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AFFILIATED COMPUTER SERVICES INC
Form 10-Q
November 14, 2001

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 September 30, 2001

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.

TITLE OF EACH CLASS OF _____ NUMBER OF SHARES OUTSTANDING AS
NOVEMBER 7, 2001

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Class A Common Stock, \$.01 par value	56,909,056
Class B Common Stock, \$.01 par value	3,299,686

	60,208,742

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES

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AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (IN THOUSANDS)

SEPTEMBER 30, JUNE 30,

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	2001 (UNAUDITED)	2001 (AUDITED)
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 34,048	\$ 242,458
Accounts receivable, net	630,345	472,042
Inventory	10,282	8,591
Prepaid expenses and other current assets	85,462	77,572
Deferred taxes	8,684	8,952
	-----	-----
Total current assets	768,821	809,615
Property, equipment and software, net	343,591	237,563
Intangibles, net	166,980	97,160
Goodwill, net	1,388,569	697,760
Long-term investments and other assets	52,969	49,589
	-----	-----
Total assets	\$ 2,720,930	\$ 1,891,687
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 46,318	\$ 40,265
Accrued compensation and benefits	75,842	82,043
Other accrued liabilities	191,872	126,875
Income taxes payable	20,873	7,742
Short-term debt	3,094	3,362
Current portion of unearned revenue	39,922	20,765
	-----	-----
Total current liabilities	377,921	281,052
Convertible notes	546,927	546,927
Long-term debt	772,136	102,386
Deferred taxes	60,948	55,601
Other long-term liabilities	19,486	20,206
	-----	-----
Total liabilities	1,777,418	1,006,172
	-----	-----
Stockholders' equity:		
Class A common stock	476	473
Class B common stock	33	33
Additional paid-in capital	365,249	350,767
Retained earnings	577,971	534,374
Accumulated other comprehensive income (net of tax)	(217)	(132)
	-----	-----
Total stockholders' equity	943,512	885,515
	-----	-----
Total liabilities and stockholders' equity	\$ 2,720,930	\$ 1,891,687
	=====	=====

See notes to 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 SEPTEMBER 30,	
	2001	2000
	-----	-----
Revenues	\$ 655,019	\$ 478,626
	-----	-----
Expenses:		
Wages and benefits	296,873	216,189
Services and supplies	172,871	129,505
Rent, lease and maintenance	72,880	62,706
Depreciation and amortization	24,415	21,092
Other operating expenses	6,438	6,961
	-----	-----
Total operating expenses	573,477	436,453
	-----	-----
Operating income	81,542	42,173
Interest expense	12,599	5,035
Other non-operating income, net	(1,316)	(13,366)
	-----	-----
Pretax profit	70,259	50,504
Income tax expense	26,346	19,949
	-----	-----
Net income	\$ 43,913	\$ 30,555
	=====	=====
Earnings per common share:		
Basic	\$.86	\$.62
	=====	=====
Diluted	\$.77	\$.57
	=====	=====
Shares used in computing earnings per common share:		
Basic	50,790	49,438
Diluted	61,672	56,207

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See notes to consolidated financial statements.

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

	THREE MONTHS SEPTEMBER 2001 -----
Cash flows from operating activities:	
Net income	\$ 43,913 -----
Adjustments to reconcile net income to net cash provided (used) by operating activities:	
Depreciation and amortization	24,415
Gain on sale of investment	(274)
Other	405
Changes in assets and liabilities, net of effects from acquisitions:	
Increase in accounts receivable	(44,661)
Increase in inventory	(1,312)
(Increase) decrease in prepaid expenses and other current assets	3,478
Change in deferred taxes	5,635
Decrease in other long-term assets	1,740
Increase (decrease) in accounts payable	6,267
Decrease in accrued compensation and benefits	(30,590)
Increase (decrease) in other accrued liabilities	7,234
Change in income taxes payable	19,883
Increase (decrease) in unearned revenue	1,952
Increase in other long-term liabilities	356
Total adjustments	(5,472) -----
Net cash provided (used) by operating activities	38,441 -----
Cash flows from investing activities:	
Purchases of property, equipment and software, net of sales	(35,946)
Payments for acquisitions, net of cash acquired	(879,503)
Proceeds from divestitures, net of transaction costs	--
Purchase of investments	--
Proceeds from sale of investment	--
Additions to other intangible assets	(5,812)
Additions to notes receivable	(2,687)
Other	(98)
Net cash provided (used) by investing activities	(924,046) -----

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Cash flows from financing activities:	
Proceeds from issuance of debt, net of issuance costs	756,710
Repayments of debt	(87,248)
Proceeds from stock options exercised	7,734
Other	(1)

Net cash provided (used) by financing activities	677,195

Net decrease in cash and cash equivalents	(208,410)
Cash and cash equivalents at beginning of period	242,458

Cash and cash equivalents at end of period	\$ 34,048
	=====

See notes to 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. and its majority-owned subsidiaries. All material intercompany profits, transactions and balances have been eliminated. We are a Fortune 1000 company comprised of nearly 32,000 full-time equivalent employees in 29 countries providing business process and technology outsourcing solutions to world-class commercial and government clients.

The financial information presented should be read in conjunction with our consolidated financial statements for the year ended June 30, 2001. 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.

2. ACQUISITIONS

In August 2001, we acquired 100% of the stock of Lockheed Martin IMS Corporation ("IMS"), a wholly owned subsidiary of Lockheed Martin Corporation for approximately \$825 million. The acquisition was funded from a \$550 million 18-month interim credit facility, borrowings from our existing revolving credit facility, and existing cash on hand. IMS' results have been included in our consolidated financial statements from the effective date of the acquisition, August 1, 2001. IMS provides business process outsourcing services to more than 230 state and local government agencies in 45 U.S. states, the District of Columbia, Canada, Australia, and Europe. IMS specializes in child support enforcement, welfare and workforce services, child care management, electronic toll collection, and other intelligent transportation services involving the trucking industry, photo

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enforcement of red-light and speeding violations, parking management, and information technology outsourcing. We believe the acquisition of IMS solidifies ACS as a leader in technology based outsourcing solutions to state and local government agencies.

The acquisition was accounted for under the purchase method of accounting with assets acquired of \$931.9 million and liabilities assumed of \$106.9 million. The purchase price was allocated to assets acquired and liabilities assumed based on the estimated fair value at July 31, 2001, subject to finalization of third party valuation, as follows (in thousands):

Current Assets	\$	117,949
Property, equipment and software		80,021
Other long-term assets		2,826
Intangible assets		64,700
Goodwill		666,416

Total assets acquired		931,912
Current liabilities		106,912

Total liabilities assumed		106,912

Net assets acquired	\$	825,000
		=====

The total amount of goodwill is expected to be fully deductible for tax purposes. Software of \$41.5 million is included in property, equipment and software and has anticipated useful life ranging from 2 to 10 years. The \$64.7 million acquired intangible assets is attributable to customer contracts with an aggregate anticipated useful life of approximately 8 years.

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

2. ACQUISITIONS (CONTINUED)

Pro forma Financial Information

The following unaudited pro forma information presents a summary of our consolidated results of operations as if the IMS acquisition had occurred at the beginning of the periods presented and are not necessarily indicative of future results or actual results that would have been achieved had the acquisition occurred at the beginning of the periods presented.

For the three months ended September 30,

2001

2000

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Revenue	\$ 706,672	\$ 637,167
Net income	45,907	34,103
Earnings per common share:		
Basic	\$.90	\$.69
Diluted	\$.80	\$.63

In August 2001, we acquired the business process outsourcing services unit of National Processing Company (NPC) for approximately \$43 million in cash. NPC's results have been included in our consolidated financial statements from the effective date of the acquisition, August 1, 2001. NPC's business process outsourcing services unit specializes in healthcare claim processing, credit card application processing and airline lift ticket processing.

The acquisition was accounted for under the purchase method of accounting with assets acquired of \$50.3 million and liabilities assumed of \$7.3 million. We recorded goodwill of \$25.8 million (which is fully deductible for tax purposes) and \$2.8 million in intangible assets. The \$2.8 million acquired intangible assets are attributable to customer contracts with an aggregate anticipated useful life of approximately 3 years. This acquisition is not considered material to our results of operations; therefore, no pro forma information is presented.

3. NEW ACCOUNTING STANDARDS

In July 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, ("SFAS 141") "Business Combinations" and No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets." SFAS 141 requires that all business combinations be accounted for under the purchase method only and that certain acquired intangible assets in a business combination be recognized as assets apart from goodwill. SFAS 142 requires that ratable amortization of goodwill be replaced with periodic tests of the goodwill's impairment and that intangible assets other than goodwill be amortized over their useful lives. SFAS 141 is effective for all business combinations initiated after June 30, 2001 and for all business combinations accounted for by the purchase method for which the date of acquisition is after June 30, 2001. We adopted the provisions of SFAS 141 and SFAS 142 effective July 1, 2001.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Standards No. 144, ("SFAS 144") "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 retains the fundamental provisions of existing generally accepted accounting principles with respect to the recognition and measurement of long-lived asset impairment contained in Statement of Financial Accounting Standards No. 121 ("SFAS 121") "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." However, SFAS No. 144 provides new guidance intended to address certain significant implementation issues associated with SFAS 121, including expanded guidance with respect to appropriate cash flows to be used to determine whether recognition of any long-lived asset impairment is required, and if required, how to measure the amount of the impairment. SFAS 144 also requires that any net assets to be disposed of by sale be reported at the lower of carrying value or fair market value less cost to sell, and expands the reporting of discontinued operations to include any component of an entity with operations and cash flows that can be clearly distinguished from the rest of the entity. SFAS

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144 is effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. We do not believe SFAS 144 will have a material impact on our future earnings and financial position.

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

4. GOODWILL AND OTHER INTANGIBLE ASSETS -- ADOPTION OF SFAS 142

The following table reflects the effect of SFAS 142 on net income and earnings per share as if SFAS 142 had been in effect for all periods presented:

		FOR THE T
		----- 2001 -----
		(in thousa
Net income	\$	4
Add back goodwill amortization, net of related tax benefit (\$951)		
Adjusted net income	\$	4 =====
Basic earnings per share:		
Reported net income	\$	
Add back goodwill amortization (net of tax benefit)		
Adjusted net income	\$	4 =====
Diluted earnings per share:		
Reported net income	\$	
Add back goodwill amortization (net of tax benefit)		
Adjusted net income	\$	4 =====

5. DERIVATIVES AND HEDGING ACTIVITIES

In order to manage interest costs and exposure to changing interest rates, we hold two interest rate hedges, designated as cash flow hedges, initiated in December 1998 and expiring in December 2001. Each hedge is structured such that we pay a fixed rate of interest of 4.54%, and receive a floating rate of interest based on one month LIBOR. The notional amount of the two hedges totals \$100 million and the fair market value of the two hedges at September 30, 2001 and June 30, 2001 was (\$408,000) and (\$355,000),

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respectively. The fair value of each interest rate hedge reflects termination cash value. The fair value of the interest rate hedges, net of \$159,000 and \$139,000 tax benefit, respectively, is reflected in "Accumulated other comprehensive income (net of tax)."

6. COMPREHENSIVE INCOME

We have adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." The objective of SFAS No. 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 other non-owner charges in equity.

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

	THREE MONTH SEPTEMBER
	----- 2001 -----
Net income	\$ 43,913
Change in fair value of derivatives (net of change in tax effect of (\$21) and \$967, respectively)	(85)
Comprehensive income	----- \$ 43,828 =====

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

7. GOODWILL

The changes in the carrying amount of goodwill for the quarter ended September 30, 2001 are as follows (in thousands):

	COMMERCIAL	FEDERAL GOVERNMENT
	-----	-----
Balance as of June 30, 2001	\$ 574,887	\$ 122,873
Goodwill adjustments during the quarter	690,809	--
	-----	-----

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Balance as of September 30, 2001	\$ 1,265,696	\$ 122,873
	=====	=====

The goodwill adjustments in the commercial segment are primarily the result of the current quarter acquisitions of IMS and NPC (see Note 2).

8. INTANGIBLE ASSETS

	AS OF SEPTEMBER 30, 2001 (IN THOUSANDS)	
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Amortized intangible assets:		
Customer related intangibles	\$ 152,461	\$ (40,650)
All other	6,168	(2,790)
Total	\$ 158,629	\$ (43,440)
Unamortized intangible asset:		
Title plant	51,800	
Total	\$ 51,800	
Aggregate amortization expense:		
For the quarter ended September 30, 2001		\$ 4,960
Estimated amortization expense:		
For the year ended June 30, 2002		\$ 22,880
For the year ended June 30, 2003		\$ 19,970
For the year ended June 30, 2004		\$ 16,550
For the year ended June 30, 2005		\$ 13,740
For the year ended June 30, 2006		\$ 12,520

Customer related intangibles are amortized over a weighted average of approximately 7 years. All other intangibles are amortized over a weighted average of 5 years.

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

9. EARNINGS PER SHARE

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

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share:

	THREE MONTHS END SEPTEMBER 30,
	----- 2001 -----
Numerator:	
Numerator for earnings per share (basic)	
Income available to common stockholders	\$ 43,913
Effect of dilutive securities:	
Interest on 4% convertible debt	1,537
Interest on 3.5% convertible debt	2,052

Numerator for earnings per share assuming Dilution - income available to common stockholders	\$ 47,502 =====
Denominator:	
Weighted average shares outstanding (basic)	50,790
Effect of dilutive securities:	
4% convertible debt	5,390
3.5% convertible debt	3,649
Stock options	1,843

Total potential common shares	10,882 -----
Denominator for earnings per share assuming Dilution	61,672 =====
Earnings per common share (basic)	\$.86 =====
Earnings per common share assuming dilution	\$.77 =====

10. ACCUMULATED DEPRECIATION AND AMORTIZATION

Property, equipment, and software are stated net of accumulated depreciation of \$235.6 million and \$216.8 million at September 30, 2001 and June 30, 2001, respectively.

11. NON-RECURRING ITEMS

In the first quarter of fiscal 2001, we recorded a \$12.8 million gain in "Other non-operating income, net" related to the sale of a non-strategic minority investment in ACS Merchant Services, Inc.

In the first quarter of fiscal 2001, we recorded a \$10.4 million charge in connection with the termination of certain hardware leases and disaster recovery contracts, which is included in "Rent, lease and maintenance" expense. In addition, we recorded a \$2.1 million charge for non-recurring litigation costs and the writedown of property held-for-sale to market value to "Other operating expense."

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

12. SEGMENT INFORMATION

Based on the criteria set forth in Statement of Financial Accounting Standard No. 131, "Disclosure about Segments of an Enterprise and Related Information", we have two reportable segments: commercial and federal government. Certain reclassifications have been made to the segment disclosure as the result of changes to our reporting structure. Prior year results have been restated for comparison purposes. The following is a summary of certain financial information by reportable segment (in thousands):

QUARTER ENDED SEPTEMBER 30, 2001

	Commercial -----	Federal Government -----
Revenue	\$ 464,843	\$ 190,176
Operating expense	372,876	171,526
	-----	-----
EBITDA(a)	91,967	18,650
Depreciation & amortization expense	20,134	3,797
Goodwill amortization	--	--
	-----	-----
Operating income	\$ 71,833 =====	\$ 14,853 =====

QUARTER ENDED SEPTEMBER 30, 2000

	Commercial -----	Federal Government -----
Revenue	\$ 301,016 (b)	\$ 177,610
Operating expense	251,444 (c)	160,416
	-----	-----
EBITDA(a)	49,572	17,194
Depreciation & amortization expense excluding goodwill amortization	12,253	2,809
Goodwill amortization	4,629	1,080
	-----	-----
Operating income	\$ 32,690 -----	\$ 13,305 -----

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- (a) EBITDA consist of earnings before interest income, interest expense, other non-operating income and expense, income taxes, depreciation and amortization. EBITDA is not a measure of financial performance under generally accepted accounting principles and should not be considered in isolation or as an alternative to net income as an indicator of a company's performance or to cash flows from operating activities as a measure of liquidity.
- (b) Revenue includes \$11.8 million for the quarter ended September 30, 2000 related to the divestitures announced in June 2000.
- (c) Operating expense includes \$12.5 million of non-recurring charges related to hardware lease buyouts and disaster recovery contracts, legal fees and a writedown of property held-for-sale to market value (see Note 11).

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

13. SUBSEQUENT EVENTS

On October 10, 2001, we completed our offering of 9.2 million shares of our Class A common stock (including the underwriters' over-allotment option of 1.2 million shares). The shares were issued at \$81.00 per share. Net proceeds of \$714.5 million (net of underwriters' fees and other costs) were used to repay the \$550 million 18-month interim credit facility incurred to fund the IMS acquisition and a portion of the amount outstanding under our revolving credit facility.

The following pro forma September 30, 2001 information is adjusted for the issuance of 9.2 million shares and the subsequent paydown of debt from the net proceeds of the equity offering (in thousands):

Total Assets	\$ 2,720,930
Total Liabilities	1,062,876
Total Stockholders' Equity	1,658,054
Total debt /total capitalization ratio	26.8%

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements, other than statements of historical facts, included in

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this MD&A regarding our financial position, business strategy and plans and objectives of our management for future operations are forward-looking statements. While management has based any forward looking statements contained herein on its current expectations, the information on which such expectations were based may change. These forward-looking statements rely on a number of assumptions concerning future events and are subject to a number of risks, uncertainties and other factors, many of which are outside of our control, that could cause actual results to materially differ from such statements. Such events include, but are not necessarily limited to: (i) uncertainties caused by terrorist attacks on September 11, 2001 and the threat of other attacks, acts of war or other related events that may disrupt the markets in which we operate, our customers, our operations and our profitability; (ii) the loss of business from significant customers; (iii) the impairment of our capital investments as the result of the deterioration of the financial condition of our customers in whom we have made a significant capital investment; (iv) the competition in the information technology industry and the impact of such competition on pricing, revenues and margins; (v) difficulty or inability to execute our acquisition strategy; (vi) timing and magnitude of technological advances; (vii) loss of significant vendor(s) resulting in increased expense or inability to serve our customers; (viii) provisions in our contracts permitting termination for convenience, permitting termination of or subjecting us to penalties under certain contracts, if specified service levels are not maintained, and/or permitting audits of our pricing and compliance; (ix) changes in federal, state or local government requirements imposing additional burdens and subjecting us to additional expenditures and increased compliance risk; and (x) the cost of attracting and retaining highly skilled personnel. These risks and uncertainties and other risks and uncertainties are discussed in more detail in the "Risk Factors" section of our Prospectus Supplement dated October 3, 2001, which has been filed with the Securities and Exchange Commission. In addition, we operate in a highly and rapidly changing environment and new risks may arise. Accordingly, investors should not place any reliance on forward looking statements as a prediction of actual results. We undertake no obligation to update any forward looking statements. We undertake no obligation to update any forward looking information.

SIGNIFICANT DEVELOPMENTS

QUARTER ENDED SEPTEMBER 30, 2001

In August 2001, we acquired Lockheed Martin IMS Corporation ("IMS"), a wholly-owned subsidiary of Lockheed Martin Corporation. IMS, with its principal offices located in Washington D.C. and approximately 4,800 employees throughout the United States, Canada, Australia, and Europe, provides services to state and local government agencies in health and human services, transportation, public safety and child support. The transaction, valued at \$825 million plus related transaction costs, was funded initially through a combination of a \$550 million, 18-month interim credit facility, borrowings on our existing credit facility and existing cash on hand. IMS' operating results are included in our financial statements from the effective date of the acquisition, August 1, 2001.

Also in August 2001, we acquired the business process outsourcing services unit of National Processing Company ("NPC"). NPC provides healthcare claims processing, credit card application processing and airline lift ticket processing. As part of the transaction, we acquired all of NPC's offshore operations in Jamaica, the Dominican Republic, Barbados and a majority of NPC's Mexican operations. The transaction value was \$43 million plus related transaction costs. NPC's operating results are included in our financial statements from the effective date of the acquisition, August 1, 2001.

QUARTER ENDED SEPTEMBER 30, 2000

During the first quarter of fiscal 2001, we recorded a \$12.8 million gain in

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"Other non-operating income, net" associated with the sale of a certain non-strategic minority investment in ACS Merchant Services, Inc. In addition, we recorded non-recurring charges totaling \$12.5 million related to the termination of certain computer equipment leases and consolidation of disaster recovery contracts (\$10.4 million recorded in "Rent, lease and maintenance") and litigation expense and the writedown of a facility held-for-sale to market value (\$2.1 million recorded in "Other operating expense").

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RESULTS OF OPERATIONS

The following table sets forth certain items from our consolidated statements of income as a percentage of revenues:

	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
Revenues	100%	100%
Expenses:		
Wages and benefits	45.3	45.2
Services and supplies	26.4	27.1
Rent, lease and maintenance	11.2	13.1
Depreciation and amortization	3.7	4.4
Other operating expenses	1.0	1.4
Total operating expenses	87.6	91.2
Operating income	12.4	8.8
Interest expense	1.9	1.0
Other non-operating income, net	(0.2)	(2.8)
Pretax profit	10.7	10.6
Income tax expense	4.0	4.2
Net income	6.7%	6.4%

COMPARISON OF THE QUARTER ENDED SEPTEMBER 30, 2001 TO THE QUARTER ENDED SEPTEMBER 30, 2000

Revenues for the first quarter of fiscal 2002 increased 37% to \$655.0 million, compared to \$478.6 million for the same period last year. Included in the revenues for the first quarter of fiscal 2001 was \$11.8 million related to business units which were divested in fiscal 2001. Excluding these revenues, revenues increased \$188.2 million, or 40%, to \$655.0 million from the first quarter of fiscal 2001. Of this increase 10% was from internal growth and 30%

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was revenue from the IMS and NPC acquisitions in the first quarter of fiscal year 2002 and the acquisitions of Business Resources Corporation and the Global Government Solutions division of Systems & Computer Technology Corporation during fiscal year 2001. Revenue growth in our commercial segment, excluding the revenues from divested units, was 61%, 49% from acquisitions and 12% from internal growth. The internal growth in our commercial segment was primarily the result of growth in new and existing state Medicaid and Welfare benefit program management contracts and business process outsourcing contracts. Our federal government revenue growth was 7%, all internal growth. The federal government increases were primarily in our defense and education contracts.

When adjusting for the application of SFAS 142 (see Note 3) and non-recurring charges (see "Significant Developments"), our operating margins decreased slightly from 12.6% in the first quarter of fiscal 2001 to 12.4% in the first quarter of fiscal 2002. Services and supplies decreased 0.7% as a percentage of revenue due to the fourth quarter fiscal 2001 acquisition of SCT and the first quarter fiscal 2002 acquisition of NPC, which have a lower component of services and supplies. Depreciation and amortization expense increased 0.5% as a percentage of revenue due to increased capital expenditures during fiscal year 2001.

Interest expense increased \$7.6 million, or 0.9% as a percentage of revenue, due to the February 2001 convertible debt offering as well as the interest expense and financing costs on the \$550 million interim credit facility we entered into in connection with the IMS acquisition.

Our effective tax rate of approximately 37.5% in the first quarter of fiscal 2001 exceeded the federal statutory rate of 35%, due primarily to the net effect of state income taxes.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2001, we had cash and cash equivalents totaling \$34.0 million compared to \$242.5 million at June 30, 2001. Included in the cash balances at September 30, 2001 and June 30, 2001 were \$3.2 million and \$4.9 million, respectively, of restricted cash held on behalf of governmental customers. Working capital decreased to \$390.9 million at September 30, 2001 from \$528.6 million at June 30, 2001 primarily due to cash paid for the IMS and NPC acquisitions closed during the quarter, partially offset by the net current assets purchased in the acquisitions.

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Cash flow from operations was \$38.4 million for the quarter ended September 30, 2001, compared to (\$57.4 million) in the same period last year. In the first quarter of fiscal year 2001, we paid approximately \$50.0 million in income taxes related to our divestiture activity and approximately \$10.4 million of non-recurring lease termination charges, which are included in cash flow from operations. After adjusting for these items, cash flow from operating activities would have been \$3.0 million for the quarter ended September 30, 2000. Cash used in investing activities was \$924.0 million primarily due to the IMS and NPC acquisitions and capital expenditures during the quarter. Cash flow from financing activities was \$677.2 million as a result of borrowings on the \$550 million interim credit facility incurred to fund the IMS acquisition as well as other net borrowings on our existing credit facility.

On October 10, 2001, we completed our offering of 9.2 million shares of our Class A common stock (including the underwriters' over-allotment option of 1.2 million shares). The shares were issued at \$81.00 per share. Net proceeds of

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\$714.5 million (net of underwriters' fees and other costs) were used to repay the \$550 million 18-month interim credit facility incurred to fund the IMS acquisition and a portion of the amount outstanding under our revolving credit facility.

Management believes that available cash and cash equivalents, together with cash generated from operations and available borrowings under our credit facility, will provide adequate funds for our anticipated internal growth needs, including working capital expenditures. Our management also believes that cash provided by operations will be sufficient to satisfy all existing debt obligations as they become due. However, we intend to continue our growth through acquisitions and from time to time to engage in discussions with potential acquisition candidates, which could require significant commitments of capital. In order to pursue such opportunities we may be required to incur debt or to issue additional potentially dilutive securities in the future. No assurance can be given as to our future acquisitions and expansion opportunities and how such opportunities will be financed.

NEW ACCOUNTING STANDARDS

On July 1, 2001, we adopted Statements Financial Accounting Standards No. 141, "Business Combinations," and No. 142 "Goodwill and Other Intangible Assets." SFAS 141 requires that all business combinations be accounted for under the purchase method only and that certain acquired intangible assets in a business combination be recognized as assets apart from goodwill. SFAS 142 requires that ratable amortization of goodwill be replaced with periodic tests of the goodwill's impairment and that intangible assets other than goodwill be amortized over their useful lives. SFAS 141 is effective for all business combinations initiated after June 30, 2001 and for all business combinations accounted for by the purchase method for which the date of acquisition is after June 30, 2001.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Standards No. 144, ("SFAS 144") "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 retains the fundamental provisions of existing generally accepted accounting principles with respect to the recognition and measurement of long-lived asset impairment contained in Statement of Financial Accounting Standards No. 121 ("SFAS 121") "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." However, SFAS No. 144 provides new guidance intended to address certain significant implementation issues associated with SFAS 121, including expanded guidance with respect to appropriate cash flows to be used to determine whether recognition of any long-lived asset impairment is required, and if required, how to measure the amount of the impairment. SFAS 144 also requires that any net assets to be disposed of by sale be reported at the lower of carrying value or fair market value less cost to sell, and expands the reporting of discontinued operations to include any component of an entity with operations and cash flows that can be clearly distinguished from the rest of the entity. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. We do not believe SFAS 144 will have a material impact on our future earnings and financial position.

PART II

Item 1. Legal Proceedings

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On December 16, 1998, a state district court in Houston, Texas entered final judgment against us in a lawsuit brought by twenty-one former employees of Gibraltar Savings Association and/or First Texas Savings Association (collectively, "GSA/FTSA"). The GSA/FTSA employees alleged that they were entitled to the value of 401,541 shares of our stock pursuant to options issued to the GSA/FTSA employees in 1988 in connection with a former data processing services agreement between GSA/FTSA and us. The judgment against us was for approximately \$17 million, which includes attorneys' fees and pre-judgment interest, but excludes additional attorneys' fees of approximately \$850,000 and post-judgment interest at the statutorily mandated rate, which could be awarded in the event the plaintiffs are successful upon appeal and final judgment. We continue to believe that we have a meritorious defense to all or a substantial portion of the plaintiffs' claims, and accordingly, have not accrued any amount on our balance sheet related to the lawsuit. We filed our appeal of the judgment on March 15, 1999 and a brief in support of such appeal has been filed. We plan to vigorously pursue the appeal. The plaintiffs also have filed a notice of appeal. A hearing for oral arguments on the parties' appeals occurred on September 20, 2001. Should the proceedings not be favorably resolved on appeal, we would be subject to a material charge. The court of appeals has given no indication of when it will issue its decision.

In addition to the foregoing, we are subject to certain other legal proceedings, claims and disputes which arise in the ordinary course of our business. Although we cannot predict the outcomes of these legal proceedings, we do not believe these actions, in the aggregate, will have a material adverse effect on our financial position, results of operations or liquidity.

Item 2. Changes in Securities and Use of Proceeds

On October 10, 2001, we completed our offering of 9.2 million shares of our Class A common stock (including the underwriters' over-allotment option of 1.2 million shares). The shares were issued at \$81.00 per share. Net proceeds of \$714.5 million (net of underwriters' fees and other costs) were used to repay the \$550 million 18-month interim credit facility we obtained in connection with the IMS acquisition and a portion of the amount outstanding under our revolving credit facility.

Item 4. Submission of Matters to a Vote of Stockholders

At our 2001 Annual Meeting of Stockholders held on October 25, 2001, the following actions were taken:

1. The following Directors were elected for terms of office expiring in 2002:

Name ----	For -----	Withheld -----
Darwin Deason	73,256,249	1,709,992
Jeffrey A. Rich	73,625,057	1,341,184
Mark A. King	73,625,546	1,340,965
William L. Deckelman, Jr.	73,617,567	1,348,674
Henry G. Hortenstine	73,620,187	1,346,054
Peter A. Bracken	73,619,620	1,346,621
Joseph P. O'Neill	73,439,232	1,527,009
Frank A. Rossi	73,439,115	1,527,126
Clifford M. Kendall	73,448,396	1,517,845

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Pursuant to the terms of our Notice of Annual Meeting and Proxy Statement, proxies received were voted, unless authority was withheld, in favor of the election of the nine nominees named.

2. A proposal by the Board of Directors to approve Performance Based Incentive Compensation for our executive officers was approved by the stockholders. The stockholders cast 71,437,080 votes in favor of this proposal; 3,399,481 votes against this proposal and there were 129,680 abstentions.
3. A stockholder resolution regarding diversity of the board of directors proposed by Calvert Asset Management Company, Inc. was defeated by the stockholders. The stockholders cast 19,809,854 votes in favor of the resolution and 50,529,227 votes against the proposal and there were 861,993 abstentions.

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Item 6. Exhibits and Reports on Form 8-K

a.) Exhibits

None.

b.) Reports on Form 8-K

1. On July 19, 2001, the Company filed a Current Report on Form 8-K announcing the signing of a definitive agreement to acquire the stock of Lockheed Martin IMS Corporation for cash consideration of \$825 million.
2. On August 24, 2001, the Company filed a Current Report on Form 8-K announcing the acquisition of 100% of the stock of Lockheed Martin IMS Corporation, a subsidiary of Lockheed Martin Corporate, for \$825 million.
3. On October 16, 2001, the Company filed a Current Report on Form 8-K reporting the sale of 9.2 million shares of the Company's Class A common stock for net proceeds of approximately \$715 million.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on the 14th day of November, 2001.

AFFILIATED COMPUTER SERVICES, INC.

By: /s/ Warren D. Edwards

Warren D. Edwards
Executive Vice President and
Chief Financial Officer