

AFFILIATED COMPUTER SERVICES INC

Form 10-Q

November 07, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

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

For the period from _____ to _____

Commission file number 001-12665

AFFILIATED COMPUTER SERVICES, INC.

(Exact name of registrant as specified in its charter)

Delaware

51-0310342

(State or other jurisdiction of incorporation or organization)

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

2828 North Haskell, Dallas, Texas

75204

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code (214) 841-6111

Not Applicable

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Title of each class

**Number of shares outstanding as of
October 29, 2008**

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Class A Common Stock, \$.01 par value	90,951,472
Class B Common Stock, \$.01 par value	6,599,372

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PART I
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS
AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands)

	September 30, 2008	June 30, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 434,815	\$ 461,883
Accounts receivable, net	1,459,272	1,378,285
Income taxes receivable		7,076
Prepaid expenses and other current assets	261,953	255,872
Total current assets	2,156,040	2,103,116
Property, equipment and software, net	897,785	920,637
Goodwill	2,764,591	2,785,164
Other intangibles, net	428,356	444,479
Other assets	199,121	216,003
Total assets	\$ 6,445,893	\$ 6,469,399
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 197,167	\$ 198,191
Accrued compensation and benefits	154,443	244,888
Other accrued liabilities	354,351	338,861
Income taxes payable	21,493	
Deferred taxes	83,072	82,017
Current portion of long-term debt	46,978	47,373
Current portion of unearned revenue	172,921	173,809
Total current liabilities	1,030,425	1,085,139
Senior Notes, net of unamortized discount	499,549	499,529
Other long-term debt	1,824,143	1,858,012
Deferred taxes	424,812	411,836
Other long-term liabilities	299,719	306,509
Total liabilities	4,078,648	4,161,025

Commitments and contingencies (See Note 11)

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Stockholders' equity:

Class A common stock, \$.01 par value, 500,000 shares authorized, 111,803 and 111,660 shares issued, respectively	1,117	1,116
Class B convertible common stock, \$.01 par value, 14,000 shares authorized, 6,600 shares issued and outstanding	66	66
Additional paid-in capital	1,714,701	1,702,340
Accumulated other comprehensive income (loss), net	(18,296)	18,830
Retained earnings	1,725,625	1,641,990
Treasury stock at cost, 21,002 shares	(1,055,968)	(1,055,968)
 Total stockholders' equity	 2,367,245	 2,308,374
 Total liabilities and stockholders' equity	 \$ 6,445,893	 \$ 6,469,399

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

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CONSOLIDATED STATEMENTS OF INCOME****(UNAUDITED)****(in thousands, except per share amounts)**

	Three months ended September 30,	
	2008	2007
Revenues	\$ 1,604,454	\$ 1,493,083
Operating expenses:		
Cost of revenues:		
Wages and benefits	734,016	699,949
Services and supplies	373,505	341,766
Rent, lease and maintenance	202,143	184,918
Depreciation and amortization	97,606	90,824
Other	10,348	6,915
Cost of revenues	1,417,618	1,324,372
Other operating expenses	14,088	23,310
Total operating expenses	1,431,706	1,347,682
Operating income	172,748	145,401
Interest expense	35,208	43,970
Other non-operating expense (income), net	3,700	(680)
Pretax profit	133,840	102,111
Income tax expense	50,205	35,967
Net income	\$ 83,635	\$ 66,144
Earnings per share:		
Basic	\$ 0.86	\$ 0.66
Diluted	\$ 0.85	\$ 0.65
Shares used in computing earnings per share:		
Basic	97,307	99,721

Diluted

98,091

100,986

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

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AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

	Three months ended	
	September 30,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 83,635	\$ 66,144
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	97,606	90,824
Stock-based compensation expense	5,695	7,601
Excess tax benefit on stock-based compensation	(80)	(1,955)
Deferred income tax expense	14,319	3,791
Loss on long-term investments	5,987	1,853
Gain on sale of business units	(441)	
Other non-cash activities	12,054	6,846
Changes in assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(84,192)	(130,635)
Prepaid expenses and other current assets	(13,257)	(4,222)
Other assets	1,840	(3,598)
Accounts payable	(1,202)	51,547
Accrued compensation and benefits	(90,483)	(106,925)
Other accrued liabilities	9,564	(2,796)
Income taxes receivable/payable	29,301	36,322
Other long-term liabilities	(8,988)	5,058
Unearned revenue	1,244	(11,832)
Total adjustments	(21,033)	(58,121)
Net cash provided by operating activities	62,602	8,023
Cash flows from investing activities:		
Purchases of property, equipment and software, net	(64,550)	(65,841)
Additions to other intangible assets	(9,541)	(9,481)
Payments for acquisitions, net of cash acquired	(4,751)	(23,697)
Proceeds from divestitures, net of transaction costs	9,307	
Purchases of investments	(2,596)	
Proceeds from sale of investments	10,551	
Net cash used in investing activities	(61,580)	(99,019)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt, net		22,961
Payments of long-term debt	(33,688)	(22,365)

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Excess tax benefit on stock-based compensation	80	1,955
Proceeds from stock options exercised	5,599	27,276
Other, net	(81)	(102)
Net cash provided by (used in) financing activities	(28,090)	29,725
Net decrease in cash and cash equivalents	(27,068)	(61,271)
Cash and cash equivalents at beginning of period	461,883	307,286
Cash and cash equivalents at end of period	\$ 434,815	\$ 246,015

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

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AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

We are a Fortune 500 and S&P 500 company with approximately 63,000 employees providing business process outsourcing and information technology services to commercial and government clients. We were incorporated in Delaware on June 8, 1988 and our corporate headquarters is located in Dallas, Texas. Our clients have time-critical, transaction-intensive business and information processing needs, and we typically service these needs through long-term contracts.

The consolidated financial statements are comprised of our accounts and the accounts of our controlled subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The financial information presented should be read in conjunction with our consolidated financial statements for the year ended June 30, 2008. The foregoing unaudited consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results of the interim period. The results for the interim period are not necessarily indicative of results to be expected for the year.

Significant accounting policies are detailed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008.

We present cost of revenues in our Consolidated Statements of Income based on the nature of the costs incurred. Substantially all these costs are incurred in the provision of services to our customers. The selling, general and administrative costs included in cost of revenues are not material and are not separately presented in the Consolidated Statements of Income.

2. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

The changes in the carrying amount of goodwill for the three months ended September 30, 2008 are as follows (in thousands):

	Commercial	Government	Total
Balance as of June 30, 2008	\$ 1,546,870	\$ 1,238,294	\$ 2,785,164
Acquisition activity during the period	(3)	2,843	2,840
Divestiture activity during the period		(2,834)	(2,834)
Foreign currency translation adjustments	(15,229)	(5,350)	(20,579)
Balance as of September 30, 2008	\$ 1,531,638	\$ 1,232,953	\$ 2,764,591

Approximately \$2.2 billion, or 78%, of the original gross amount of goodwill recorded is deductible for income tax purposes. The acquisition activity during the three months ended September 30, 2008 is primarily due to the payment of contingent consideration earned during the three months ended September 30, 2008 on a prior year acquisition. The divestiture activity during the three months ended September 30, 2008 is due to the sale of the bindery business as discussed in Note 10.

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AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following information relates to our other intangible assets (in thousands):

	As of September 30, 2008		As of June 30, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets:				
Acquired customer-related intangibles	\$ 424,489	\$ (177,969)	\$ 445,753	\$ (184,400)
Customer contract costs	251,423	(130,388)	251,837	(130,319)
All other	19,038	(13,125)	19,121	(12,401)
	\$ 694,950	\$ (321,482)	\$ 716,711	\$ (327,120)
Non-amortizable intangible assets:				
Title plant	\$ 51,045		\$ 51,045	
Tradename	3,843		3,843	
	\$ 54,888		\$ 54,888	

	Three months ended September 30,	
	2008	2007
Amortization:		
Contract inducements	\$ 3,872	\$ 3,727
Acquired customer-related intangibles	11,205	11,034
All other intangibles	8,213	6,364
Total amortization	\$ 23,290	\$ 21,125

Aggregate amortization includes amounts charged to amortization expense for customer-related intangibles and other intangibles, other than contract inducements. Amortization of contract inducements is recorded as a reduction of related contract revenue. Amortizable intangible assets are amortized over the related contract term. The amortization period of customer-related intangible assets ranges from 1 to 17 years, with a weighted average of approximately 9 years. The amortization period for all other intangible assets, including trademarks, ranges from 3 to 20 years, with a weighted average of approximately 5 years.

Estimated amortization for the years ending June 30, (in thousands)

2009	\$87,864
2010	73,555
2011	62,212
2012	43,250
2013	29,784

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AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

3. PENSION AND OTHER POST-EMPLOYMENT PLANS*Net periodic benefit cost*

The following table provides the components of net periodic benefit cost (in thousands):

	Three months ended September 30,			
	2008		2007	
	Non-U.S.	U.S.	Non-U.S.	U.S.
<u>Components of net periodic benefit cost</u>				
Defined benefit plans:				
Service cost	\$ 1,732	\$ 894	\$ 1,528	\$ 926
Interest cost	1,994	191	1,632	123
Expected return on assets	(1,786)	(240)	(1,800)	(173)
Recognized net actuarial gain	1			
Amortization of prior service costs		55		54
Net periodic benefit cost for defined benefit plans	\$ 1,941	\$ 900	\$ 1,360	\$ 930

Contributions

We made contributions to the pension plans of approximately \$3.6 million during the three months ended September 30, 2008. We expect to contribute approximately \$15 million to our pension plans during fiscal year 2009.

4. EQUITY*Share repurchase programs*

On November 25, 2007, our Board of Directors endorsed a new \$1 billion share repurchase program and authorized the purchase of up to \$200 million of our Class A common stock under this program. The program allowed us to repurchase our shares on the open market, from time to time, in accordance with the requirements of the SEC rules and regulations, including shares that could be purchased pursuant to SEC Rule 10b5-1. The number of shares to be purchased and the timing of purchases will be based on the level of cash and debt balances, general business conditions, and other factors, including alternative investment opportunities. During the three months ended December 31, 2007, we repurchased approximately 4.5 million shares at an average cost of approximately \$44.18 per share (approximately \$200 million) all of which have been retired. The purchase of these shares was funded with cash on hand and borrowings under our Credit Facility.

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AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
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(UNAUDITED)

5. EARNINGS PER SHARE

In accordance with Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share, the following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended September	
	30,	
	2008	2007
Numerator:		
Net Income	\$ 83,635	\$ 66,144
Denominator:		
Basic weighted average shares	97,307	99,721
Effect of dilutive securities:		
Stock options	784	1,265
Total potential common shares	784	1,265
Diluted weighted average shares	98,091	100,986
Earnings per share		
Basic	\$ 0.86	\$ 0.66
Diluted	\$ 0.85	\$ 0.65

Additional dilution from assumed exercises of stock options is dependent upon several factors, including the market price of our common stock. Weighted average stock options to purchase approximately 9.6 million and 8.2 million shares of common stock during the three months ended September 30, 2008 and 2007, respectively, were outstanding but were not included in the computation of diluted earnings per share because the average market price of the underlying stock did not exceed the sum of the option exercise price, unrecognized compensation expense and the windfall tax benefit.

The calculation of diluted earnings per share requires us to make certain assumptions related to the use of proceeds that would be received upon the assumed exercise of stock options. These assumed proceeds include the excess tax benefit that we receive upon assumed exercises. We calculate the assumed proceeds from excess tax benefits based on the deferred tax assets actually recorded without consideration of as if deferred tax assets calculated under the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)).

6. COMPREHENSIVE INCOME

SFAS No. 130, Reporting Comprehensive Income (SFAS 130), establishes standards for reporting and display of comprehensive income and its components in financial statements. The objective of SFAS 130 is to report a measure of all changes in equity of an enterprise that result from transactions and other economic events of the period other than transactions with owners. Comprehensive income is the total of net income and all other non-owner changes within a company s equity.

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AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The components of comprehensive income are as follows (in thousands):

	Three months ended	
	September 30,	
	2008	2007
Net income	\$ 83,635	\$ 66,144
Other comprehensive income (loss):		
Foreign currency translation adjustment	(36,334)	11,743
Unrealized losses on foreign exchange forward agreements (net of income tax of \$(694) and \$(114), respectively)	(1,145)	(201)
Amortization of unrealized loss on forward interest rate agreements (net of income tax of \$240 and \$240, respectively)	396	396
Unrealized gains (losses) on interest rate swap agreement (net of income tax of \$159 and \$(4,489), respectively)	264	(8,014)
Unrealized losses on interest rate collar agreements (net of income tax of \$(207) and \$0, respectively)	(342)	
Amortization of prior service costs (net of income tax of \$20 and \$20, respectively)	35	34
Comprehensive income	\$ 46,509	\$ 70,102

The following table represents the components of accumulated other comprehensive income (in thousands):

	As of	As of
	September 30,	June 30,
	2008	2008
Foreign currency gains	\$ 5,668	\$ 42,002
Unrealized gains on foreign exchange forward agreements (net of income tax of \$259 and \$953, respectively)	510	1,655
Unrealized loss on forward interest rate agreements (net of income tax of \$(3,972) and \$(4,212), respectively)	(6,633)	(7,029)
Unrealized losses on interest rate swap agreement (net of income tax of \$(6,018) and \$(6,177), respectively)	(9,960)	(10,224)
Unrealized gains on interest rate collar agreements (net of income tax of \$572 and \$779, respectively)	947	1,289
Unrecognized prior service costs (net of income tax of \$(508) and \$(528), respectively)	(898)	(933)
Unrealized losses on funded status of pension and other benefit plans (net of income tax of \$(3,259) and \$(3,259), respectively)	(7,930)	(7,930)
Total	\$ (18,296)	\$ 18,830