

AFFILIATED COMPUTER SERVICES INC

Form 10-Q

February 14, 2003

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

(Mark One)

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

For the quarterly period ended December 31, 2002

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 0-24787

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

<u>Title of each class</u>	<u>Number of shares outstanding as of February 10, 2003</u>
Class A Common Stock, \$.01 par value	125,937,089
Class B Common Stock, \$.01 par value	6,599,372

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ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

	December 31, 2002 (Unaudited)	June 30, 2002 (Audited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 58,900	\$ 33,814
Accounts receivable, net	769,177	736,471
Inventory	8,837	9,740
Prepaid expenses and other current assets	92,673	94,464
	<u> </u>	<u> </u>
Total current assets	929,587	874,489
Property, equipment and software, net	430,965	394,830
Goodwill, net	1,855,598	1,846,482
Intangibles, net	238,703	234,287
Long-term investments and other assets	55,868	53,479
	<u> </u>	<u> </u>
Total assets	\$3,510,721	\$3,403,567
	<u> </u>	<u> </u>
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 47,143	\$ 72,858
Accrued compensation and benefits	98,381	125,290
Other accrued liabilities	251,654	210,003
Income taxes payable	18,057	20,452
Deferred taxes	22,068	7,344
Current portion of long-term debt	626	1,330
Current portion of unearned revenue	56,549	48,636
	<u> </u>	<u> </u>
Total current liabilities	494,478	485,913
Convertible notes	316,990	316,990
Long-term debt	301,911	391,243
Deferred taxes	123,259	95,394
Other long-term liabilities	31,475	18,607
	<u> </u>	<u> </u>
Total liabilities	1,268,113	1,308,147
	<u> </u>	<u> </u>
Stockholders' equity:		
Class A common stock	1,257	1,254
Class B common stock	66	66
Additional paid-in capital	1,334,367	1,330,533
Retained earnings	906,918	763,567
	<u> </u>	<u> </u>
Total stockholders' equity	2,242,608	2,095,420
	<u> </u>	<u> </u>

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Total liabilities and stockholders' equity	\$3,510,721	\$3,403,567
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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 INCOME
(UNAUDITED)
(in thousands, except per share amounts)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2002	2001	2002	2001
Revenues	\$ 929,164	\$ 750,427	\$ 1,827,040	\$ 1,405,446
Expenses:				
Wages and benefits	403,880	327,417	806,779	624,290
Services and supplies	264,546	224,707	506,331	397,578
Rent, lease and maintenance	86,944	65,980	171,279	138,860
Depreciation and amortization	35,717	27,499	71,859	51,914
Other operating expenses	13,111	7,403	26,171	13,841
Total operating expenses	<u>804,198</u>	<u>653,006</u>	<u>1,582,419</u>	<u>1,226,483</u>
Operating income	124,966	97,421	244,621	178,963
Interest expense	6,147	7,583	13,201	20,182
Other non-operating (income) expense, net	417	942	1,889	(374)
Pretax profit	<u>118,402</u>	<u>88,896</u>	<u>229,531</u>	<u>159,155</u>
Income tax expense	44,401	33,336	86,074	59,682
Net income	<u>\$ 74,001</u>	<u>\$ 55,560</u>	<u>\$ 143,457</u>	<u>\$ 99,473</u>
Earnings per common share:				
Basic	<u>\$.56</u>	<u>\$.47</u>	<u>\$ 1.09</u>	<u>\$.90</u>
Diluted	<u>\$.53</u>	<u>\$.42</u>	<u>\$ 1.03</u>	<u>\$.81</u>
Shares used in computing earnings per common share:				
Basic	132,175	118,572	132,124	110,076
Diluted	143,295	140,692	143,139	132,018

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)

	Six Months Ended December 31,	
	2002	2001
Cash flows from operating activities:		
Net income	\$ 143,457	\$ 99,473
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	71,859	51,914
Impairment of long-term investments	2,000	1,000
Other	5,880	1,549
Changes in assets and liabilities, net of effects from acquisitions:		
Increase in accounts receivable	(41,638)	(44,156)
(Increase) decrease in inventory	152	(3,606)
Increase in prepaid expenses and other current assets	(4,694)	(660)
Change in deferred taxes	42,412	20,745
(Increase) decrease in other long-term assets	2,498	(1,069)
Increase (decrease) in accounts payable	(25,716)	6,952
Decrease in accrued compensation and benefits	(27,152)	(23,858)
Increase in other accrued liabilities	42,453	25,065
Change in income taxes payable	1,287	17,869
Increase (decrease) in unearned revenue	15,792	(2,393)
Increase (decrease) in other long-term liabilities	4,989	(615)
Total adjustments	90,122	48,737
Net cash provided by operating activities	233,579	148,210
Cash flows from investing activities:		
Purchases of property, equipment and software, net of sales	(92,540)	(78,550)
Payments for acquisitions, net of cash acquired	(6,381)	(878,809)
Proceeds from divestitures, net of transaction costs	5,802	(3,401)
Proceeds from sale of investment	132	
Additions to other intangible assets	(25,819)	(8,523)
Additions to notes receivable	(2,871)	(2,823)
Proceeds received on notes receivable	7,555	2,395
Net cash used by investing activities	(114,122)	(969,711)
Cash flows from financing activities:		
Proceeds from issuance of debt	519,062	810,360
Repayments of debt	(613,567)	(911,468)
Proceeds from equity offering, net of transaction costs		715,392
Proceeds from stock options exercised	2,037	9,733
Other	(1,903)	(800)
Net cash provided (used) by financing activities	(94,371)	623,217

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Net increase (decrease) in cash and cash equivalents	25,086	(198,284)
Cash and cash equivalents at beginning of period	33,814	242,458
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	\$ 58,900	\$ 44,174
	<u> </u>	<u> </u>

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

The consolidated financial statements include the accounts of Affiliated Computer Services, Inc. (ACS) and its majority-owned subsidiaries. All material intercompany profits, transactions and balances have been eliminated. We are a Fortune 1000 company comprised of approximately 37,000 full-time equivalent employees in 48 countries providing business process and technology outsourcing solutions to commercial, state and local government and federal government clients.

The financial information presented should be read in conjunction with our consolidated financial statements for the year ended June 30, 2002. The foregoing unaudited consolidated financial statements reflect all adjustments (all of which are of a normal recurring nature) which are, in the opinion of management, necessary for a fair presentation of the results of the interim periods. The results for the interim periods are not necessarily indicative of results to be expected for the year.

All share and per share information is presented after giving effect to the two-for-one stock split of our Class A and Class B common shares declared on January 22, 2002, paid on February 22, 2002 in the form of a stock dividend to shareholders of record as of February 15, 2002.

Significant accounting policies are detailed in our Annual Report on Form 10-K for the year ended June 30, 2002. For discussion of our critical accounting policies, please refer to Management's Discussion and Analysis of Financial Condition and Results of Operations.

2. DEBT

In September 2002, we entered into a new \$875 million senior unsecured revolving credit facility with a term of 39 months. This new facility replaced our \$450 million credit facility and the \$375 million interim credit facility, which was used to fund the acquisition of AFSA Data Corporation (AFSA) in June 2002. The new revolving credit agreement provides for unsecured borrowings at floating rates and fees based upon LIBOR and ACS credit ratings. As a result, rates will fluctuate with both changes in the overall interest rate environment as well as changes in ACS credit ratings. Currently borrowings bear interest at LIBOR plus 0.575%, a facility fee of 0.175% per annum on the committed amount of the facility plus a usage fee of 0.125% per annum on the total amount of outstanding borrowings. After March 2003, the usage fee will be applicable only when borrowings exceed \$437.5 million. The agreement matures in December 2005 and contains certain financial covenants. As of December 31, 2002, we were in compliance with the covenants of our credit facility.

As of December 31, 2002, we had approximately \$404 million available for use under the new facility, after giving effect to outstanding letters of credit of \$170 million that secure certain contractual performance and other obligations.

3. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the quarter ended December 31, 2002 are as follow (in thousands):

	State and Local Government	Commercial	Federal Government	Total
Balance as of September 30, 2002	\$ 1,054,499	\$ 655,566	\$ 136,402	\$ 1,846,467
Goodwill activity during the quarter	42	9,089		9,131
Balance as of December 31, 2002	\$ 1,054,541	\$ 664,655	\$ 136,402	\$ 1,855,598

Current quarter activity primarily reflects contingent consideration due to former shareholders of a prior year acquisition. This contingent consideration has been subsequently paid in January.

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

The following information relates to our intangibles as of December 31, 2002 (in thousands):

	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Amortized intangible assets:		
Acquired customer related intangibles	\$ 146,600	\$(23,349)
Customer related intangibles	103,008	(40,341)
All other	4,011	(2,026)
	<u> </u>	<u> </u>
Total	\$253,619	\$(65,716)
	<u> </u>	<u> </u>
Unamortized intangible asset:		
Title plant	\$ 50,800	
	<u> </u>	
Total	\$ 50,800	
	<u> </u>	
Aggregate amortization:		
For the quarter ended December 31, 2002		\$ 8,504
For the six months ended December 31, 2002		\$17,290
Estimated amortization:		
For the year ended June 30, 2003		\$33,482
For the year ended June 30, 2004		\$30,397
For the year ended June 30, 2005		\$27,167
For the year ended June 30, 2006		\$22,074
For the year ended June 30, 2007		\$18,884

Amortization includes amounts charged to amortization expense for customer related intangibles and other intangibles, other than contract inducements. Amortization of contract inducements of \$1.7 million and \$2.9 million for the three and six months ended December 31, 2002, respectively, is recorded as a reduction to related contract revenue. Amortization expense for the three and six months ended December 31, 2002 includes approximately \$3.8 million and \$7.9 million, respectively, for acquired customer related intangibles. Customer related intangibles