

SUNGARD DATA SYSTEMS INC

Form 10-Q

August 06, 2004

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**United States**

**Securities and Exchange Commission**

**Washington, D.C. 20549**

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**FORM 10-Q**

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(Mark One)

**Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended June 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 1-12989**

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**SunGard<sup>®</sup> Data Systems Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**51-0267091**  
(IRS Employer  
Identification No.)

**680 East Swedesford Road, Wayne, Pennsylvania 19087**

(Address of principal executive offices, including zip code)

**484-582-2000**

(Registrant's telephone number, including area code)

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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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

There were 288,396,605 shares of the registrant's common stock, par value \$.01 per share, outstanding at June 30, 2004.

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**SUNGARD DATA SYSTEMS INC.**

**AND SUBSIDIARIES**

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**Table of Contents****Part I. FINANCIAL INFORMATION****Item 1. Financial Statements****SunGard Data Systems Inc.****Consolidated Balance Sheets****(In thousands, except per-share amounts)**

	June 30, 2004	December 31, 2003
	(unaudited)	
<b>Assets</b>		
Current:		
Cash and equivalents	\$ 312,058	\$ 478,941
Trade receivables, less allowance for doubtful accounts of \$55,562 and \$45,785	591,288	560,898
Earned but unbilled receivables	121,334	62,194
Prepaid expenses and other current assets	119,246	95,495
Assets to be disposed of	115,648	
Clearing broker assets	178,952	126,250
Deferred income taxes	51,171	39,514
	<u>1,489,697</u>	<u>1,363,292</u>
Total current assets		
Property and equipment, less accumulated depreciation of \$812,968 and \$744,264	590,405	562,325
Software products, less accumulated amortization of \$373,062 and \$335,175	359,139	220,091
Customer base, less accumulated amortization of \$180,963 and \$156,318	573,660	398,765
Other tangible and intangible assets, less accumulated amortization of \$23,919 and \$20,562	63,245	72,166
Deferred income taxes		29,070
Goodwill	1,796,514	1,354,398
	<u>4,872,660</u>	<u>4,000,107</u>
<b>Total Assets</b>		
<b>Liabilities and Stockholders Equity</b>		
Current:		
Short-term and current portion of long-term debt	\$ 49,723	\$ 12,943
Accounts payable	47,006	51,111
Accrued compensation and benefits	122,615	149,147
Other accrued expenses	227,827	195,828
Clearing broker liabilities	151,443	120,357
Deferred revenue	598,261	517,999
	<u>1,196,875</u>	<u>1,047,385</u>
Total current liabilities		
Long-term debt	651,797	186,854
Deferred income taxes	88,651	
	<u>1,937,323</u>	<u>1,234,239</u>
Total liabilities		

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Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value \$.01 per share; 5,000 shares authorized, of which 3,200 is designated as Series A Junior Participating Preferred Stock		
Common stock, par value \$.01 per share; 800,000 shares authorized; 290,897 and 288,536 shares issued	2,909	2,885
Capital in excess of par value	931,820	886,651
Restricted stock plans	(2,093)	(2,002)
Retained earnings	1,955,214	1,766,990
Accumulated other comprehensive income	113,417	111,344
	<b>3,001,267</b>	<b>2,765,868</b>
Treasury stock, at cost, 2,500 and 0 shares	(65,930)	
Total stockholders' equity	<b>2,935,337</b>	<b>2,765,868</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 4,872,660</b>	<b>\$ 4,000,107</b>

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

**Table of Contents****SunGard Data Systems Inc.****Consolidated Statements of Income****(In thousands, except per-share amounts)****(Unaudited)**

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
<b>Revenues:</b>				
Services	\$ 1,564,385	\$ 1,285,878	\$ 804,911	\$ 665,643
License and resale fees	125,434	86,348	69,670	49,635
Total products and services	1,689,819	1,372,226	874,581	715,278
Reimbursed expenses	49,549	36,298	24,138	18,685
	<b>1,739,368</b>	<b>1,408,524</b>	<b>898,719</b>	<b>733,963</b>
<b>Costs and expenses:</b>				
Cost of sales and direct operating	806,309	625,187	415,243	321,777
Sales, marketing and administration	322,506	261,332	158,862	131,866
Product development	119,813	91,682	60,889	49,636
Depreciation and amortization	108,010	111,486	54,653	55,258
Amortization of acquisition-related intangible assets	58,426	39,999	31,644	22,764
Merger costs	(424)	1,296	(424)	1,296
	<b>1,414,640</b>	<b>1,130,982</b>	<b>720,867</b>	<b>582,597</b>
Income from operations	324,728	277,542	177,852	151,366
Interest income	3,374	2,912	1,532	1,636
Interest expense	(14,393)	(5,301)	(7,199)	(3,533)
Income before income taxes	313,709	275,153	172,185	149,469
Income taxes	125,484	109,234	69,582	59,589
Net income	<b>\$ 188,225</b>	<b>\$ 165,919</b>	<b>\$ 102,603</b>	<b>\$ 89,880</b>
Basic net income per common share	<b>\$ 0.65</b>	<b>\$ 0.58</b>	<b>\$ 0.35</b>	<b>\$ 0.32</b>
Shares used to compute basic net income per common share	289,129	284,339	289,102	284,744
Diluted net income per common share	<b>\$ 0.64</b>	<b>\$ 0.57</b>	<b>\$ 0.35</b>	<b>\$ 0.31</b>
Shares used to compute diluted net income per common share	296,068	289,572	295,360	290,786

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

**Table of Contents****SunGard Data Systems Inc.****Consolidated Statements of Cash Flows****(In thousands)****(Unaudited)**

	Six Months Ended	
	June 30,	
	2004	2003
<b><i>Cash flow from operations:</i></b>		
Net income	\$ 188,225	\$ 165,919
Reconciliation of net income to cash flow from operations:		
Depreciation and amortization	166,436	151,485
Other noncash credits	(10,427)	(10,456)
Deferred income tax provision	20,452	9,092
Accounts receivable and other current assets	38,130	29,195
Accounts payable and accrued expenses	(93,023)	(79,816)
Clearing broker assets and liabilities, net	(21,647)	(3,029)
Deferred revenues	(10,636)	(184)
Cash flow from operations	<u>277,510</u>	<u>262,206</u>
<b><i>Financing activities:</i></b>		
Cash received from stock option and award plans	37,257	23,358
Cash used to purchase treasury stock	(65,930)	
Cash received from borrowings, net of fees	590,514	140,484
Cash used to repay debt	(146,794)	(49,384)
Cash provided by financing activities	<u>415,047</u>	<u>114,458</u>
<b><i>Investment activities:</i></b>		
Cash paid for acquired businesses, net of cash acquired	(749,016)	(328,054)
Cash received from sale of businesses	3,993	
Cash paid for property and equipment	(97,894)	(97,357)
Cash paid for software and other assets	(16,523)	(11,298)
Cash used in investment activities	<u>(859,440)</u>	<u>(436,709)</u>
Decrease in cash and equivalents	(166,883)	(60,045)
Beginning cash and equivalents	478,941	439,735
Ending cash and equivalents	<u>\$ 312,058</u>	<u>\$ 379,690</u>
<b><i>Supplemental information:</i></b>		
Acquired businesses:		
Property and equipment	\$ 27,291	\$ 8,492



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Software products	<b>163,707</b>	95,936
Purchased in-process research and development		910
Customer base	<b>201,665</b>	57,206
Goodwill	<b>521,087</b>	278,764
Other tangible and intangible assets	<b>7,914</b>	4,498
Deferred income taxes	<b>(78,606)</b>	(42,779)
Purchase price obligations and debt assumed	<b>(58,086)</b>	(6,696)
Net current liabilities assumed	<b>(35,956)</b>	(68,277)
	<hr/>	<hr/>
Cash paid for acquired businesses, net of cash acquired of \$148,595 and \$57,874, respectively	<b>\$ 749,016</b>	\$ 328,054
	<hr/>	<hr/>

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

**Table of Contents****SUNGARD DATA SYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****1. Basis of Presentation:**

SunGard Data Systems Inc. has three segments: Investment Support Systems (ISS), Availability Services (AS) and Higher Education and Public Sector Systems (HE/PS). The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany transactions and accounts have been eliminated.

The accompanying interim consolidated financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), consistent in all material respects with those applied in the Company's Annual Report on Form 10-K for the year ended December 31, 2003. Interim financial reporting does not include all of the information and footnotes required by GAAP for complete financial statements. The interim financial information is unaudited, but reflects all normal adjustments which are, in the opinion of management, necessary to provide a fair statement of results for the interim periods presented. Operating results for the six and three months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

**2. Acquisitions and Dispositions:****ACQUISITIONS:**

The Company seeks to grow through both internal development and the acquisition of businesses that broaden or complement its existing product lines. During the six months ended June 30, 2004, the Company completed five acquisitions in its ISS segment and three acquisitions in its HE/PS segment. Gross cash paid was \$883 million, subject to certain adjustments, and there was \$508 million of goodwill recorded in connection with these acquisitions, including the acquisition of Systems & Computer Technology Corporation (SCT) on February 12, 2004 for approximately \$574 million in cash. SCT is part of the HE/PS segment.

The following table lists the businesses the Company acquired since January 1, 2004:

<b><u>Acquired Company/Business</u></b>	<b>Date</b>	
	<b><u>Acquired</u></b>	<b><u>Description</u></b>
FAME Information Services, Inc.	01/22/04	Historical market and reference data, and data management technology.
Systems & Computer Technology Corporation	02/12/04	Global technology solutions for higher education.
Collegis, Inc.	03/04/04	Outsourced IT solutions for higher education.

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Real Time Financial Management Limited

03/05/04

Global bond and equity trading systems.

Derivatech Risk Solutions, Inc.

03/17/04

Foreign exchange derivative trading software solutions.

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<u>Acquired Company/Business</u>	<u>Date</u>	
	<u>Acquired</u>	<u>Description</u>
SBPA Systems, Inc.	05/10/04	Health claims administration software for third-party administrators and health-insurance companies.
Octigon, LLC	05/13/04	Workflow solutions add-in technology.
Open Software Solutions, Inc.	05/21/04	Public safety and justice software solutions.

At June 30, 2004, the purchase-price allocations to the assets acquired and liabilities assumed for SCT and Open Software Solutions, Inc. (OSSI) are preliminary and subject to finalization of independent appraisals of acquired software and customer base, deferred income taxes and facility integration plans. The preliminary purchase-price allocation for the SCT acquisition follows (in thousands):

	<u>June 30, 2004</u>
Property and equipment	\$ 22,803
Software products	113,329
Customer base	120,700
Goodwill	287,658
Other tangible and intangible assets	977
Deferred income taxes	(62,796)
Purchase price obligations and debt assumed	(16,981)
Net current liabilities assumed	(15,135)
	<u>          </u>
Cash paid, net of cash acquired of \$123,604	<u>\$ 450,555</u>

In connection with nine previously acquired businesses, up to \$195 million could be paid as additional consideration over the next two years depending on the future operating results of those businesses. The amounts paid, if any, are recorded as additional goodwill at the time the actual performance is known and the amounts become due. During each of the six months ended June 30, 2004 and 2003, the Company paid \$15 million as additional consideration based upon the operating performance of a business previously acquired.

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Changes in goodwill by segment during the six months ended June 30, 2004 follow (in thousands):

	<u>ISS</u>	<u>AS</u>	<u>HE/PS</u>	<u>Total</u>
Balances at December 31, 2003	\$ 627,903	\$ 618,148	\$ 108,347	\$ 1,354,398
2004 acquisitions	58,449		449,907	508,356
Adjustments to previous acquisitions	(358)	(1,533)	(379)	(2,270)
Payment of contingent purchase price	15,000			15,000
Reclassification of Brut goodwill to assets to be disposed of	(85,814)			(85,814)
Effect of foreign currency translation	934	5,910		6,844
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Balances at June 30, 2004	\$ 616,114	\$ 622,525	\$ 557,875	\$ 1,796,514
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

Because of the acquisitions completed in 2004, the estimated amortization expense for each of the years 2004 to 2008 contained in Footnote 1 to the Company's Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2003 has been updated below. In addition, because these allocations are still preliminary, it is likely that the estimated annual amortization expense will continue to be updated as the allocations are finalized. Based on amounts recorded at June 30, 2004, total estimated amortization of all acquisition-related intangible assets during each of the years ended December 31 follows (in thousands):

2004	\$ 118,628
2005	112,632
2006	106,188
2007	95,372
2008	82,261

**Table of Contents****DISPOSITIONS:**

On May 25, 2004, the Company entered into a definitive agreement for the sale of 100% of the membership interests of Brut LLC, an electronic communications network, to NASDAQ Stock Market, Inc. (NASDAQ) for a total consideration of \$190 million of cash. In addition, and conditioned upon completion of the sale, SunGard and NASDAQ will enter into a multiyear agreement for the continued processing of Brut trades by SunGard. The transaction is subject to customary closing conditions and regulatory approval and is expected to close during the third quarter of 2004. The Brut assets and liabilities to be sold are reported in the accompanying Consolidated Balance Sheet at June 30, 2004 in assets to be disposed of and other accrued expenses, respectively, and are set forth below:

	<b>June 30, 2004</b>
Trade receivables, net	\$ 19,309
Property and equipment, net	3,124
Goodwill	85,814
Deferred income taxes	6,318
Other tangible and intangible assets, net	1,083
	<hr/>
Assets to be disposed of	\$ 115,648
	<hr/>
Accounts payable	\$ 4,345
Accrued compensation and benefits	1,352
Other accrued expenses	6,344
Accumulated other comprehensive income	100
	<hr/>
Liabilities to be disposed of	\$ 12,141
	<hr/>

During the second quarter of 2004, the Company sold two businesses in its ISS segment for net cash proceeds of \$4 million with no material gain or loss on the transactions.

**PRO FORMA FINANCIAL INFORMATION:**

The following unaudited pro forma results of operations (in thousands, except per-share amounts) assume that the acquisitions of Andover Brokerage, LLC; Caminus Corporation; Collegis, Inc.; FAME Information Services, Inc.; H.T.E., Inc.; OSSI; SCT and Sherwood International plc occurred on January 1, 2003 and were included in the Company's results from that date.

<b>Six Months Ended</b>		<b>Three Months Ended</b>	
<b>June 30,</b>		<b>June 30,</b>	
<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
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Revenue	\$ 1,794,645	\$ 1,691,881	\$ 900,350	\$ 857,944
Net income	190,165	127,579	102,311	70,356
Diluted net income per common share, as reported	0.64	0.57	0.35	0.31
Pro forma diluted net income per common share	0.64	0.44	0.35	0.24

This unaudited pro forma information should not be relied upon as necessarily being indicative of the results that would have been obtained if these acquisitions had actually occurred on that date, nor of the results that may be obtained in the future.

**Table of Contents****3. Stock-Based Compensation:**

The Company applies Accounting Principles Board Opinion Number 25, Accounting for Stock Issued to Employees, in accounting for its stock option and award plans. Accordingly, compensation expense has been recorded for its restricted stock awards and no expense has been recorded for its other stock-based plans. As required by Statement of Financial Accounting Standards Number 123, Accounting for Stock-Based Compensation (SFAS 123), the following supplemental information is provided for each of the six and three months ended June 30 (in thousands, except per-share amounts) :

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Net income, as reported (including stock-based compensation costs, net of tax, of \$245, \$248, \$123 and \$119, respectively)	\$ 188,225	\$ 165,919	\$ 102,603	\$ 89,880
Additional stock-based employee compensation costs under SFAS 123, net of tax	(40,278)	(32,533)	(26,315)	(18,911)
<b>Pro forma net income</b>	<b>\$ 147,947</b>	<b>\$ 133,386</b>	<b>\$ 76,288</b>	<b>\$ 70,969</b>
Pro forma net income per common share:				
Basic	\$ 0.51	\$ 0.47	\$ 0.26	\$ 0.25
Diluted	\$ 0.50	\$ 0.46	\$ 0.26	\$ 0.24

The fair value of the options granted using the Black-Scholes pricing model and the related assumptions follow:

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Weighted-average fair value on date of grant	\$ 15.74	\$ 11.67	\$ 13.74	\$ 12.30
Ratio of weighted-average fair value to weighted-average market value on date of grant	57%	58%	52%	54%
Assumptions used to calculate fair value:				
Volatility	49%	53%	49%	53%
Risk-free interest rate	3.2%	3.1%	4.0%	2.85%
Expected term <sup>(1)</sup>	6 years	6 years	6 years	6 years
Dividends	zero	zero	zero	zero

<sup>(1)</sup> Nine and one-half years for unvested performance accelerated stock options.



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This pro forma disclosure is not necessarily indicative of what the impact would be of applying SFAS 123 in future years.

**Table of Contents****4. Clearing Broker Assets and Liabilities:**

Clearing broker assets and liabilities are comprised of the following (in thousands):

	<b>June 30, 2004</b>	<b>December 31, 2003</b>
Segregated customer cash and treasury bills	\$ 48,216	\$ 52,531
Customer securities	23,926	7,826
Securities borrowed	76,023	52,187
Receivables from customers and other	30,787	13,706
<b>Clearing broker assets</b>	<b>\$ 178,952</b>	<b>\$ 126,250</b>
Payables to customers	\$ 64,139	\$ 67,208
Securities loaned	57,266	38,824
Customer securities sold short, not yet purchased	20,833	6,919
Other	9,205	7,406
<b>Clearing broker liabilities</b>	<b>\$ 151,443</b>	<b>\$ 120,357</b>

Segregated customer cash and treasury bills are held by the Company on behalf of customers. Customer securities consist of trading and investment securities at fair market values. Securities borrowed and loaned represent deposits made to or received from other broker/dealers. Receivables from and payables to customers represent amounts due or payable on cash and margin transactions.

**5. Shares Used in Computing Net Income per Common Share:**

The computation of shares used in computing basic and diluted net income per common share follows (in thousands):

	<b>Six Months Ended June 30,</b>		<b>Three Months Ended June 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Weighted-average common shares outstanding used for calculation of basic net income per common share	289,129	284,339	289,102	284,744
Dilutive effect of employee stock options	6,939	5,233	6,258	6,042
<b>Total shares used for calculation of diluted net income per common share</b>	<b>296,068</b>	<b>289,572</b>	<b>295,360</b>	<b>290,786</b>

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During the six months ended June 30, 2004 and 2003, there were approximately 16.5 million and 18.8 million outstanding employee stock options, respectively, that are out-of-the-money and therefore excluded from the calculation of the dilutive effect of employee stock options. During the three months ended June 30, 2004 and 2003, there were approximately 18.7 million and 18.0 million outstanding employee stock options, respectively, that are out-of-the-money and therefore excluded from the calculation of the dilutive effect of employee stock options. Stock options are considered to be out-of-the-money when the option exercise price exceeds the average share price during the respective periods. The range of exercise prices for out-of-the-money options for the six and three month periods ended June 30, 2004 is \$27.81 to \$32.81 per share and \$26.89 to \$32.81 per share, respectively.

In February 2004, the Company announced a five million share repurchase program to provide

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shares for the Company's employee stock purchase and stock option programs which expires in February 2005. There were 2.5 million shares repurchased under the program in the three month period ended June 30, 2004 for a total cost of \$65.9 million.

**6. Comprehensive Income:**

Comprehensive income consists of net income adjusted for other increases and decreases affecting stockholders' equity that are excluded from the determination of net income. The calculation of comprehensive income follows (in thousands):

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Net income	\$ 188,225	\$ 165,919	\$ 102,603	\$ 89,880
Foreign currency translation gains (losses)	2,173	26,005	(12,265)	28,953
<b>Comprehensive income</b>	<b>\$ 190,398</b>	<b>\$ 191,924</b>	<b>\$ 90,338</b>	<b>\$ 118,833</b>

**7. Segment Information:**

The Company has three segments: ISS, AS and HE/PS. The operating results for each of the segments follow (in thousands):

**Six Months Ended**