses") are subject to the Securities Exchange Act of 1934, as amended (the "Exchange Act") and to the rules and regulations of the Securities and Exchange Commission ("SEC") under the Exchange Act which require them to register with the SEC and which impose on them recordkeeping and reporting requirements. Certain of the operations and records of the Domestic Transfer Agent Businesses are subject to examination by the SEC and, as providers of services to financial institutions, to examination by bank and thrift regulatory agencies. In connection with its transfer agency business, EquiServe Trust serves as a limited purpose trust company subject to regulation of the Office of the Comptroller of the Currency. In addition, companies wholly owned by IFDS ("IFDS Transfer Agent Businesses") are subject to regulation of similar regulatory agencies in other countries. Any of the Domestic Transfer Agent Businesses or IFDS Transfer Agent Businesses could have its regulatory authorizations suspended or revoked if it were to materially violate applicable regulations, which could have an adverse effect on the financial condition and results of operations of the Company.

Similarly, certain of the Company's subsidiaries involved in the business of providing administrative services in connection with insurance and warranty products are licensed insurance agencies or licensed or registered service warranty providers and, as such, are subject to applicable state insurance and service warranty laws and to related rules and regulations. These laws and regulations impose on them recordkeeping, reporting, financial, and other requirements and generally regulate the conduct of regulated business operations. In the event any of the subsidiaries materially violate any of these applicable laws or regulations, their regulatory authorizations could be suspended or revoked, which could have a material adverse effect on the financial condition and results of operations of the Company.

The Company's existing and potential clients are subject to extensive regulation. Certain of the Company's customers are subject to federal and state regulation of investment advisors and broker/dealers. Certain of the Company's clients are also subject to federal and state regulations governing the privacy and use of the customer information that is collected and managed by the Company's products and services. Certain of the Company's revenue opportunities may depend on continued deregulation in the worldwide communications industry. Regulatory changes that adversely affect the Company's existing and potential clients, or material violation of regulatory requirements by clients, could diminish the business prospects of such clients. If such conditions were to materially, adversely affect the business of a material client or a material group of the Company's clients, such conditions could have a material adverse effect on the financial condition and results of operations of the Company.

Transfer Agency Investments

Certain of the Company's transfer agency businesses invest client funds in greater than one year investments. If the businesses were required by the clients to draw on the investments in excess of the amount of balances invested in immediately liquid assets, the Company could be required or may be forced to liquidate such investments, or a portion thereof, and the Company may be required to recognize what otherwise may be an unrealized loss.

Interest Earnings as a Portion of Revenue

The Company's transfer agent businesses derive a certain amount of service revenue from investment earnings related to cash balances maintained in transfer agency customer bank accounts. The balances maintained in the bank accounts are subject to fluctuation. A change in interest rates could have a material adverse effect on the financial condition and results of operations of the Company.

Anti-Takeover Considerations

Some provisions of the Company's Certificate of Incorporation could make it more difficult for a third party to acquire control of the Company, even if the change of control would be beneficial to certain stockholders. The Company has also adopted a stockholders' rights plan, which could delay, deter or prevent a change in control of the Company. A few of the Company's client agreements allow the client to terminate its agreement or to obtain rights to use the Company's software used in processing the client's data in the event of an acquisition or change of control of the Company. In the event of a change in control of the Company (as defined in the applicable plan or agreement), vesting of awards (including stock options, restricted stock, and rights to receive stock as deferred compensation) under the Company's Stock Option and Performance Award Plan will be automatically accelerated, certain limited rights related to stock options will become exercisable, and employment continuation provisions will apply under the employment agreements of certain executive officers. Certain of the Company's joint venture agreements allow other parties to the joint venture to buy the Company's joint venture interests in the event of a change of control of the Company.

Non-U.S. Operations

Consolidated revenues from the Company's subsidiaries in Canada, Europe and elsewhere outside the U.S. account for a percentage of the Company's revenues. The Company's current and proposed international business activities are subject to certain inherent risks, including but not limited to, specific country, regional or global economic conditions, exchange rate fluctuation and its impact on liquidity, change in the national priorities of any given country, and cultural differences. There can be no assurance that such risks will not have a material adverse effect on the Company's future international sales and, consequently, the Company's financial condition and results of operations.

Variability of Quarterly Operating Results

The Company's quarterly and annual operating results may fluctuate from quarter to quarter and year to year depending on various factors, including but not limited to the impact of significant start-up costs associated with initiating the delivery of contracted services to new clients, the hiring of additional staff, new product development and other expenses, introduction of new products by competitors, pricing pressures, the evolving and unpredictable nature of the markets in which the Company's products and services are sold, and general economic conditions.

Client Failure to Renew or Utilize Contracts

Substantially all of the Company's revenue is derived from the sale of services or products under long-term contracts with its clients. The Company does not have the unilateral option to extend the terms of such contracts upon their expiration. Certain of the Company's service agreements contain "termination for convenience" clauses that enable clients to cancel the agreements by providing written notice to the Company a specified number of days prior to the

desired termination date. Such clauses are sometimes coupled with a requirement for payment by the client of a fee in the event of termination for convenience. In addition, under certain of the Company's agreements, the fees the Company receives are dependent on utilization rates for the Company's services. The failure of clients to renew contracts, a reduction in usage by clients under any contracts or the cancellation of contracts could have a material adverse effect on the Company's financial condition and results of operations.

Dependence on Proprietary Technology

The Company relies on a combination of patent, trade secret and copyright laws, nondisclosure agreements, and other contractual and technical measures to protect its proprietary technology. There can be no assurance that these provisions will be adequate to protect its proprietary rights. There can be no assurance that third parties will not assert infringement claims against the Company or the Company's clients or that such claims, if brought, would not have a material adverse effect on the financial condition and results of operations of the Company.

Security of Proprietary Customer Information

The Company's business involves the electronic recordkeeping of proprietary information of the Company's customers, and of the clients of such customers. The Company maintains systems and procedures to protect against unauthorized access to such information and against computer viruses ("Security Systems"), and there is no guarantee that the Security Systems are adequate to protect against all security breaches. Rapid advances in technology make it impossible to anticipate or be prepared to address all potential security threats. A material breach of Security Systems could cause the Company's customers to reconsider use of the Company's services and products, affect the Company's reputation, or otherwise have a material adverse effect on the Company's financial condition and results of operations.

Dilution of Company Common Stock

In August 2003, the Company issued \$840 million aggregate principal amount of convertible senior debentures. The debentures are under specified circumstances convertible into shares of the Company's common stock at a conversion rate of 20.3732 shares per \$1,000 principal amount of debentures, subject to adjustment. Each series of debentures are convertible under any of the following circumstances: (1) during any calendar quarter (and only during such calendar quarter) if the closing price of the Company's common stock, for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the previous calendar quarter, is greater than or equal to 120% of the applicable conversion price; (2) subject to certain exceptions, during the five business day period after any five consecutive trading-day period in which the trading price per \$1,000 original principal amount of the applicable series of debentures for each day of that period was less than 95% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such day; (3) if the Company call the debentures for redemption; or (4) upon the occurrence of specified corporate transactions. Upon conversion, the Company will have the right to deliver, in lieu of shares of its common stock, cash or a combination of cash and shares of common stock. The debentures, if converted into common stock, would have a potentially dilutive effect on the Company's common stock.

Under the Company's Employee Stock Purchase Plan, employees have a right, subject to certain limits, to purchase Company common stock at 85% of the lower of the average market price of the stock on the exercise date or the offering date. Under the Company's Stock Option and Performance Award Plan, the Company issues to directors and employees options to purchase shares of the Company's common stock, restricted shares and other equity awards. Purchases under the Employee Stock Purchase Plan, exercises of options, and the granting of equity awards could have a dilutive effect on the Company's common stock.

A change of control under the Company's stockholders' rights plan would cause the issuance of rights to purchase 1/1000th shares of preferred stock of the Company for each share of Company common stock, or, in some circumstances, other securities of the Company, which could have a dilutive effect on the Company's common stock.

Miscellaneous

In addition to the factors noted above, there may be other factors that cause any forward-looking comment to become inaccurate. One such factor is litigation and claims involving the Company, including routine litigation and claims involving transfer agency operations in which the plaintiffs or claimants allege that errors or delays in transaction processing cause damages based on factors such as unfavorable changes in the market value of securities processed and including class action claims based upon various regulatory rules and consumer protection statutes with respect to which class action plaintiffs may attempt to assert private rights of action. Other factors include, but are not limited to, accounting or other fraud that may occur with respect to the financial statements or business of a financial service provider or other client of the Company, changes in management strategies, changes in lines of business or markets, failure of anticipated opportunities to materialize, changes in the cost of necessary supplies, changes in accounting principles, and changes in the economic, political or regulatory environments in the United States and/or the other countries where the Company now competes or may compete in the future.

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 September 30, 2004 was \$1.2 billion. The impact of a 10% change in fair value of these investments would be approximately \$75.6 million to comprehensive income. As discussed under "Comprehensive income (loss)" above, net unrealized gains on the Company's investments in available-for-sale securities have had a material effect on the Company's comprehensive income 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 transfer agency customer bank accounts that the Company is agent to. The balances maintained in the bank accounts are subject to fluctuation. At September 30, 2004, the Company and its joint ventures had approximately \$3.2 billion of cash balances maintained in such accounts, of which \$127.1 million is included in current assets and \$149.7 million is included in non-current assets on the Company's balance sheet. The Company estimates that a 50 basis point change in interest earnings rate would be approximately \$6.8 million of net income (loss).

At September 30, 2004, the Company had \$1,418 million of debt, of which \$556.1 million was subject to variable interest rates (Federal Funds rates, LIBOR rates, Prime rates). 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.

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 and Australian dollar. Currency exchange rate fluctuations have not historically materially affected the consolidated financial results of the Company. At September 30, 2004, the Company's international subsidiaries had approximately \$220 million in total assets and for the quarter ended September 30, 2004, these international subsidiaries produced approximately \$13 million in net income. The Company estimates that a 10% change in exchange rates would increase or decrease total assets by approximately \$22 million and would increase or decrease net income by approximately \$1.3 million.

The Company's international subsidiaries use the local currency as the functional currency. The Company translates all assets and liabilities at year-end exchange rates and 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

As of the end of the fiscal quarter for which this quarterly report on Form 10-Q is filed, the Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (i) are effective for recording, processing, summarizing and reporting, within the time periods specified in the Securities and Exchange Commission's rules and forms, the information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934, and (ii) include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. There has been no change in the Company's internal control over financial reporting that occurred during the fiscal quarter for which this quarterly report on Form 10-Q is filed that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is from time to time a party to litigation arising in the ordinary course of its business. Currently, there are no legal proceedings that management believes would have a material adverse effect upon the consolidated results of operations or financial condition of the Company.

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 quarter ended September 30, 2004.

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid Per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs</u>
July 1-July 31	133,623 (1)	\$45.76	132,000	4,968,000 (2)
August 1-August 31	315,747 (1)	\$44.43	304,000	4,664,000 (2)
September 1-September 30	140,605 (1)	\$45.72	130,500	4,533,500 (2)

- (1) For the three months ended September 30, 2004, the Company purchased, in accordance with the 1995 Stock Option and Performance Award Plan, 23,475 shares of its common stock for participant income tax withholding in conjunction with stock option exercises, as requested by the participants. These purchases were not made under the publicly announced repurchase plans or programs. Of these shares, 1,623 shares were purchased in July, 11,747 shares were purchased in August and 10,105 shares were purchased in September.
- (2) On February 26, 2004, the Company's Board of Directors authorized a stock repurchase plan allowing but not requiring the repurchase of up to 6 million shares of Company common stock in open market and private transactions during the period beginning March 1, 2004 through February 28, 2007. On October 19, 2004, the Company's Board of Directors authorized an additional 5.5 million share repurchase to the plan. These shares are not included in the table since they were not authorized during the period ending September 30, 2004.

Item 3. Defaults Upon Senior Securities

None.

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

None.

If a stockholder desires to have a proposal included in DST's Proxy Statement for the annual meeting of stockholders to be held in 2005, the Corporate Secretary of DST must receive such proposal on or before December 1, 2004, and the proposal must comply with the applicable SEC laws and rules and the procedures set forth in the DST By-laws.

Item 5. Other Information

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

	September 30, 2004	December 31, 2003
Financial Services Operating Data		
Mutual fund shareowner accounts processed (millions)		
U.S.		
Non-retirement accounts	55.3	54.0
IRA mutual fund accounts	24.7	23.7
TRAC mutual fund accounts	6.3	6.1
Section 529 and Educational IRA's	4.7	4.1
	<u>91.0</u>	<u>87.9</u>
International		
United Kingdom (1)	4.7	4.6
Canada (2)	3.0	2.7
TRAC participants (millions)	3.7	3.5
Security transfer accounts processed (millions)	19.5	22.9
Automated Work Distributor workstations (thousands)	93.8	87.0
lock\line supported consumers (millions)	24.8	19.8
Customer Management Operating Data		
Video/broadband/satellite TV subscribers processed (millions)		
U.S.	31.0	30.4
International	6.2	8.9
	For the Nine Months Ended September 30,	
	2004	2003
Output Solutions Operating Data		
Images produced (millions)	6,391	6,933
Items mailed (millions)	1,225	1,281

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

(2) Processed by International Financial Data Services, (Canada) Limited, an unconsolidated affiliate of the Company.

Item 6. Exhibits

(a) Exhibits:

- 31.1 Certification of Thomas A. McDonnell, Chief Executive Officer of Registrant
- 31.2 Certification of Kenneth V. Hager, Chief Financial Officer of Registrant
- 32 Certification Pursuant to 18 U.S.C. Section 1350 of Thomas A. McDonnell, Chief Executive Officer of Registrant and Kenneth V. Hager, Chief Financial Officer of Registrant

Exhibit 32 shall not be deemed “filed” for the purposes of or otherwise subject to the liabilities under Section 18 of the Securities Exchange Act of 1934 and shall not be deemed to be incorporated by reference into the filings of the Company under the Securities Act of 1933.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, and in the capacities indicated, on November 9, 2004.

DST Systems, Inc.

/s/ Kenneth V. Hager

Kenneth V. Hager

Vice President, Chief Financial Officer and Treasurer

(Principal Financial Officer)