

TOTAL SYSTEM SERVICES INC

Form 10-Q

November 06, 2018

Table of Contents

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, 2018

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: 1-10254

Total System Services, Inc.

[www.tsys.com](http://www.tsys.com)

(Exact name of registrant as specified in its charter)

Georgia

(State or other jurisdiction of incorporation or organization)

58-1493818

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

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

One TSYS Way, Post Office Box 1755, Columbus, Georgia 31902

(Address of principal executive offices) (Zip Code)

(706) 644-6081

(Registrant's telephone number, including area code)

(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 Sections 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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

Large accelerated filer      Accelerated filer    Non-accelerated filer  
Smaller reporting company    Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 issuer's classes of common stock, as of the latest practicable date.

CLASS	OUTSTANDING AS OF: October 31, 2018
Common Stock, \$0.10 par value	182,441,467 shares

---

Table of Contents

TOTAL SYSTEM SERVICES, INC.

Table of Contents

	Page Number
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Balance Sheets (unaudited) — September 30, 2018 and December 31, 2017</u>	3
<u>Consolidated Statements of Income (unaudited) — Three and nine months ended September 30, 2018 and 2017</u>	4
<u>Consolidated Statements of Comprehensive Income (unaudited) — Three and nine months ended September 30, 2018 and 2017</u>	5
<u>Consolidated Statements of Cash Flows (unaudited) — Nine months ended September 30, 2018 and 2017</u>	6
<u>Consolidated Statement of Changes in Equity (unaudited) — Nine months ended September 30, 2018</u>	7
<u>Notes to Unaudited Consolidated Financial Statements</u>	8
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	37
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	56
<u>Item 4. Controls and Procedures</u>	57
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	57
<u>Item 1A. Risk Factors</u>	57
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	58
<u>Item 6. Exhibits</u>	58
<u>SIGNATURES</u>	59

---

Table of Contents

## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements.

## TOTAL SYSTEM SERVICES, INC.

## Consolidated Balance Sheets

(Unaudited)

(in thousands, except per share data)	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents (Note 4)	\$ 484,581	450,357
Accounts receivable, net of allowances for doubtful accounts and billing adjustments of \$5.7 million and \$5.9 million as of 2018 and 2017, respectively	485,722	412,322
Contract assets (Note 2)	32,604	-
Prepaid expenses and other current assets (Note 4)	197,010	216,565
Total current assets	1,199,917	1,079,244
Contract assets (Note 2)	49,956	-
Goodwill (Note 3)	4,113,669	3,264,071
Other intangible assets, net of accumulated amortization of \$757.4 million and \$600.9 million as of 2018 and 2017, respectively	855,527	727,146
Intangible assets - computer software, net of accumulated amortization of \$913.9 million and \$849.3 million as of 2018 and 2017, respectively	440,904	383,715
Property and equipment, net of accumulated depreciation and amortization of \$538.5 million and \$521.1 million as of 2018 and 2017, respectively	372,900	325,218
Contract cost assets, net of accumulated amortization (Notes 2 and 4)	147,732	258,665
Equity investments, net	170,177	163,518
Deferred income tax assets	6,928	6,091
Other assets	115,334	124,021
Total assets	\$ 7,473,044	6,331,689
Liabilities		
Current liabilities:		
Current portion of long-term borrowings (Note 5)	\$ 12,975	559,050
Accounts payable	59,770	62,310
Contract liabilities (Note 2)	50,673	52,913
Accrued salaries and employee benefits	59,951	82,135
Current portion of obligations under capital leases and license agreements (Note 5)	8,196	6,762
Other current liabilities (Note 4)	275,606	225,922
Total current liabilities	467,171	989,092
Long-term borrowings, excluding current portion (Note 5)	3,837,659	2,591,949
Deferred income tax liabilities	394,119	238,317
Contract liabilities (Note 2)	21,730	48,526

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

Obligations under capital leases and license agreements, excluding current portion (Note 5)	37,156	36,053
Other long-term liabilities	75,027	71,070
Total liabilities	4,832,862	3,975,007
Redeemable noncontrolling interest in consolidated subsidiary	-	115,689
Commitments and contingencies (Note 10)		
Shareholders' Equity		
Shareholders' equity:		
Common stock- \$0.10 par value. Authorized 600,000 shares; 202,765 issued as of 2018 and 2017; 182,441 and 180,903 outstanding as of 2018 and 2017, respectively	20,277	20,277
Additional paid-in capital	178,155	162,806
Accumulated other comprehensive loss, net (Note 4)	(50,086)	(36,148)
Treasury stock, at cost (20,324 and 21,862 shares as of 2018 and 2017, respectively)	(873,946)	(909,960)
Retained earnings	3,365,782	3,004,018
Total shareholders' equity	2,640,182	2,240,993
Total liabilities and shareholders' equity	\$ 7,473,044	6,331,689

See accompanying Notes to Unaudited Consolidated Financial Statements

Table of Contents

## TOTAL SYSTEM SERVICES, INC.

## Consolidated Statements of Income

(Unaudited)

(in thousands, except per share data)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Total revenues (Notes 2 and 8)	\$ 1,015,371	1,247,576	3,010,121	3,654,676
Cost of services (Note 2)	624,363	898,471	1,855,546	2,638,214
Selling, general and administrative expenses	175,025	149,413	541,623	456,339
Total operating expenses	799,388	1,047,884	2,397,169	3,094,553
Operating income	215,983	199,692	612,952	560,123
Nonoperating expenses, net	(41,294)	(28,835)	(120,106)	(88,780)
Income before income taxes and equity in income of equity investments	174,689	170,857	492,846	471,343
Income taxes (Note 7)	31,112	54,628	86,662	153,917
Income before equity in income of equity investments	143,577	116,229	406,184	317,426
Equity in income of equity investments, net of tax	12,383	8,497	35,313	30,919
Net income	155,960	124,726	441,497	348,345
Net income attributable to noncontrolling interests	-	(1,631)	(1,261)	(4,368)
Net income attributable to Total System Services, Inc. (TSYS) common shareholders	\$ 155,960	123,095	440,236	343,977
Basic earnings per share (EPS) attributable to TSYS common shareholders (Note 11)	\$ 0.85	0.67	2.42	1.87
Diluted EPS attributable to TSYS common shareholders (Note 11)	\$ 0.85	0.66	2.40	1.85

See accompanying Notes to Unaudited Consolidated Financial Statements

Table of Contents

## TOTAL SYSTEM SERVICES, INC.

## Consolidated Statements of Comprehensive Income

(Unaudited)

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net income	\$ 155,960	124,726	441,497	348,345
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(4,912)	7,946	(14,169)	20,511
Postretirement healthcare plan adjustments	(179)	(693)	(537)	(445)
Unrealized loss on available-for-sale securities	(2,302)	(1,373)	(1,561)	(3,166)
Other comprehensive (loss) income	(7,393)	5,880	(16,267)	16,900
Comprehensive income	148,567	130,606	425,230	365,245
Comprehensive income attributable to noncontrolling interests	-	(1,631)	(1,261)	(4,368)
Comprehensive income attributable to TSYS common shareholders	\$ 148,567	128,975	423,969	360,877

See accompanying Notes to Unaudited Consolidated Financial Statements



Table of Contents

## TOTAL SYSTEM SERVICES, INC.

## Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	Nine months ended	
	September 30, 2018	2017
Cash flows from operating activities:		
Net income	\$ 441,497	348,345
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	310,010	303,821
Provisions for cardholder losses	50,911	39,036
Share-based compensation	32,916	28,462
Provisions for bad debt expenses and billing adjustments	7,451	7,835
Charges for transaction processing provisions	4,694	5,719
Amortization of debt issuance costs	3,668	3,247
Dividends received from equity investments	24,921	20,589
(Gain) loss on foreign currency	(295)	1,250
Amortization of bond discount	753	677
Loss on disposal of equipment, net	27	1,247
Deferred income tax expense (benefit)	21,173	(46,435)
Equity in income of equity investments, net of tax	(35,313)	(30,919)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(62,751)	(24,582)
Contract assets and contract liabilities	(4,824)	8,282
Contract cost assets	2,906	-
Prepaid expenses, other current assets and other long-term assets	15,684	12,118
Accounts payable	(3,760)	14,419
Accrued salaries and employee benefits	(26,199)	(10,315)
Other current liabilities and other long-term liabilities	(30,961)	(23,368)
Net cash provided by operating activities	752,508	659,428
Cash flows from investing activities:		
Purchases of property and equipment	(77,841)	(42,572)
Additions to contract acquisition costs	-	(21,662)
Additions to internally developed computer software	(29,692)	(22,011)
Additions to licensed computer software from vendors	(32,496)	(23,114)
Cash used in acquisitions, net of cash acquired	(1,051,629)	-
Other investing activities	(5,670)	(1,436)
Net cash used in investing activities	(1,197,328)	(110,795)
Cash flows from financing activities:		
Principal payments on long-term borrowings, capital lease obligations and license agreements	(2,807,187)	(415,788)
Purchase of noncontrolling interest	(126,000)	(70,000)
Dividends paid on common stock	(70,897)	(55,151)

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

Subsidiary dividends paid to noncontrolling shareholders	(3,778)	(5,216)
Repurchase of common stock under plans and tax withholding	(443)	(27,895)
Debt issuance costs	(16,004)	-
Proceeds from borrowings of long-term debt	3,477,000	-
Proceeds from exercise of stock options	31,024	15,499
Net cash provided by (used in) financing activities	483,715	(558,551)
Cash, cash equivalents and restricted cash:		
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(3,639)	5,589
Net increase (decrease) in cash, cash equivalents and restricted cash	35,256	(4,329)
Cash, cash equivalents and restricted cash at beginning of period	451,370	425,810
Cash, cash equivalents and restricted cash at end of period	\$ 486,626	421,481
Supplemental cash flow information:		
Interest paid	\$ 113,099	93,151
Income taxes paid, net	\$ 59,099	194,435

See accompanying Notes to Unaudited Consolidated Financial Statements

Table of Contents

## Consolidated Financial Statements

## TOTAL SYSTEM SERVICES, INC.

## Consolidated Statement of Changes in Equity

(Unaudited)

(in thousands, except per share data)	TSYS Shareholders			Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss), Net of Tax	Treasury Stock	Retained Earnings
	Redeemable Noncontrolling Interests	Common Stock Shares	Dollars				
	Balance as of December 31, 2017	\$ 115,689	202,765				
Cumulative effect adjustment from adoption of ASU 2014-09 (Note 2)	-	-	-	-	-	-	(4,445)
Reclassification from adoption of ASU 2018-02 (Notes 1 and 4)	-	-	-	-	2,329	-	(2,329)
Net income	1,261	-	-	-	-	-	440,236
Other comprehensive loss	-	-	-	-	(16,267)	-	-
Common stock issued from treasury shares for exercise of stock options	-	-	-	7,075	-	23,943	-
Common stock unissued due to forfeiture of nonvested awards	-	-	-	658	-	(658)	-
Common stock issued from treasury shares for nonvested awards	-	-	-	(13,163)	-	13,163	-
Common stock issued from treasury shares for dividend equivalents	-	-	-	925	-	9	-

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

Share-based compensation	-	-	-	32,682	-	-	-
Cash dividends declared (\$0.39 per share)	-	-	-	-	-	-	(71,698)
Purchase of treasury shares	-	-	-	-	-	(443)	-
Adjustments to redemption value of redeemable noncontrolling interest	12,828	-	-	(12,828)	-	-	-
Repurchase of noncontrolling interest	(126,000)	-	-	-	-	-	-
Subsidiary dividends paid to noncontrolling interest	(3,778)	-	-	-	-	-	-
Balance as of September 30, 2018	\$ -	202,765	\$ 20,277	178,155	(50,086)	(873,946)	3,365,782

See accompanying Notes to Unaudited Consolidated Financial Statements

Table of Contents

TOTAL SYSTEM SERVICES, INC.

Notes to Unaudited Consolidated Financial Statements

Note 1 —Summary of Significant Accounting Policies

Business

Total System Services, Inc.'s ("TSYS" or the "Company's") revenues are derived from providing payment processing, merchant services and related payment services to financial and nonfinancial institutions, generally under long-term processing contracts. The Company also derives revenues by providing general-purpose reloadable (GPR) prepaid debit and payroll cards, demand deposit accounts and other financial service solutions to the underbanked and other consumers and businesses. The Company's services are provided through three operating segments: Issuer Solutions, Merchant Solutions and Consumer Solutions.

Through the Company's Issuer Solutions segment, TSYS processes information through its cardholder systems for financial and nonfinancial institutions throughout the United States and internationally. The Company's Merchant Solutions segment provides merchant services to merchant acquirers and merchants mainly in the United States. The Company's Consumer Solutions segment provides financial service solutions to consumers and businesses in the United States.

Basis of Presentation

The accompanying unaudited consolidated financial statements of TSYS include the accounts of TSYS and its wholly- and majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

These financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and, therefore, do not include all information and footnotes required by U.S. GAAP for complete financial statements. The preparation of the consolidated financial statements requires management of the Company to make estimates and

assumptions relating to the reported amounts of assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. These estimates and assumptions are developed based upon all information available. Actual results could differ from estimated amounts. All adjustments, consisting of normal recurring accruals, which, in the opinion of management, are necessary for a fair presentation of financial position and results of operations for the periods covered by this report, have been included.

The accompanying unaudited consolidated financial statements should be read in conjunction with the Company's summary of significant accounting policies, consolidated financial statements and related notes appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission ("SEC"). Results of interim periods are not necessarily indicative of results to be expected for the year.

#### Recently Adopted Accounting Pronouncements

The Company adopted the following Accounting Standards Updates ("ASUs") on January 1, 2018:

In March 2018, the FASB issued ASU 2018-05 Income Taxes (Topic 740) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118. This ASU adds SEC paragraphs pursuant to the SEC Staff Accounting Bulletin No. 118, which expresses the view of the staff regarding application of Topic 740, Income Taxes, in the reporting period that includes December 22, 2017 - the date on which the Tax Cuts and

Table of Contents

Jobs Act was signed into law. The Company adopted the provisions of SEC Staff Accounting Bulletin No. 118 as of December 22, 2017. See Note 7 for further discussion regarding income taxes.

In May 2017, the Financial Accounting Standards Board (“FASB”) issued ASU 2017-09 Compensation - Stock Compensation (Topic 718), Scope of Modification Accounting, to provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all the following are met:

1. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.
2. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.
3. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The ASU was adopted by the Company on January 1, 2018. The adoption of this ASU did not have a material impact on the Company’s financial position, results of operations or cash flows.

In January 2017, the FASB issued ASU 2017-01 Business Combinations (Topic 805), Clarifying the Definition of a Business, which provides a more robust framework to use in determining when a set of assets and activities is a business. The framework assists entities in evaluating whether both an input and a substantive process are present. The framework includes two sets of criteria to consider that depend on whether a set has outputs. Although outputs are not required for a set to be a business, outputs generally are a key element of a business; therefore, the FASB has developed more stringent criteria for sets without outputs. The ASU was adopted by the Company on January 1, 2018. The adoption of this ASU did not have a material impact on the Company’s financial position, results of operations or cash flows.

In November 2016, the FASB issued ASU 2016-18 Statement of Cash Flows (Topic 230): Restricted Cash, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The Company adopted this guidance on January 1, 2018 and has applied the guidance using a retrospective transition method for all periods presented.

In October 2016, the FASB issued ASU 2016-16 Income Taxes (Topic 740): Intra-Equity Transfers of Assets Other Than Inventory, which requires that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs and eliminates the exception for an intra-entity transfer of an

asset other than inventory. The ASU was adopted by the Company on January 1, 2018. The adoption of this ASU did not have a material impact on the Company's financial position, results of operations or cash flows.

In August 2016, the FASB issued ASU 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Receipts and Cash Payments, which clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows. The guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flow. The ASU was adopted by the Company on January 1, 2018. The adoption of this ASU did not have a material impact on the Company's financial position, results of operations or cash flows.

In January 2016, the FASB issued ASU 2016-01 Recognition and Measurement of Financial Assets and Financial Liabilities, which amends the guidance in U.S. GAAP on the classification and measurement of financial instruments. The ASU significantly revises an entity's accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. The ASU also amends certain disclosure requirements associated with the fair value of financial instruments. The ASU was adopted by the Company on January 1, 2018. The



Table of Contents

adoption of this ASU did not have a material impact on the Company's financial position, results of operations or cash flows.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The FASB has issued several additional ASUs since this time that add additional clarification to certain issues existing after the original ASU was released. All of the new standards were effective for the Company on January 1, 2018. The standards permit the use of either the full retrospective or modified retrospective transition method. TSYS adopted the new revenue standard as of January 1, 2018 using the modified retrospective transition method. See Note 2 for further discussion of the Company's adoption of this new standard.

In February 2018, the FASB issued ASU 2018-02 Income Statement - Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments in this ASU eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. The amendments in this ASU are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this ASU is permitted. The amendments in this ASU should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The ASU was early adopted by the Company as of July 1, 2018 and the Company recorded a balance sheet reclassification of \$2.3 million between accumulated other comprehensive loss and retained earnings.

New Accounting Pronouncements

In August 2018, the FASB issued ASU 2018-15, Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40), Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The amendments in this update align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The ASU is effective for the Company on January 1, 2020. Early adoption of the ASU is permitted. The Company is evaluating the effects of ASU 2018-15 on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820), Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement. The FASB is issuing the amendments in this update in connection with the FASB Statement of Financial Accounting Concepts No.8, Conceptual Framework for Financial Reporting-Chapter 8: Notes to Financial Statements, which was finalized in August 2018. The amendments in this update modify the disclosure requirements on fair value measurement in Topic

820, Fair Value Measurement, by removing, modifying or adding disclosures. The ASU is effective for the Company on January 1, 2020. Early adoption of the ASU is permitted. The Company is evaluating the effects of ASU 2018-13 on its consolidated financial statements.

In September 2017, the FASB issued ASU 2017-13 Revenue Recognition (Topic 605), Revenues from Customers (Topic 606), Leases (Topic 840) and Leases (Topic 842), which made amendments to SEC paragraphs pursuant to the Staff Announcement at the July 20, 2017 Emerging Issues Task Force (EITF) Meeting and rescission of prior SEC Staff Announcements and Observer comments. This guidance, which is effective immediately, generally relates to the adoption of ASC 606 and 842. The adoption of the amendments in this ASU relating to ASC 606 did not have a material impact on the Company's financial position, results of operations or cash flows. The Company does not expect the adoption of the amendments in this ASU relating to ASC 842 to have a material impact on the Company's financial position, results of operations or cash flows.

## Table of Contents

In June 2016, the FASB issued ASU 2016-13 Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments in this update change how companies measure and recognize credit impairment for many financial assets. The new expected credit loss model will require companies to immediately recognize an estimate of credit losses expected to occur over the remaining life of the financial assets (including trade receivables) that are in the scope of the update. The update also made amendments to the current impairment model for held-to-maturity and available-for-sale debt securities and certain guarantees. The ASU is effective for the Company on January 1, 2020. Early adoption is permitted for periods beginning on or after January 1, 2019. The Company is evaluating the effect of ASU 2016-13 on its consolidated financial statements.

## Recent Accounting Pronouncements Related to Leases

In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842), which introduces a lessee model that brings most leases on the balance sheet and aligns many of the underlying principles of the new lessor model with those in the FASB's new revenue recognition standard. The ASU also addresses other concerns related to the current leases model. The new guidance will be effective for fiscal years and interim periods within those years beginning after December 15, 2018. Early adoption is permitted for all entities.

The FASB has issued several additional ASUs that provide additional clarification to certain issues existing after the original ASU was released. In July 2018, the FASB issued ASU 2018-11 Leases (Topic 842): Targeted Improvements to provide entities with an additional (and optional) transition method to adopt the new leases standard and provide lessors with a practical expedient, by class of underlying asset, to not separate non-lease components from the associated lease component and, instead, to account for those components as a single component if certain criteria are met. Also in July 2018, the FASB issued ASU 2018-10 Codification Improvements to Topic 842 to make amendments addressing sixteen issues related to various aspects of ASU 2016-02. The effective date and transition requirements for the amendments in ASU 2018-11 and ASU 2018-10 will be the same as the effective date and transition requirements in ASU 2016-02.

The Company will adopt ASU 2016-02 on January 1, 2019 using the additional transition method (cumulative effect method) provided by ASU 2018-11. To date, the Company has elected to utilize the following practical expedients and accounting policy elections:

- The Company, electing as a package, will not reassess: (a) whether expired or existing contracts contain leases under the new definition of a lease, (b) lease classification for expired or existing leases, and (c) whether previously capitalized initial direct costs would qualify for capitalization under ASU 2016-02.
- The Company will not evaluate land easements that exist or expired before the Company's adoption of ASU 2016-02 and that were not previously accounted for as leases.
- From a lessee perspective, the Company has elected, as an accounting policy election by class of underlying asset, not to separate non-lease components from lease components. By electing to utilize this practical expedient, the Company will account for the combined lease and non-lease components as a single lease component.

- From a lessee perspective, the Company has elected, as an accounting policy election by class of underlying asset, not to recognize Right-of-Use (ROU) assets and lease liabilities for short-term leases.
- The Company will utilize incremental borrowing rates in transition (as of January 1, 2019) based on the remaining lease payments and remaining lease term.

The Company decided not to elect the use of hindsight in determining the lease term and in assessing impairment of the Company's ROU assets.

The Company has formed a cross-functional project team to evaluate the requirements of the new leases standard from both a lessee and lessor perspective, and to monitor ongoing standard setting activities of the FASB. The Company is reviewing its lease contracts under the new standard to identify and evaluate differences from current guidance. From a lessee standpoint, the Company's leases primarily involve

Table of Contents

computer and other equipment, and facilities. Also, from a lessor perspective, the Company continues to evaluate the accounting treatment for point-of-sale (“POS”) terminals.

While the Company is continuing to evaluate the effects of this ASU, the Company expects to record material ROU assets and lease liabilities on its consolidated balance sheet upon adoption as of January 1, 2019. The Company does not expect the adoption of this ASU to have a material impact on its results of operations or cash flows. The adoption of this guidance will require the implementation of new or updated accounting processes, procedures and internal controls over financial reporting. The Company plans to implement a new lease accounting software solution to facilitate compliance with the requirements of the new standard. The new standard will also require expanded qualitative and quantitative disclosures regarding the Company’s leases.

Note 2 — Revenue from Contracts with Customers

The Company adopted ASU 2014-09 and related ASUs (“ASC 606”) as of January 1, 2018 using the modified retrospective method for all contracts not completed as of the date of adoption. For contracts that were modified before the effective date, the Company considered the effect of all modifications when identifying performance obligations and allocating transaction price, which did not have a material effect on the adjustment to retained earnings. The reported results for 2018 reflect the application of ASC 606 guidance while the reported results for 2017 were prepared under the guidance of ASC 605, Revenue Recognition (“ASC 605”), which is also referred to herein as "legacy GAAP" or the "previous guidance." In accordance with ASC 606, revenue is recognized when a customer obtains control of promised goods or services. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these services. To achieve this core principle, the Company applies the following five steps:

1. Identify the contract with a customer. A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer that defines each party’s rights regarding the services to be transferred and identifies the payment terms related to these services, (ii) the contract has commercial substance and, (iii) the Company determines that collection of substantially all consideration for services that are transferred is probable based on the customer’s intent and ability to pay the promised consideration. The Company applies judgment in determining the customer’s ability and intention to pay, which is based on a variety of factors including the customer’s historical payment experience or, in the case of a new customer, published credit and financial information pertaining to the customer.
2. Identify the performance obligations in the contract. Performance obligations promised in a contract are identified based on the goods or services that will be transferred to the customer that are both capable of being distinct, whereby the customer can benefit from the service either on its own or together with other resources that are readily available from third parties or from the Company, and are distinct in the context of the contract, whereby the transfer of the services is separately identifiable from other promises in the contract. To the extent a contract

includes multiple promised services, the Company must apply judgment to determine whether promised services are capable of being distinct and are distinct in the context of the contract. If these criteria are not met, the promised services are accounted for as a combined performance obligation.

3. Determine the transaction price. The transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods and services to the customer. To the extent the transaction price includes variable consideration, the Company estimates the amount of variable consideration that should be included in the transaction price utilizing either the expected value method or the most likely amount method depending on the nature of the variable consideration. Variable consideration is included in the transaction price if, in the Company's judgment, it is probable that a significant future reversal of cumulative revenue under the contract will not occur.
  
4. Allocate the transaction price to performance obligations in the contract. If the contract contains a single performance obligation, the entire transaction price is allocated to the single

12

---

## Table of Contents

performance obligation. However, if a series of distinct services that are substantially the same qualifies as a single performance obligation in a contract with variable consideration, the Company must determine if the variable consideration is attributable to the entire contract or to a specific part of the contract. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative standalone selling price basis unless the transaction price is variable and meets the criteria to be allocated entirely to a performance obligation or to a distinct service that forms part of a single performance obligation. The Company determines standalone selling prices based on the price at which the performance obligation is sold separately. If the standalone selling price is not observable through past transactions, the Company estimates the standalone selling price taking into account available information such as market conditions and internally approved pricing guidelines related to the performance obligations.

5. Recognize revenue when or as the Company satisfies a performance obligation. The Company satisfies performance obligations either over time or at a point in time as discussed in further detail below. Revenue is recognized at the time the related performance obligation is satisfied by transferring a promised good or service to a customer.

Description of service offerings and revenue recognition policies

Issuer Solutions

Description of service offerings

The Company's Issuer Solutions revenues are derived from long-term processing contracts with financial and nonfinancial institutions. Payment processing services revenues are generated primarily from charges based on:

- The number of accounts on file;
- Transactions and authorizations processed;
- Statements generated and/or mailed;
- Managed services; and
- Cards embossed and mailed and other processing services for cardholder accounts on file.

Most of these contracts have prescribed annual revenue minimums, penalties for early termination, and service level agreements which may impact contractual fees if certain service levels are not achieved.

Issuer Solutions revenues also include loyalty redemption services and professional services.

Description of revenue recognition policies

Issuer Solutions revenues typically include a performance obligation to provide processing services to financial and non-financial institutions. The Company has determined that these processing services represent a stand-ready series of distinct daily services that are substantially the same, with the same pattern of transfer to the customer. In many cases, Issuer Solutions arrangements may include additional performance obligations relating to loyalty redemption services and other professional services. Similar to processing services, the Company has determined that loyalty redemption services represent a stand-ready series of distinct daily services that are substantially the same, with the same pattern of transfer to the customer. Professional services represent performance obligations that are satisfied over time.

The Company has determined that the vast majority of performance obligations to provide processing services and loyalty redemption services meet the allocation of variable consideration exception criteria (“direct allocation”) in that (a) the terms of a variable payment relate specifically to the entity’s efforts to satisfy the performance obligation or transfer the distinct service and (b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective when considering all of the performance obligations and payment terms in the contract. As a result, for those performance obligations qualifying for direct allocation, the Company allocates and recognizes variable consideration in the period in which it has the contractual right to invoice the customer. In



## Table of Contents

certain instances when a performance obligation does not meet the criteria for direct allocation, the Company recognizes revenue on either a straight-line basis or a blended rate method (i.e., an output method using the estimated per transaction fee based on estimated total contract consideration and volumes, multiplied by the actual monthly transaction volumes) over the term of the contract. A blended rate method is utilized for contracts that have estimates of significant growth over the contract term. The Company determined that straight-line or blended rate are the most appropriate methods of measuring progress toward completion for performance obligations that do not meet the criteria for direct allocation.

For professional services, the Company recognizes revenue based on the labor hours incurred for time and materials projects or on a straight-line basis for fixed fee projects.

For Issuer Solutions contracts that contain multiple performance obligations, the transaction price is allocated to each performance obligation based on a relative standalone selling price basis unless the transaction price is variable and meets the criteria to be allocated entirely to a performance obligation or to a distinct service that forms part of a single performance obligation. The Company determines standalone selling price based on the price at which the performance obligation is sold separately. If the standalone selling price is not observable through past transactions, the Company estimates the standalone selling price taking into account available information such as market conditions and internally approved pricing guidelines related to the performance obligations.

The Issuer Solutions segment also enters into licensing arrangements with customers. Under these arrangements, the Company provides the customer with a term license (functional IP), implementation services and annual support, which includes unspecified upgrades and enhancements. The Company has determined that these promised goods and services represent one combined performance obligation since the individual promised goods or services are not distinct in the context of the contract. The Company recognizes revenue over the remaining contract period beginning at go-live, on a straight-line basis, for this performance obligation. Revenues related to this combined performance obligation are immaterial. For separate performance obligations relating to professional services, revenue is recognized using an input method based on labor hours expended.

## Merchant Solutions

### Description of service offerings

The Company's Merchant Solutions revenues are partially derived from relationships with thousands of individual merchants whose contracts range from thirty days to five years. Additionally, part of the revenues are derived from long-term processing contracts with large financial institutions, other merchant acquirers and merchant organizations which generally range from three to eight years. Merchant services revenue is generated primarily from processing all payment forms including credit, debit and electronic benefits transfer for merchants of all sizes across a wide array of retail market segments.

The products and services offered include:

- Authorizations and capture of electronic transactions;
- Clearing and settlement of electronic transactions;
- Information reporting services related to electronic transactions;
- Merchant billing services; and
- Point-of-sale equipment and services.

Most of these contracts have prescribed revenue minimums, penalties for early termination, and service level agreements which may impact contractual fees if certain service levels are not achieved.

Description of revenue recognition policies

Merchant Solutions revenues typically include one performance obligation to provide processing services to individual merchants, large financial institutions, other merchant acquirers or merchant organizations. The Company has determined that merchant processing services represent a stand-ready series of distinct daily services that are substantially the same, with the same pattern of transfer to the customer. Merchant

## Table of Contents

Solutions arrangements also include other promised goods or services (such as point-of-sale terminals and merchant statement services) that are immaterial in the context of the contract. As a result, the Company has determined that Merchant Solutions arrangements represent one performance obligation.

The Company has determined that the performance obligation to provide merchant processing services meets the allocation of variable consideration exception criteria (“direct allocation”) in that (a) the terms of a variable payment relate specifically to the entity’s efforts to satisfy the performance obligation or transfer the distinct service and (b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective when considering all of the performance obligations and payment terms in the contract. As a result, the Company allocates and recognizes variable consideration in the period it has the contractual right to invoice the customer.

### Interchange and payment network fees

Interchange and payment network fees are charged by the card associations or payment networks and relate primarily to the Company’s Merchant Solutions segment. With respect to interchange and payment network fees, the Company evaluated whether it is the principal or the agent in the arrangement. With the adoption of ASC 606, the Company determined that interchange and payment network fees are not provided in return or exchange for services that the Company controls or acts as the principal, and, therefore, are not part of the consideration paid for its services. These fees collected on behalf of the payment networks and card issuers are presented net of the amounts paid to them. Accordingly, the Company is acting as an agent and presents the fees collected from merchants on behalf of the payment networks and card issuers net of the amounts paid to them. In reaching this determination, the Company considered a number of factors including indicators of control such as the party primarily responsible and the party who has discretion in establishing prices.

### Consumer Solutions

#### Description of service offerings

The Company’s Consumer Solutions revenues principally consist of a portion of the service fees collected from cardholders and interchange revenues received by the issuing banks in connection with the programs that the Consumer Solutions segment manages.

Customers are charged fees in connection with the Consumer Solutions segment’s products and services as follows:

- Transactions - Customers are typically charged a fee for each Personal Identification Number (“PIN”) and signature-based purchase transaction made using their cards, unless the customer is on a monthly or annual service

- plan, in which case the customer is instead charged a monthly or annual subscription fee, as applicable. Customers are also charged fees for Automated Teller Machine (“ATM”) withdrawals and other transactions conducted at ATMs.
- Customer Service and Maintenance - Customers are typically charged fees for balance inquiries made through Consumer Solutions call centers. Customers are also charged a monthly maintenance fee after a specified period of inactivity.
  - Additional Products and Services - Customers are charged fees associated with additional products and services offered in connection with certain cards, including the use of overdraft features, a variety of bill payment options, custom card designs and card-to-card transfers of funds initiated through the call centers.
  - Other - Customers are charged fees in connection with the acquisition and reloading of the GPR cards at retailers and the Company receives a portion of these amounts in some cases.

#### Description of revenue recognition policies

Consumer Solutions revenues include one performance obligation to provide account access and facilitate purchase transactions and interchange fees. The Company has determined that Consumer Solutions services represent a stand-ready series of distinct daily services that are substantially the same, with the same pattern of transfer to the customer. Further, the Company has determined that the performance obligation to provide account access and facilitate purchase transactions meets the criteria for the “as

Table of Contents

invoiced” practical expedient in that the Company has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the Company’s performance completed to date. As a result, the Company recognizes revenue in the amount to which the Company has a right to invoice.

## Disaggregation of revenue

The following table summarizes volume-based and non-volume related revenue from contracts with external customers for the three and nine months ended September 30, 2018:

(in thousands)	Three months ended September 30, 2018			
	Issuer	Merchant	Consumer	Total
	Solutions	Solutions	Solutions	
Volume-based revenues	\$ 227,423	325,831	195,722	\$ 748,976
Non-volume related revenues	243,555	22,760	80	266,395
Total revenues	\$ 470,978	348,591	195,802	\$ 1,015,371

(in thousands)	Nine months ended September 30, 2018			
	Issuer	Merchant	Consumer	Total
	Solutions	Solutions	Solutions	
Volume-based revenues	\$ 670,374	954,073	604,933	\$ 2,229,380
Non-volume related revenues	716,565	62,654	1,522	780,741
Total revenues	\$ 1,386,939	1,016,727	606,455	\$ 3,010,121

## Issuer Solutions

Volume-based revenues are generated from charges based on the number of Accounts on File (AOF), transactions and authorizations processed, statements generated, and other processing services for cardholder AOF. Cardholder AOF includes active and inactive consumer credit, retail, prepaid, stored value, government services and commercial card accounts. TSYS’ clients also have the option to use fraud and portfolio management services which are based on authorizations processed and AOF, respectively. Collectively, these services are considered volume-based revenues. Non-volume related revenues include processing fees which are not directly associated with AOF and transactional activity, such as value-added products and services, custom programming and certain other services, which are only offered to TSYS’ processing clients. Additionally, non-volume based revenues include licensing, managed services and output services such as card and document production.

## Merchant Solutions

The Merchant Solutions segment's revenues primarily consist of volume-based revenues generated from charges based on sales volume processed, and authorized transactions and settled transactions processed. Non-volume related revenues include chargeback and retrieval services, data transmissions, value added products and managed services which are not directly associated with transactional activity.

## Consumer Solutions

The Consumer Solutions segment's revenues primarily consist of a portion of the service fees collected from cardholders and interchange revenues. Customers are charged fees for transactions including fees for purchase transactions, ATM withdrawals, balance inquiries, monthly maintenance services and other transaction fees. Customers are also charged fees associated with additional features and services offered in connection with certain products including the use of courtesy overdraft protection, bill payment options, custom card designs and card-to-card transfers of funds initiated through call centers. The Consumer Solutions segment also earns revenues from a portion of the interchange fees remitted by merchants when customers make purchase transactions using their products. Substantially all of the Consumer Solutions segment revenues are volume driven by the active card and gross dollar volume (spend) indicators.

Table of Contents

The following table summarizes revenue from contracts with customers, by currency, for the three and nine months ended September 30, 2018:

(in thousands)	Three months ended September 30, 2018			
	Issuer Solutions	Merchant Solutions	Consumer Solutions	Total
U.S. Dollar	\$ 373,821	348,419	195,802	\$ 918,042
British Pound Sterling	65,259	-	-	65,259
Euro	25,135	-	-	25,135
Other	6,763	172	-	6,935
Total revenues	\$ 470,978	348,591	195,802	\$ 1,015,371

(in thousands)	Nine months ended September 30, 2018			
	Issuer Solutions	Merchant Solutions	Consumer Solutions	Total
U.S. Dollar	\$ 1,101,180	1,016,161	606,455	\$ 2,723,796
British Pound Sterling	187,478	-	-	187,478
Euro	77,152	-	-	77,152
Other	21,129	566	-	21,695
Total revenues	\$ 1,386,939	1,016,727	606,455	\$ 3,010,121

See Note 8 for disclosure of revenues by geography.

## Performance obligations

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The purpose of this disclosure is to provide additional information about the amounts and expected timing of revenue to be recognized from the remaining performance obligations in the Company's existing contracts. For revenue which is recognized using (i) the "as-invoiced" practical expedient and (ii) the "direct allocation" method, the Company is required to disclose the value of unsatisfied performance obligations for contractual minimums only. Accordingly, the total unsatisfied or partially unsatisfied performance obligations related to processing services are materially higher than the amounts disclosed in the below table.

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

(in thousands)	Remainder of 2018	2019	2020	2021	2022 - 2029	Total
Unsatisfied or partially unsatisfied performance obligations	\$ 200,261	698,863	605,797	508,478	808,194	\$ 2,821,593

Contract balances

The following table provides information about accounts receivable, contract assets and contract liabilities from contracts with customers:

(in thousands)	As of	
	September 30, 2018	January 1, 2018
Accounts receivable	\$ 485,722	\$ 412,322
Contract assets	82,560	87,812
Contract liabilities	72,403	76,541

ASC 606 requires an entity to present in its consolidated balance sheets the net position in a customer contract on a contract-by-contract basis. The net position in a customer contract is presented as either contract assets or contract liabilities.



Table of Contents

Contract assets are defined as an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

Contract liabilities are defined as an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer. Contract liabilities as of December 31, 2017 were previously described as deferred revenues.

Net contract assets and liabilities may include amounts related to signing incentives for signing or renewing long-term contracts. Capitalized signing incentives are amortized over the contract term and the amortization is included as a reduction of revenues in the Company's consolidated statements of income.

Significant changes in the contract assets and liabilities balances during the nine months ended September 30, 2018 are as follows:

(in thousands)	Nine months ended September 30, 2018	
	Contract Assets Increase/(Decrease)	Contract Liabilities Increase/(Decrease)
Changes in net contract assets and net contract liabilities related to signing incentives	\$ 18,366	\$ 57
Changes in net contract assets and net contract liabilities related to signing incentive amortization	(19,980)	(5,986)
Changes in net contract assets and net contract liabilities related to revenue recognized in advance of billings	3,900	1,584
Change in net contract assets and liabilities due to billed amounts transferred to receivables	(3,694)	(2,612)
Changes in net contract assets and net contract liabilities primarily relating to cash received from customers	(3,925)	(111,778)
Deferred revenue that was released from net contract assets and net contract liabilities	6,308	113,520

Other changes in contract assets and contract liabilities primarily relate to foreign currency translation.

Costs to obtain or fulfill a contract

The Company capitalizes the incremental costs of obtaining a contract with a customer if the Company expects to recover those costs. The incremental costs of obtaining a contract are those that the Company incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission). The Company also makes commission payments to third parties such as agents and partners. To date, costs to obtain a contract that qualify for capitalization are immaterial.

The Company capitalizes the costs incurred to fulfill a contract only if those costs meet all of the following criteria:

- a. The costs relate directly to a contract or to an anticipated contract that the Company can specifically identify.
- b. The costs generate or enhance resources of the Company that will be used in satisfying (or in continuing to satisfy) performance obligations in the future.
- c. The costs are expected to be recovered.

See related discussion of contract cost assets in Note 4.

Contract acquisition and fulfillment costs are amortized using the straight-line method over the expected period of benefit (ranging from 20 months to seven years or the longer of the contract term) beginning when the client's cardholder accounts are converted or activated and producing revenues. The amortization of contract fulfillment costs associated with conversion activity is recorded as cost of services in the Company's consolidated statements of income. The amortization of contract acquisition costs associated with sales commissions that qualify for capitalization is recorded as selling, general and administrative expense in the

Table of Contents

Company's consolidated statements of income. Costs to obtain or fulfill a contract are classified as contract cost assets in the Company's consolidated balance sheets.

In evaluating contract acquisition and fulfillment costs for recoverability, expected cash flows are estimated by management should events indicate a loss may have been triggered. The Company evaluates the carrying value of contract cost assets associated with each customer for impairment on the basis of whether these costs are fully recoverable from either contractual minimum fees or from expected undiscounted net operating cash flows of the related contract. The determination of expected undiscounted net operating cash flows requires management to make estimates. If the actual cash flows are not consistent with the Company's estimates, a material impairment charge may result and net income may be materially different than was initially recorded. These costs may become impaired with the loss of a contract, the financial decline of a client, termination of conversion efforts after a contract is signed, diminished prospects for current clients or if the Company's actual results differ from its estimates of future cash flows. The amount of the impairment is written off in the period that such a determination is made.

Optional exemptions, practical expedients and policy elections

The Company has elected to treat shipping and handling activities as a cost of fulfillment rather than a separate performance obligation.

The Company has elected to exclude all sales and other similar taxes from the transaction price. Accordingly, the Company presents all collections from customers for these taxes on a net basis, rather than having to assess whether the Company is acting as an agent or a principal in each taxing jurisdiction.

In certain arrangements with customers, the Company has determined that certain promised goods or services are immaterial in the context of the contract, from both a quantitative and qualitative perspective.

The Company utilizes a portfolio approach in order to estimate amounts for service level agreement penalties and similar items for portfolios of contracts with similar characteristics, using estimates and assumptions that reflect the size and composition of the portfolio.

As a practical expedient, the Company is not required to adjust the promised amount of consideration for the effects of a significant financing component if the Company expects, at contract inception, that the period between when the Company transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less. None of the Company's contracts as of September 30, 2018 contained a significant financing component.

The Company has elected to use the ‘as-invoiced’ practical expedient for its performance obligations to provide account access and facilitate purchase transactions related to the Consumer Solutions segment.

The Company does not disclose the value of unsatisfied performance obligations (except for contractual minimums) for which revenue is recognized using (i) the “as-invoiced” practical expedient and (ii) the “direct allocation” method.

The Company adopted ASC 606 as of January 1, 2018 using the modified retrospective method for all contracts not completed as of the date of adoption. For contracts that were modified before the effective date, the Company utilized the practical expedient to consider the aggregate effect of all modifications when identifying performance obligations and allocating transaction price.

Table of Contents

## Impact of New Revenue Guidance on Financial Statement Line Items

The disclosure of the impact of adoption of ASC 606 on the Company's consolidated balance sheets, statements of income, and statements of cash flows was as follows:

(in thousands)	As of September 30, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change Higher/(Lower)
Assets:			
Prepaid expenses and other current assets	\$ 197,010	\$ 199,071	\$ (2,061)
Contract assets (short-term and long-term)	82,560	-	82,560
Contract cost assets (short-term and long-term)	147,732	255,567	(107,835)
Deferred income tax assets	6,928	6,051	877
Other assets	115,334	120,752	(5,418)
Liabilities:			
Contract liabilities (short-term and long-term)	72,403	91,576	(19,173)
Other liabilities (short-term and long-term)	350,633	352,435	(1,802)
Shareholders' equity:			
Accumulated other comprehensive loss, net	(50,086)	(49,707)	(379)
Retained earnings	3,365,782	3,376,305	(10,523)

(in thousands, except per share data)	Three months ended September 30, 2018			Nine months ended September 30, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change Higher/(Lower)	As Reported	Balances without adoption of ASC 606	Effect of Change Higher/(Lower)
Total revenues	\$ 1,015,371	1,459,182	(443,811)	3,010,121	4,252,569	(1,242,448)
Total operating expenses	799,388	1,239,228	(439,840)	2,397,169	3,631,739	(1,234,570)
Operating income	\$ 215,983	219,954	(3,971)	612,952	620,830	(7,878)
Income taxes	\$ 31,112	32,033	(921)	86,662	88,461	(1,799)
Net income	\$ 155,960	159,010	(3,050)	441,497	447,575	(6,078)
Net income attributable to TSYS common shareholders	\$ 155,960	159,010	(3,050)	440,236	446,314	(6,078)
Basic earnings per share (EPS) attributable to TSYS common shareholders <sup>1</sup>	\$ 0.85	0.87	(0.02)	2.42	2.45	(0.03)
	\$ 0.85	0.86	(0.02)	2.40	2.43	(0.03)

Diluted EPS attributable  
to TSYS common  
shareholders<sup>1</sup>

<sup>1</sup> EPS Amounts may not total due to rounding.

(in thousands)	Nine months ended September 30, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change Higher/(Lower)
Cash flows from operating activities:			
Net income	\$ 441,497	\$ 447,575	\$ (6,078)
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	310,010	356,247	(46,237)
Changes in contract assets and contract liabilities	(4,824)	(34,687)	29,863
Changes in contract cost assets	2,906	-	2,906
Changes in other current and other long-term liabilities	(30,961)	(25,584)	(5,377)
Cash flows from investing activities:			
Additions to contract cost assets	-	(24,923)	24,923

Table of Contents

## Note 3 — Fair Value Measurement

Refer to Note 2 of the Company's audited financial statements for the year ended December 31, 2017, which is included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC, for a discussion regarding fair value measurement.

The Company had no transfers between Level 1, Level 2 or Level 3 assets during the nine months ended September 30, 2018 and 2017.

As of September 30, 2018, the Company had recorded goodwill in the amount of \$4.1 billion. The Company performed its annual impairment testing of its goodwill balance as of May 31, 2018, and this test did not indicate any impairment. The fair value of the reporting units substantially exceeds their carrying value.

## Note 4 — Supplementary Balance Sheet Information

## Cash, Cash Equivalents and Restricted Cash

The Company maintains accounts outside the United States denominated in currencies other than the U.S. dollar. All amounts in domestic accounts are denominated in U.S. dollars. The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the consolidated balance sheets that sum to the total of the same such amounts shown in the consolidated statements of cash flows.

Cash, cash equivalents and restricted cash balances are summarized as follows:

(in thousands)	September 30, 2018	December 31, 2017
Cash and cash equivalents in domestic accounts	\$ 422,044	396,577
Cash and cash equivalents in foreign accounts	62,537	53,780
Total cash and cash equivalents	484,581	450,357
Restricted cash included in other assets	2,045	1,013

Total cash, cash equivalents and restricted cash shown in the statement of cash flows	\$ 486,626	451,370
---	------------	---------

Restricted cash included in other assets in the consolidated balance sheets represents immaterial amounts required across the Company's segments for operational purposes.

#### Prepaid Expenses and Other Current Assets

Significant components of prepaid expenses and other current assets are summarized as follows:

(in thousands)	September 30, 2018	December 31, 2017
Prepaid expenses	\$ 43,458	65,159
Income taxes receivable	38,615	41,400
R&D state tax credit	26,346	22,642
Supplies inventory	19,401	17,072
Other	69,190	70,292
Total	\$ 197,010	216,565



Table of Contents

## Contract Cost Assets, Net

Significant components of contract cost assets are summarized as follows:

(in thousands)	September 30, 2018	December 31, 2017
Contract cost assets <sup>1</sup> , net	\$ 147,732	139,249
Payments for processing rights <sup>2</sup> , net	-	119,416
Total	\$ 147,732	258,665

Amortization expense related to contract cost assets is as follows:

(in thousands)	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Amortization expense related to:				
Contract cost assets <sup>1</sup>	\$ 8,592	7,266	27,830	22,596
Payments for processing rights <sup>2</sup>	-	5,076	-	15,405

1. Upon the Company's adoption of ASC 606, costs to obtain or fulfill a contract are classified as contract cost assets. As of September 30, 2018, contract cost assets primarily relate to conversion costs. Costs to obtain a contract that qualify for capitalization are immaterial. See further discussion in Note 2. Prior to the Company's adoption of ASC 606, contract cost assets were referred to as contract acquisition costs and included both conversion costs and payments for processing rights (signing incentives).
2. Upon the Company's adoption of ASC 606, payments for processing rights (signing incentives) are classified as contract assets in the Company's consolidated balance sheets. See further discussion in Note 2. Prior to the Company's adoption of ASC 606, contract cost assets were referred to as contract acquisition costs and included both conversion costs and payments for processing rights.

## Other Current Liabilities

Significant components of other current liabilities are summarized as follows:

(in thousands)	September 30, 2018	December 31, 2017
Accrued card brand fees	\$ 52,894	43,814
Accrued third-party commissions	43,005	34,276
Accrued expenses	34,726	34,260
Dividends payable	24,753	24,886
Accrued interest	23,923	19,330
Other	96,305	69,356
Total	\$ 275,606	225,922

Accumulated Other Comprehensive Loss (AOCL)

The income tax effects allocated to and the cumulative balance of accumulated other comprehensive income (AOCI) (loss) attributable to TSYS shareholders are as follows:

(in thousands)	Foreign currency translation adjustments and transfers from noncontrolling interests	Gain on available-for-sale securities	Change in postretirement healthcare plans	Total accumulated other comprehensive loss, net of tax
Balance as of December 31, 2017	\$ (43,464)	8,446	(1,130)	\$ (36,148)
Pretax amount	(14,528)	(2,000)	(451)	(16,979)
Tax effect	(359)	(439)	86	(712)
Net-of-tax amount	(14,169)	(1,561)	(537)	(16,267)
Reclassification for adoption of ASU 2018-02 (Note 1)	604	1,968	(243)	2,329
Balance as of September 30, 2018	\$ (57,029)	8,853	(1,910)	\$ (50,086)

Table of Contents

As discussed in Note 1, the Company early adopted ASU 2018-02 as of July 1, 2018 and recorded a balance sheet reclassification of \$2.3 million between accumulated other comprehensive loss and retained earnings.

## Note 5 — Long-Term Borrowings, Capital Lease Obligations and License Agreements

Long-term debt as of September 30, 2018 and December 31, 2017 consists of:

(in thousands)	September 30, 2018	December 31, 2017
3.800% Senior Notes due April 1, 2021 (5 year tranche), net of discount and debt issuance costs	\$ 746,067	745,000
4.800% Senior Notes due April 1, 2026 (10 year tranche), net of discount and debt issuance costs	743,558	743,042
2.375% Senior Notes due June 1, 2018 (5 year tranche), net of discount and debt issuance costs	-	549,532
3.750% Senior Notes due June 1, 2023 (10 year tranche), net of discount and debt issuance costs	545,427	544,780
4.000% Senior Notes due June 1, 2023 (5 year tranche), net of discount and debt issuance costs	545,591	-
4.450% Senior Notes due June 1, 2028 (10 year tranche), net of discount and debt issuance costs	445,343	-
LIBOR + 1.300%, unsecured revolving loan, due April 23, 2023, with monthly interest payments on outstanding balances	805,000	-
3.760% note payable due March 20, 2020, with monthly interest and principal payments	19,648	-
LIBOR + 1.500%, unsecured term facility, due February 23, 2021, with quarterly principal and interest payments, net of debt issuance costs	-	368,645
LIBOR + 1.300%, unsecured revolving loan, due February 23, 2021, with monthly interest payments on outstanding balances	-	200,000
Total debt	3,850,634	3,150,999
Less current portion	(12,975)	(559,050)
Noncurrent portion of long-term debt	\$ 3,837,659	2,591,949

## Senior Notes

On May 11, 2018, TSYS closed its sale (the “Transaction”) of \$550 million aggregate principal amount of 4.000% Senior Notes due 2023 and \$450 million aggregate principal amount of 4.450% Senior Notes due 2028 (collectively, the “Notes”) pursuant to an underwriting agreement, dated May 9, 2018 (the “Underwriting Agreement”), with Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities LLC, as representatives of the underwriters (the “Underwriters”), whereby the Company agreed to sell and the Underwriters agreed to purchase the Notes from the

Company, subject to and upon the terms and conditions set forth in the Underwriting Agreement. The Company used the net proceeds of the Transaction to repay (i) all of its outstanding 2.375% Senior Notes due June 1, 2018 at maturity, (ii) all of its remaining outstanding indebtedness under that certain credit agreement dated January 10, 2018, among the Company and Bank of America, N.A., as administrative agent and the lenders party thereto, as amended and (iii) with any remaining amounts, a portion of the \$1.34 billion outstanding under that certain Credit Agreement dated April 23, 2018, among the Company and Bank of America, N.A., as Administrative Agent and L/C Issuer, JPMorgan Chase Bank, N.A., as Syndication Agent, and the lenders party thereto. The Notes were issued pursuant to a Senior Indenture, dated as of March 17, 2016, between the Company and Regions Bank, as trustee.

#### Senior Credit Facility

On April 23, 2018, TSYS entered into a Credit Agreement with Bank of America, N.A., as Administrative Agent and letter of credit issuer. The Credit Agreement provides the Company with a \$1.75 billion five-year revolving senior credit facility, which includes a \$50 million sub-facility for the issuance of standby letters of credit.

## Table of Contents

The Credit Agreement was used to repay (i) in full, borrowings under that certain Credit Agreement dated February 23, 2016, among the Company, JPMorgan Chase Bank, N.A., as administrative agent and the lenders party thereto, as amended, and (ii) in part, borrowings under that certain Credit Agreement dated January 10, 2018, among the Company and Bank of America as administrative agent and the lenders party thereto, as amended.

Borrowings under the Credit Agreement will accrue interest at either the base rate (as defined in the Credit Agreement) or, for certain euro-denominated borrowings, the LIBOR, in each case plus a margin based on the Company's corporate credit ratings.

The Credit Agreement contains customary covenants regarding, among other matters, the maintenance of insurance, the preservation and maintenance of the Company's corporate existence, material compliance with laws and the payment of taxes and other material obligations. The Credit Agreement also contains financial covenants including (i) a minimum consolidated fixed charge coverage ratio (the "Minimum Fixed Charge Coverage Ratio") of 2.5 to 1.0 and (ii) a maximum consolidated leverage ratio ("Maximum Leverage Ratio") (x) of 4.00 to 1.0, for the fiscal quarter ending June 30, 2018, (y) of 3.75 to 1.0, for each of the fiscal quarters ending September 30, 2018, December 31, 2018 and March 31, 2019, and (z) of 3.50 to 1.0, for any fiscal quarter ending thereafter. The Company was in compliance with all applicable financial covenants as of September 30, 2018.

## Term Loan Facility

On January 10, 2018, TSYS entered into a credit agreement with Bank of America, N.A. as Administrative Agent and other lenders party thereto from time to time. The credit agreement provides the Company with a \$450 million two-year term loan facility ("Term Loan Facility"). The Term Loan Facility was used to finance, in part, the Company's acquisition of Cayan Holdings LLC ("Cayan").

Borrowings under the credit agreement will accrue interest at the base rate (as defined in the Credit Agreement) or, for certain euro-denominated borrowings, the London Interbank Offered Rate ("LIBOR"), in each case plus a margin based on the Company's corporate credit ratings. The applicable margin for loans bearing interest based on LIBOR ranges from 1.000% to 1.750%. The applicable margin for loans bearing interest based on the base rate ranges from 0.000% to 0.750%.

The credit agreement contains customary covenants regarding, among other matters, the maintenance of insurance, the preservation and maintenance of the Company's corporate existence, material compliance with laws and the payment of taxes and other material obligations. The credit agreement also contains financial covenants requiring the maintenance as of the end of each fiscal quarter of (i) a minimum fixed charge coverage ratio of 2.5 to 1.0 and (ii) a maximum consolidated leverage ratio of 3.5 to 1.0, which may be increased upon the occurrence of certain events (including the consummation of the acquisition of Cayan). As discussed above, the remaining balance of the Term

Loan Facility was paid off in June 2018.

Refer to Note 11 of the Company's audited financial statements for the year ended December 31, 2017, which is included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC, for further discussion regarding long-term borrowings and capital lease obligations and license agreements.

Below is a summary of the Company's borrowings and repayments on outstanding debt, capital lease obligations and license agreements:

(in thousands)	Nine months ended September 30, 2018			
	Borrowings	Capital lease obligations	License agreements	Total
Additional borrowings	\$ 3,502,955	8,435	3,416	\$ 3,514,806
Principal payments	2,798,308	7,271	1,608	2,807,187

Refer to Note 9 for more information on capital lease obligations and license agreements.

Table of Contents

## Note 6 — Share-Based Compensation

Refer to Notes 1 and 17 of the Company's audited financial statements for the year ended December 31, 2017, which are included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC, for a discussion regarding the Company's share-based compensation plans and policy.

## Share-Based Compensation

Share-based compensation costs are classified as selling, general and administrative expenses on the Company's statements of income and corporate administration and other expenses for segment reporting purposes. TSYS' share-based compensation costs are expensed, rather than capitalized, as these awards are typically granted to individuals not involved in capitalizable activities.

Below is a summary of share-based compensation expense for the three and nine months ended September 30, 2018 and 2017:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2018	2017	2018	2017
Share-based compensation	\$ 12,392	8,407	32,916	28,462

## Nonvested Share Awards - Time-Based

The Company granted shares of TSYS common stock to certain key employees. The nonvested stock bonus awards are typically for services to be provided in the future and vest over a period of up to four years. The market value of the TSYS common stock as of the date of issuance is charged as compensation expense over the vesting periods of the awards. As of September 30, 2018, there was approximately \$26.5 million of unrecognized compensation cost related to time-based nonvested share awards.

	Nine months ended September 30,	
	2018	2017
Number of shares granted	323,384	323,497
Market value (in millions)	\$ 28.8	17.7

#### Performance- and Market-Based Awards

The Company granted performance- and market-based shares to certain key employees. The performance- and market-based goals are established by the Compensation Committee of the Board of Directors and will vest up to a maximum of 200%. During the first nine months of 2018 and 2017, the Compensation Committee established performance goals based primarily on various financial and market-based measures. The Company's market-based awards are based upon the Company's Total Shareholder Return ("TSR") as compared to the TSR of the companies in the S&P 500 at the end of the performance period.

Compensation expense for performance shares is measured on the grant date based on the quoted market price of TSYS common stock. The Company estimates the probability of achieving the goals through the performance period and expenses the awards on a straight-line basis. The fair value of market-based awards is estimated on the grant date using a Monte Carlo simulation model. The Company expenses market-based awards on a straight-line basis. Compensation costs related to performance- and market-based shares are recognized through the longer of the performance period or the vesting period. As of September 30, 2018, there was approximately \$24.2 million of unrecognized compensation cost related to TSYS performance-based awards that is expected to be recognized through December 2020. As of September 30, 2018, there was approximately \$2.9 million of unrecognized compensation cost related to TSYS market-based awards that is expected to be recognized through December 2020.



Table of Contents

During the nine months ended September 30, 2018, the Company granted performance-based awards based on performance measures of adjusted diluted EPS, net revenue and non-financial operational metrics. Adjusted diluted EPS is adjusted earnings divided by weighted average diluted shares outstanding used for diluted EPS calculations. Adjusted earnings is net income excluding the after-tax impact of share-based compensation expense, amortization of acquisition intangibles, merger and acquisition expenses for completed acquisitions and litigation claims, judgments or settlement expenses and related legal expenses. Net revenue is total revenues less reimbursable items, as well as, merchant acquiring interchange and payment network fees charged by card associations or payment networks that are recorded by TSYS as expense. The number of performance-based shares with a one year performance period granted during the nine months ended September 30, 2018 totaled 84,600. The number of performance-based shares with a three year performance period granted during the nine months ended September 30 2018, totaled 130,840. The grants awarded with a three year performance period during the first nine months of 2018 will be expensed through December 31, 2020.

During the nine months ended September 30, 2017, the Company granted performance-based awards based on performance measures of adjusted diluted EPS and net revenue. The number of performance-based shares that have a one year performance period granted during the nine months ended September 30, 2017 totaled 146,094. The number of performance-based shares with a three year performance period granted during the nine months ended September 30, 2017 totaled 103,297. The grants awarded with a three year performance period during the first nine months of 2017 will be expensed through December 31, 2019.

The following table summarizes the market-based awards granted during the first nine months of 2018 and 2017:

Year	Performance	Performance	Number of	Period Expensed
Awarded	Period Ending	Measure	Shares	Through
2018	December 2020	TSR	33,940	December 2020
2017	December 2019	TSR	44,275	December 2019

#### Stock Option Awards

The Company granted stock options to certain key executives. The grants will vest over a period of up to three years.

The weighted average fair value of the option grants was estimated on the date of grant using the Black-Scholes-Merton option-pricing model with the following weighted average assumptions:

	Nine months ended			
	September 30,			
	2018		2017	
Number of options granted	360,118		548,265	
Weighted average exercise price	\$ 86.88		54.90	
Risk-free interest rate	2.55	%	1.78	%
Expected volatility	21.80	%	21.71	%
Expected term (years)	4.8		4.6	
Dividend yield	0.60	%	0.73	%
Weighted average fair value	\$ 19.23		10.83	

As of September 30, 2018, there was approximately \$5.0 million of unrecognized compensation cost related to TSYS stock options that is expected to be recognized over a remaining weighted average period of 1.6 years.

Table of Contents

Note 7 — Income Taxes

Refer to Notes 1 and 13 of the Company's audited financial statements for the year ended December 31, 2017, which are included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC, for a discussion regarding income taxes.

TSYS is the parent of an affiliated group that files a consolidated U.S. federal income tax return and most state and foreign income tax returns on a separate entity basis. In the normal course of business, the Company is subject to examinations by these taxing authorities unless statutory examination periods lapse. TSYS is no longer subject to U.S. federal income tax examinations for years before 2011 and with few exceptions, the Company is no longer subject to income tax examinations from state and local or foreign tax authorities for years before 2011. There are currently federal income tax examinations in progress for the years 2011 through 2013. Additionally, a number of tax examinations are in progress by the relevant state tax authorities. Although TSYS is unable to determine the ultimate outcome of these examinations, TSYS believes that its liability for uncertain tax positions relating to these jurisdictions for such years is adequate.

TSYS' effective tax rate was 17.8% and 32.0% for the three months ended September 30, 2018 and 2017, respectively, and 17.6% and 32.7% for the nine months ended September 30, 2018 and 2017, respectively. The primary reasons for the lower effective income tax rate for the three months ended September 30, 2018 as compared to the same period last year are the lower 2018 statutory Federal income tax rate as enacted by the Tax Cuts and Jobs Act of 2017 ("Tax Act"), and favorable variances in discrete items related to 2017 return to provision true-up adjustments and changes in unrecognized tax benefits from uncertain tax positions. The primary reasons for the lower effective income tax rate for the nine months ended September 30, 2018 as compared to the same period last year are the lower 2018 statutory Federal income tax rate as enacted by the Tax Act, and favorable variances in discrete items related to excess tax benefits from share-based compensation and 2017 return to provision true-up adjustments.

On December 22, 2017, the President signed into law the Tax Act. Some key provisions of this law impacted the Company during this reporting period. One such provision was the reduction of the Federal corporate income tax rate from 35.0% to 21.0%. The Company's consolidated financial statements reflect the impact of this rate reduction.

Additionally, the Tax Act provides for two U.S. tax base erosion provisions which began in 2018. They are the base-erosion and anti-abuse tax ("BEAT") and the global intangible low-taxed income ("GILTI"). While TSYS' calculations indicate no impact related to BEAT in 2018, the Company's GILTI calculations did indicate an insignificant impact, which has been reflected in the Company's financial statements. TSYS will continue to perform all necessary calculations, make any needed elections and report any future impacts of GILTI and BEAT as appropriate.

The Tax Act also provides for another new deduction starting in 2018 which impacted TSYS. This deduction is described as a deduction for foreign-derived intangible income. TSYS has appropriately incorporated the results of this calculated deduction in the Company's consolidated financial statements.

Pursuant to SEC Staff Accounting Bulletin No. 118, some amounts related to the Tax Act may be provisional and adjusted during the measurement period ending December 31, 2018. TSYS no longer has any such provisional amounts.

GAAP prescribes a recognition threshold and measurement attribute for the financial statement recognition, measurement and disclosure of a tax position taken or expected to be taken in a tax return. The unrecognized tax benefit amounts were \$21.7 million and \$23.8 million as of September 30, 2018 and December 31, 2017, respectively, which resulted in a decrease of \$2.1 million during the period.

TSYS recognizes potential interest and penalties related to the underpayment of income taxes as income tax expense in the consolidated statements of income. Gross accrued interest and penalties on unrecognized tax benefits totaled \$2.3 million and \$2.0 million as of September 30, 2018 and December 31, 2017, respectively. The total amounts of unrecognized income tax benefits as of September 30, 2018 and December 31, 2017, that, if recognized, would affect the effective tax rates are \$22.7 million and \$24.5 million (net of the federal

Table of Contents

benefit on state tax issues), respectively, which include interest and penalties of \$1.5 million and \$1.3 million, respectively. TSYS does not expect any significant changes to its calculation of uncertain tax positions during the next twelve months.

## Note 8 — Segment Reporting and Major Customers

Refer to Note 20 of the Company's audited financial statements for the year ended December 31, 2017, which is included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC, for a discussion regarding segment reporting and major customers.

At TSYS, the chief operating decision maker ("CODM") is a group consisting of Senior Executive Management and above. During the second quarter of 2018, the CODM renamed the Netspend segment to the Consumer Solutions segment as a part of the rebranding of the segment. There has been no change to the composition of the Consumer Solutions segment. Therefore, no prior periods were restated.

The following table presents the Company's total assets by segment:

(in thousands)	As of	
	September 30, 2018	December 31, 2017
Issuer Solutions	\$ 6,823,643	5,735,195
Merchant Solutions	4,288,618	3,136,395
Consumer Solutions	1,394,470	1,418,644
Intersegment assets	(5,033,687)	(3,958,545)
Total assets	\$ 7,473,044	6,331,689

The Company maintains property and equipment, net of accumulated depreciation and amortization, in the following geographic areas:

(in thousands)	As of	
	September 30, 2018	December 31, 2017
United States	\$ 309,796	271,877
Europe	48,258	43,586
Other	14,846	9,755

Total                   \$ 372,900   325,218

The following table presents the Company's depreciation and amortization by segment:

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Depreciation and amortization by segment:				
Issuer Solutions	\$ 30,411	36,699	88,382	109,287
Merchant Solutions	8,014	7,588	23,362	21,990
Consumer Solutions	4,303	3,785	12,875	12,057
Segment depreciation and amortization	42,728	48,072	124,619	143,334
Acquisition intangible amortization	57,590	50,856	182,479	156,966
Corporate administration and other	1,014	1,356	2,912	3,521
Total depreciation and amortization <sup>1</sup>	\$ 101,332	100,284	310,010	303,821

1. Client incentive/contract asset amortization is no longer included in depreciation and amortization due to the adoption of ASC 606 on January 1, 2018.

Table of Contents

The following tables reconcile geographic revenues to external revenues by operating segment based on the domicile of the Company's customers:

(in thousands)	Three months ended September 30, 2018			
	Issuer		Consumer	Total
	Solutions	Merchant Solutions	Solutions	
United States	\$ 271,158	347,858	195,802	\$ 814,818
Europe1	95,196	166	-	95,362
Canada1	82,434	270	-	82,704
Other1	22,190	297	-	22,487
Total	\$ 470,978	348,591	195,802	\$ 1,015,371

(in thousands)	Nine months ended September 30, 2018			
	Issuer			Total
	Solutions	Merchant Solutions	Consumer Solutions	
United States	\$ 801,464	1,014,618	606,455	\$ 2,422,537
Europe1	279,678	418	-	280,096
Canada1	241,092	828	-	241,920
Other1	64,705	863	-	65,568
Total	\$ 1,386,939	1,016,727	606,455	\$ 3,010,121

(in thousands)	Three months ended September 30, 2017			
	Issuer		Consumer	Total
	Solutions	Merchant Solutions	Solutions	
United States	\$ 261,878	625,148	179,488	\$ 1,066,514
Europe1	80,492	49	-	80,541
Canada1	79,098	381	-	79,479
Other1	20,762	280	-	21,042
Total	\$ 442,230	625,858	179,488	\$ 1,247,576

(in thousands)	Nine months ended September 30, 2017			
	Issuer			Total
	Solutions	Merchant Solutions	Consumer Solutions	
United States	\$ 780,728	1,795,919	559,183	\$ 3,135,830
Europe1	237,039	187	-	237,226
Canada1	234,055	1,004	-	235,059
Other1	45,656	905	-	46,561

Total	\$ 1,297,478	1,798,015	559,183	\$ 3,654,676
-------	--------------	-----------	---------	--------------

<sup>1</sup> Certain of these revenues are impacted by movements in foreign currency exchange rates.

As discussed in Note 2, the most significant impact of the Company's adoption of ASC 606 as of January 1, 2018 is the result of gross versus net presentation of interchange and payment network fees. In 2018, these fees collected on behalf of the payment networks and card issuers are presented "net" of the amounts paid to them, as opposed to the "gross" presentation for certain of these fees in 2017.



Table of Contents

The following table presents the Company's operating results by segment:

Operating Segments (in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Adjusted operating income by segment:				
Issuer Solutions (a)	\$ 154,107	147,758	456,588	428,909
Merchant Solutions (b)	125,153	103,275	359,983	296,551
Consumer Solutions (c)	49,503	48,560	149,089	143,251
Corporate Administration and Other	(39,911)	(39,560)	(117,477)	(111,170)
Adjusted segment operating income <sup>1</sup> (d)	288,852	260,033	848,183	757,541
Less:				
Share-based compensation	12,392	8,407	32,916	28,462
Cayan and TransFirst merger & acquisition (M&A) and integration expenses <sup>2</sup>	2,887	1,052	19,836	10,086
Litigation, claims, judgments or settlements	-	26	-	1,904
Acquisition intangible amortization	57,590	50,856	182,479	156,966
Operating income	215,983	199,692	612,952	560,123
Nonoperating expenses, net	(41,294)	(28,835)	(120,106)	(88,780)
Income before income taxes and equity in income of equity investments	\$ 174,689	170,857	492,846	471,343
Net revenue by segment:				
Issuer Solutions (e)	\$ 434,332	401,074	1,278,921	1,181,090
Merchant Solutions (f)	346,309	281,819	1,010,101	820,968
Consumer Solutions (g)	195,810	179,918	606,591	560,448
Segment net revenue	976,451	862,811	2,895,613	2,562,506
Less: intersegment revenues	11,857	10,052	38,974	32,787
Net revenue <sup>3</sup> (h)	964,594	852,759	2,856,639	2,529,719
Add: reimbursable items, interchange and payment network fees <sup>4</sup>	50,777	394,817	153,482	1,124,957
Total revenues	\$ 1,015,371	1,247,576	3,010,121	3,654,676
Adjusted segment operating margin on net revenue:				
Issuer Solutions (a)/(e)	35.5%	36.8%	35.7%	36.3%
Merchant Solutions (b)/(f)	36.1%	36.6%	35.6%	36.1%
Consumer Solutions (c)/(g)	25.3%	27.0%	24.6%	25.6%
Adjusted segment operating margin on net revenue (d)/(h)	29.9%	30.5%	29.7%	29.9%

<sup>1</sup> Adjusted segment operating income excludes acquisition intangible amortization, Cayan and TransFirst M&A and integration expenses, share-based compensation, litigation and related expenses, and expenses associated with Corporate Administration and Other.

<sup>2</sup> Excludes share-based compensation.

<sup>3</sup>

Net revenue is defined as total revenues less reimbursable items (such as postage), as well as, merchant acquiring interchange and payment network fees charged by the card associations or payment networks that are recorded by TSYS as expense.

- <sup>4</sup> As discussed in Note 2, the most significant impact of the Company's adoption of ASC 606 as of January 1, 2018 is the result of gross versus net presentation of interchange and payment network fees. In 2018, these fees collected on behalf of the payment networks and card issuers are presented "net" of the amounts paid to them, as opposed to the "gross" presentation for certain of these fees in 2017.

#### Major Customers

For the three and nine months ended September 30, 2018 and 2017, the Company did not have any major customers.

#### Note 9 — Supplementary Cash Flow Information

#### Nonvested Awards

The Company issued shares of common stock to certain key employees during the first nine months of 2018 and 2017, respectively. The grants were issued under nonvested stock bonus awards for services to be provided in the future. Refer to Note 6 for more information.

Table of Contents

Equipment Acquired Under Capital Lease Obligations and Software Acquired Under License Agreements

There was approximately \$8.4 million of equipment acquired under capital lease obligations and \$3.4 million of software acquired under license agreements in the first nine months of 2018. Additionally, the Company acquired \$36.5 million of software through vendor financing and other arrangements during the first nine months of 2018. During the first nine months of 2017, the Company acquired approximately \$3.7 million of equipment under capital lease obligations and \$7.4 million of software under license agreements.

Acquisitions

Refer to Note 12 for a summary of the assets acquired and liabilities assumed through acquisition in January 2018.

Note 10 — Commitments and Contingencies

Refer to Note 14 of the Company's audited financial statements for the year ended December 31, 2017, which is included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC, for a discussion regarding commitments and contingencies.

Legal Proceedings

The Company is subject to various legal proceedings and claims and is also subject to information requests, inquiries and investigations arising out of the ordinary conduct of its business. The Company establishes accruals for litigation and similar matters when those matters present loss contingencies that TSYS determines to be both probable and reasonably estimable in accordance with GAAP. Legal costs are expensed as incurred. In the opinion of management, based on current knowledge and in part upon the advice of legal counsel, all matters not specifically discussed below are believed to be adequately covered by insurance, or, if not covered, the possibility of losses from such matters are believed to be remote or such matters are of such kind or involve such amounts that would not have a material adverse effect on the financial position, results of operations or cash flows of the Company if disposed of unfavorably.

TelexFree Matter

ProPay, Inc. (“ProPay”), a subsidiary of the Company, has been named as one of a number of defendants (including other merchant processors) in several purported class action lawsuits relating to the activities of TelexFree, Inc. and its affiliates and principals. TelexFree is a former merchant customer of ProPay. With regard to TelexFree, each purported class action lawsuit generally alleges that TelexFree engaged in an improper multi-tier marketing scheme involving voice-over Internet protocol telephone services. The plaintiffs in each of the purported class action complaints generally allege that the various merchant processor defendants, including ProPay, aided and abetted the improper activities of TelexFree. TelexFree filed for bankruptcy protection in Nevada. The bankruptcy proceeding was subsequently transferred to the Massachusetts Bankruptcy Court.

Specifically, ProPay has been named as one of a number of defendants (including other merchant processors) in each of the following purported class action complaints relating to TelexFree: (i) Waldemara Martin, et al. v. TelexFree, Inc., et al. (Case No. BK-S-14-12524-ABL) (Bankr. D. Nev.); (ii) Anthony Cellucci, et al. v. TelexFree, Inc., et. al. (Case No. 4:14-BK-40987) (Bankr. D. Mass.); (iii) Maduako C. Ferguson Sr., et al. v. Telexelectric, LLP, et. al (Case No. 5:14-CV-00316-D) (E.D.N.C.); (iv) Todd Cook v. TelexElectric LLP et al. (Case No. 2:14-CV-00134) (N.D. Ga.); (v) Felicia Guevara v. James M. Merrill et al., CA No. 1:14-cv-22405-DPG) (S.D. Fla.); (vi) Reverend Jeremiah Githere, et al. v. TelexElectric LLP et al. (Case No. 1:14-CV-12825-GAO) (D. Mass.); (vii) Paulo Eduardo Ferrari et al. v. Telexfree, Inc. et al. (Case No. 14-04080) (Bankr. D. Mass); (viii) Magalhaes v. TelexFree, Inc., et al., No. 14-cv-12437 (D. Mass.); (ix) Griffith v. Merrill et al., No. 14-CV-12058 (D. Mass.); (x) Abeldadir v. Telexelectric, LLP, No. 14-09857 (S.D.N.Y.); and (xi) Rita Dos Santos, v. TelexElectric, LLP et al., 2:15-cv-01906-NVW (D. Ariz.) (together, the “Actions”).

On October 21, 2014, the Judicial Panel on Multidistrict Litigation (“JPML”) transferred and consolidated the Actions filed before that date to the United States District Court for the District of Massachusetts (the

Table of Contents

“Consolidated Action”). The JPML subsequently transferred the remaining Actions to the Consolidated Action. The Consolidated Action is styled In Re: Telexfree Securities Litigation (4:14-md-02566-TSH) (D. Mass.).

The plaintiffs in the Consolidated Action filed a First Consolidated Amended Complaint on March 31, 2015 and filed a Second Consolidated Amended Complaint (the “Second Amended Complaint”) on April 30, 2015. The Second Amended Complaint, which supersedes the complaints filed prior to consolidation of the Actions, purports to bring claims on behalf of all persons who purchased certain TelexFree “memberships” and suffered a “net loss” between January 1, 2012 and April 16, 2014. With respect to ProPay, the Second Amended Complaint alleges that ProPay aided and abetted tortious acts committed by TelexFree, and that ProPay was unjustly enriched in the course of providing payment processing services to TelexFree. Several defendants, including ProPay, moved to dismiss the Second Amended Complaint on June 2, 2015. The court held a hearing on the motions to dismiss on November 2, 2015, but has not yet issued a ruling on the vast majority of the motions. The court did, however, deny the motion to dismiss filed by Defendant Katia Wanzeler, the wife of one of the principals of TelexFree, in an order dated May 7, 2018. The court has not ruled on any motions to dismiss since that time.

At present, pursuant to a court order, all discovery in the action is stayed pending the resolution of parallel criminal proceedings against certain former principals of TelexFree, Inc. Despite that stay of discovery, the lead plaintiffs have subpoenaed documents previously produced by ProPay pursuant to the Federal Rules of Bankruptcy Procedure to the court-appointed trustee in the TelexFree bankruptcy proceeding. ProPay has filed a motion to quash that subpoena. ProPay’s motion remains pending before the Court. On April 4, 2017, lead plaintiffs moved the court for leave to further amend the Second Amended Complaint, and submitted a proposed amendment with their motion. The proposed amendment sought to add new defendants to the case but did not make any new or additional allegations against ProPay. The Court ultimately permitted lead plaintiffs to amend their complaint to add new defendants, but did not require defendants such as ProPay to refile their motions to dismiss the Second Amended Complaint.

ProPay has also received various subpoenas, a seizure warrant and other inquiries requesting information regarding TelexFree from (i) the Commonwealth of Massachusetts, Securities Division, (ii) United States Securities and Exchange Commission, (iii) US Immigration and Customs Enforcement, and (iv) the bankruptcy Trustee of the Chapter 11 entities of TelexFree, Inc., TelexFree, LLC and TelexFree Financial, Inc. Pursuant to the seizure warrant served by the United States Attorney’s Office for the District of Massachusetts, ProPay delivered all funds associated with TelexFree held for chargeback and other purposes by ProPay to US Immigration and Customs Enforcement. In addition, ProPay received a notice of potential claim from the bankruptcy Trustee as a result of the relationship of ProPay with TelexFree and its affiliates.

The above proceedings and actions are preliminary in nature. While the Company and ProPay intend to vigorously defend matters arising out of the relationship of ProPay with TelexFree and believe ProPay has substantial defenses related to these purported claims, the Company currently cannot reasonably estimate losses attributable to these matters.



Table of Contents

## Note 11 – Earnings Per Share

The following tables illustrate basic and diluted EPS for the three and nine months ended September 30, 2018 and 2017:

(in thousands, except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2018 Common Stock	2017 Common Stock	2018 Common Stock	2017 Common Stock
<b>Basic EPS:</b>				
Net income attributable to TSYS common shareholders	\$ 155,960	123,095	440,236	343,977
Less income allocated to nonvested awards	(62)	(231)	(299)	(871)
Net income allocated to common stock for EPS calculation (a)	\$ 155,898	122,864	439,937	343,106
Average common shares outstanding (b)	182,355	183,917	182,016	183,633
Basic EPS (a)/(b)	\$ 0.85	0.67	2.42	1.87
<b>Diluted EPS:</b>				
Net income attributable to TSYS common shareholders	\$ 155,960	123,095	440,236	343,977
Less income allocated to nonvested awards	(62)	(231)	(299)	(871)
Add income reallocated to nonvested awards <sup>1</sup>	62	231	299	871
Net income allocated to common stock for EPS calculation (c)	\$ 155,960	123,095	440,236	343,977
Average common shares outstanding	182,355	183,917	182,016	183,633
Increase due to assumed issuance of shares related to common equivalent shares outstanding	919	1,192	1,014	1,123
Average nonvested awards <sup>1</sup>	572	699	571	717
Average common and common equivalent shares outstanding (d)	183,846	185,808	183,601	185,473
Diluted EPS (c)/(d)	\$ 0.85	0.66	2.40	1.85

<sup>1</sup> In accordance with the diluted EPS guidance under the two-class method, the Company uses the approach- either the treasury stock method or the two-class method assuming a participating security is not exercised- that is more dilutive.

(in thousands, except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2018 Participating Securities	2017 Participating Securities	2018 Participating Securities	2017 Participating Securities
<b>Basic EPS:</b>				
Net income allocated to nonvested awards (a)	\$ 62	231	299	871
Nonvested awards (b)	73	354	124	475

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

Basic EPS (a)/(b)	\$ 0.85	0.65	2.41	1.83
Diluted EPS:				
Net income allocated to nonvested awards (c)	\$ 62	229	298	867
Average common and common equivalent shares outstanding (d)	73	354	124	475
Diluted EPS (c)/(d)	\$ 0.85	0.65	2.40	1.83

<sup>1</sup> EPS Amounts may not total due to rounding.

The diluted EPS calculation excludes stock options and nonvested awards that are exercisable into 0.4 million and 0.3 million common shares for the three and nine months ended September 30, 2018, and excludes 0.1 million and 0.5 million common shares for the three and nine months ended September 30, 2017, respectively, because their inclusion would have been anti-dilutive.



Table of Contents

Note 12 — Acquisitions

Refer to Note 22 of the Company's audited financial statements for the year ended December 31, 2017, which is included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC, for a discussion regarding acquisitions.

The revenue and operating loss of the Company's 2018 acquisitions included in the Company's consolidated statements of income since the acquisition are \$47.7 million and (\$1.8) million, respectively, for the three months ended September 30, 2018 and \$135.4 million and (\$6.8) million, respectively, for the nine months ended September 30, 2018.

iMobile3

On June 1, 2018, TSYS acquired substantially all of the assets of iMobile3, LLC, a leading provider of private-labeled small business solutions within the payments industry, for \$13.4 million in cash. The newly acquired business is part of the Company's Merchant Solutions segment. The goodwill amount of \$5.3 million arising from the acquisition is primarily attributable to the economies of scale from combining the assets of TSYS and iMobile3. All of the goodwill was assigned to TSYS' Merchant Solutions segment. The goodwill recognized is expected to be deductible for income tax purposes.

Identifiable intangible assets acquired in the iMobile3 acquisition include technology of \$6.9 million and non-compete agreements of \$900,000. These amounts will remain preliminary until the valuation analysis has been finalized. The measurement period, during which changes in assets or other items of consideration are subject to adjustment, ends one year following the acquisition date. The intangible assets are being amortized over their estimated useful lives of three to five years based on the pattern of expected future economic benefit, which approximates a straight-line basis over the useful lives of the assets.

Additional disclosures relating to the iMobile3 acquisition, including pro forma financial information, have not been included since the transaction is insignificant.

Redeemable Noncontrolling Interest

In April 2018, the Company acquired the remaining 15% equity interest in Central Payment Co., LLC from a privately-owned company for \$126.0 million.

## Cayan

On January 11, 2018, TSYS completed the acquisition of 100 percent ownership of Cayan, a payment technology company focused on integrated payment solutions and merchant acquiring, in an all cash transaction valued at approximately \$1.05 billion. In connection with the acquisition, the Company entered into a Loan Facility with Bank of America, N.A. as administrative agent and the other lenders a party thereto from time to time to provide a \$450 million two-year bilateral loan (see Note 5). The results of the newly acquired business are being reported by TSYS as part of the Merchant Solutions segment.

The goodwill amount of \$0.8 billion arising from the acquisition is primarily attributable to the expansion of customer base, differentiation in market opportunity and economies of scale expected from combining the operations of TSYS and Cayan. All of the goodwill was assigned to TSYS' Merchant Solutions segment. Approximately \$0.4 billion of the goodwill recognized is expected to be deductible for income tax purposes.

The following table summarizes the consideration paid for Cayan and the preliminary recognized amounts of the identifiable assets acquired and liabilities assumed on January 11, 2018 (the acquisition date). These amounts will remain preliminary until the valuation analysis has been finalized. The measurement period, during which changes in assets, liabilities, equity interests, or items of consideration are subject to adjustment, ends one year following the acquisition date. The Company continues to evaluate deferred taxes, intangible assets, goodwill and financial liabilities.

Table of Contents

(in thousands)

Consideration	
Cash	\$ 1,054,931
Fair value of total consideration transferred	\$ 1,054,931
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash	\$ 16,856
Accounts receivable	16,846
Property and equipment	20,321
Deferred tax assets	4,187
Other assets	3,822
Identifiable intangible assets	324,885
Deferred tax liabilities	(141,291)
Other liabilities	(35,399)
Total identifiable net assets	210,227
Goodwill	844,704
Total identifiable assets acquired and liabilities assumed	\$ 1,054,931

During the three months ended September 30, 2018, there was an increase in other liabilities of \$1.7 million related to an assumed preexisting contingent consideration. Additionally, the Company recorded an adjustment of \$4.2 million related to deferred tax assets and an adjustment of \$27.5 million related to deferred tax liabilities. As a result of these adjustments, the Company recorded an increase to goodwill of \$25.0 million.

Identifiable intangible assets acquired in the Cayan acquisition include merchant relationships, channel relationships, current technology, the Cayan and Genius trade names, non-compete agreements and favorable leases. The identifiable intangible assets had no significant estimated residual value. These intangible assets are being amortized over their estimated useful lives of one to ten years based on the pattern of expected future economic benefit, which approximates a straight-line basis over the useful lives of the assets. The fair value of the acquired identifiable intangible assets of \$324.9 million was estimated using the income approach (discounted cash flow and relief from royalty methods) and cost approach. The fair values and useful lives of the identified intangible assets were primarily determined using forecasted cash flows, which included estimates for certain assumptions such as revenues, expenses, attrition rates and royalty rates. The estimated fair value of identifiable intangible assets acquired in the acquisition and the related estimated weighted average useful lives are as follows:

(in millions)	Fair Value	Weighted Average Useful Life (in years)
Merchant relationships	\$ 179.5	8.0
Channel relationships	80.4	10.0
Technology	40.8	5.0
Trade names	19.3	3.5

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

Covenants not-to-compete	3.2	2.0
Favorable leases	1.7	6.5
Total acquired identifiable intangible assets	\$ 324.9	7.7

The fair value measurement of the identifiable intangible assets represents Level 3 measurements as defined in ASC 820, Fair Value Measurement. Key assumptions include (a) cash flow projections based on market participant and internal data, (b) a discount rate of 12.0%, (c) a pre-tax royalty rate range of 1.5-2.0%, (d) attrition rate of 12.0%, (e) an effective tax rate of 27%, and (f) a terminal value based on a long-term sustainable growth rate of 3%.

In connection with the acquisition, TSYS incurred \$15.9 million in acquisition-related costs primarily related to professional legal, finance, and accounting costs. These costs were expensed as incurred and are included in

Table of Contents

selling, general and administrative expenses in the consolidated statements of income for the nine months ended September 30, 2018.

## Pro Forma Results of Operations

The following unaudited pro forma financial information shows the results of operations of the combined entities as if the acquisition of Cayan had occurred on January 1, 2017. The unaudited pro forma information reflects certain pro forma adjustments to the combined financial information of TSYS and Cayan. The pro forma adjustments include incremental depreciation and amortization expense, incremental interest expense associated with new long-term debt and the elimination of non-recurring transaction costs directly related to the acquisition.

(in thousands)	Supplemental pro forma	
	Three months ended	Nine months ended
	September 30, 2017	September 30, 2017
Total revenues	\$ 1,286,443	3,765,459
Net income attributable to TSYS common shareholders	\$ 115,964	320,714

The unaudited pro forma financial information presented above does not purport to represent what the actual results of operations would have been if the acquisition of Cayan's operations had occurred prior to January 1, 2017, nor is it indicative of the future operating results of TSYS. The unaudited pro forma financial information does not reflect the impact of future events that may occur after the acquisition, including, but not limited to, anticipated cost savings from operating synergies. As discussed in Note 2, the most significant impact of the Company's adoption of ASC 606 as of January 1, 2018 is the result of gross versus net presentation of interchange and payment network fees. In 2018, these fees collected on behalf of the payment networks and card issuers are presented "net" of the amounts paid to them, as opposed to the "gross" presentation for certain of these fees in 2017.

The unaudited pro forma financial information presented in the table above has been adjusted to give effect to adjustments that are (1) directly related to the business combination; (2) factually supportable; and (3) expected to have a continuing impact. These adjustments include, but are not limited to, the application of accounting policies; and depreciation and amortization related to fair value adjustments to property, plant and equipment and intangible assets.

The pro forma adjustments do not reflect the following material items that result directly from the acquisition and which impacted statement of operations following the acquisition:

- Acquisition and related financing transaction costs relating to fees to investment bankers, attorneys, accountants, and other professional advisors, and other transaction-related costs that were not capitalized as deferred financing costs; and
- The effect of anticipated cost savings or operating efficiencies expected to be realized and related restructuring charges such as technology and infrastructure integration expenses, and other costs related to the integration of Cayman into TSYS.

Note 13 — Subsequent Events

Management performed an evaluation of the Company's activity as of the date these consolidated financial statements were issued and has concluded that there are no significant subsequent events requiring disclosure.

Table of Contents

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

## Financial Overview

Total System Services, Inc.’s (“TSYS” or the “Company’s”) revenues are derived from providing payment processing services, merchant services and related payment services to financial and nonfinancial institutions, generally under long-term processing contracts. The Company also derives revenues by providing general-purpose reloadable (“GPR”) prepaid debit and payroll cards, demand deposit accounts and other financial service solutions to the underbanked and other consumers and businesses. The Company’s services are provided through three operating segments: Issuer Solutions, Merchant Solutions and Consumer Solutions.

Through the Company’s Issuer Solutions segment, TSYS processes information through its cardholder systems to financial and nonfinancial institutions throughout the United States and internationally. The Company’s Merchant Solutions segment provides merchant services to merchant acquirers and merchants mainly in the United States. The Company’s Consumer Solutions segment provides financial service solutions to consumers and businesses in the United States.

For a detailed discussion regarding the Company’s operations, see “Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which is included as Exhibit 13.1 to the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission (“SEC”).

Management’s discussion and analysis contains items prepared in conformity with GAAP, as well as non-GAAP measures. For detailed information and reconciliations to GAAP, refer to the discussion under the caption Non-GAAP Measures.

A summary of the financial highlights for 2018, as compared to 2017, is provided below:

	Three months ended September 30,			Nine months ended September 30,		
	2018	2017	Change Percent	2018	2017	Change Percent
(in thousands, except per share data)						
Total revenues	\$ 1,015,371	1,247,576	(18.6) %	\$ 3,010,121	3,654,676	(17.6) %
Net revenue <sup>1</sup>	\$ 964,594	852,759	13.1	\$ 2,856,639	2,529,719	12.9
Operating income	\$ 215,983	199,692	8.2	\$ 612,952	560,123	9.4

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

Net income attributable to TSYS common shareholders	\$ 155,960	123,095	26.7	\$ 440,236	343,977	28.0
Basic earnings per share (EPS) attributable to TSYS common shareholders <sup>2</sup>	\$ 0.85	0.67	28.0	\$ 2.42	1.87	29.4
Diluted EPS attributable to TSYS common shareholders <sup>2</sup>	\$ 0.85	0.66	28.1	\$ 2.40	1.85	29.3
Adjusted earnings before interest, taxes, depreciation and amortization (Adjusted EBITDA) <sup>3</sup>	\$ 348,488	309,461	12.6	\$ 1,024,431	904,396	13.3
Adjusted earnings <sup>4</sup>	\$ 212,412	162,667	30.6	\$ 623,795	473,148	31.8
Adjusted diluted EPS <sup>5</sup>	\$ 1.16	0.88	32.0	\$ 3.40	2.55	33.2
Cash flows from operating activities				\$ 752,508	659,428	14.1
Free cash flow <sup>6</sup>				\$ 612,479	550,069	11.3

Refer to the reconciliation of GAAP to non-GAAP measures later in Item 2.

<sup>1</sup> Net revenue is defined as total revenues less reimbursable items, as well as, merchant acquiring interchange and payment network fees charged by card associations or payment networks that are recorded by TSYS as expense.

<sup>2</sup> Under GAAP, entities that have participating securities must compute basic EPS using the two-class method and compute diluted EPS using the more dilutive approach of either the two-class method or the treasury stock method. Refer to Note 11 in the Notes to Unaudited Consolidated Financial Statements for more information on EPS.

<sup>3</sup> Adjusted EBITDA is defined as net income excluding equity in income of equity investments, nonoperating income/(expense), income taxes, depreciation, amortization, share-based compensation expenses and other items.

<sup>4</sup> Adjusted earnings is net income excluding noncontrolling interests, the after-tax impact of share-based compensation expenses, amortization of acquisition intangibles and other items.

<sup>5</sup> Adjusted diluted EPS is defined as adjusted earnings divided by weighted average shares outstanding used for diluted EPS calculations.

<sup>6</sup> Free cash flow is defined as net cash provided by operating activities less capital expenditures.



## Table of Contents

### Financial Review

This Financial Review provides a discussion of critical accounting policies and estimates, related party transactions and off-balance sheet arrangements. This Financial Review also discusses the results of operations, financial position, liquidity and capital resources of TSYS and outlines the factors that have affected its recent earnings, as well as those factors that may affect its future earnings. For a detailed discussion regarding these topics, refer to our Notes to Consolidated Financial Statements and “Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations” which are included as Exhibit 13.1 to the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC.

### Critical Accounting Policies and Estimates

Refer to Note 1 in the Notes to Unaudited Consolidated Financial Statements for more information on changes to the Company’s critical accounting policies, estimates and assumptions on the judgments affecting the application of those estimates and assumptions in 2018. TSYS has updated its revenue recognition policies in conjunction with the adoption of Accounting Standards Update (“ASU”) 2014-09 Revenue from Contracts with Customers (Topic 606) and related ASUs (“ASC 606”) as further described in Notes 1 and 2 in the Notes to Unaudited Consolidated Financial Statements. The most significant impact of adopting ASC 606 in 2018 is primarily the result of gross versus net presentation of interchange and payment network fees. In 2018, these fees collected on behalf of the payment networks and card issuers are presented “net” of the amounts paid to them, as opposed to the “gross” presentation for certain of these fees in 2017.

### Off-Balance Sheet Arrangements

### Operating Leases

As a method of funding its operations, TSYS employs noncancelable operating leases for computer equipment and facilities. These leases allow the Company to provide the latest technology while avoiding the risk of ownership. Neither the assets nor the obligations related to these leases are included on the consolidated balance sheets. As discussed in Note 1 in the Notes to Unaudited Consolidated Financial Statements, the Company plans to adopt ASU 2016-02 Leases (Topic 842) (ASU 2016-02) on January 1, 2019. ASU 2016-02 introduces a lessee model that brings most leases on the balance sheet and aligns many of the underlying principles of the new lessor model with those in the FASB’s new revenue recognition standard. While the Company is continuing to evaluate the effects of this ASU, the Company expects to record material right of use assets and lease liabilities on its consolidated balance sheet upon adoption.

## Contractual Obligations

The Company has long-term obligations which consist of required minimum future payments under contracts with certain of our distributors and other service providers.

## Recent Accounting Pronouncements

For a discussion of recent accounting pronouncements, refer to Note 1 in the Notes to Unaudited Consolidated Financial Statements.

## Results of Operations

### Revenues

The Company generates revenues by providing transaction processing and other payment-related services. The Company's pricing for transactions and services is complex. Each category of revenue has numerous fee components depending on the types of transactions processed or services provided. TSYS reviews its pricing and implements pricing changes on an ongoing basis. In addition, standard pricing varies among its regional businesses, and such pricing can be customized further for its clients through tiered pricing of various

## Table of Contents

thresholds for volume activity. TSYS' revenues are based upon transactional information accumulated by its systems. The Company's revenues are impacted by currency translation of foreign operations, as well as doing business in the current economic environment.

Total revenues decreased 18.6% and 17.6%, for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017. As discussed in Note 2 in the Notes to Unaudited Consolidated Financial Statements, the most significant impact of the Company's adoption of ASC 606 as of January 1, 2018 is primarily the result of gross versus net presentation of interchange and payment network fees. In 2018, these fees collected on behalf of the payment networks and card issuers are presented "net" of the amounts paid to them, as opposed to the "gross" presentation for certain of these fees in 2017. The impact of the acquisitions on total revenues for the three and nine months ended September 30, 2018 was \$47.7 million and \$135.4 million, respectively. Revenues for the three and nine months ended September 30, 2018 also included a decrease of \$1.9 million and an increase of \$14.7 million, respectively, related to the effects of currency translation of the Company's foreign-based subsidiaries and branches.

The Company reviews revenue performance on a net revenue basis which is a non-GAAP measure. Net revenue is defined as total revenues less reimbursable items, as well as, merchant acquiring interchange and payment network fees charged by the card associations or payment networks that are recorded by TSYS as expense and are mainly related to the Merchant Solutions segment. The Company has included reimbursements received for out-of-pocket expenses as revenues and expenses. The largest reimbursable expense items for which TSYS is reimbursed by clients are postage fees. The Company's reimbursable items are primarily impacted by changes in postal rates and changes in the volumes of mailing activities by its clients. Reimbursable items for the three and nine months ended September 30, 2018 were \$50.8 million and \$153.5 million, decreases of 23.0% and 20.1%, respectively, compared to the same periods last year, primarily due to the Company's adoption of ASC 606 as of January 1, 2018. See Note 2 in the Notes to Unaudited Consolidated Financial Statements for further discussion.

Net revenue increased \$111.8 million and \$326.9 million, or 13.1% and 12.9% during the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017. The increase in net revenue for the three months ended September 30, 2018, as compared to the same period in 2017, is primarily the result of organic growth and \$47.7 million of revenues related to acquisitions, partially offset by a decrease of \$1.8 million associated with currency translation. The increase in net revenue for the nine months ended September 30, 2018, as compared to the same period in 2017, is primarily the result of organic growth, \$135.4 million of revenues related to acquisitions and an increase of \$13.7 million associated with currency translation.

## Major Customers

For a discussion regarding the Company's major customers, refer to Note 8 in the Notes to Unaudited Consolidated Financial Statements and see "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations," which is included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC.

The Company works to maintain a large and diverse customer base across various industries. For the three and nine months ended September 30, 2018, the Company did not have a major customer on a consolidated basis. However, a significant amount of the Company's revenues are derived from long-term contracts with large clients. TSYS derives revenues from providing various processing and other services to these clients, including processing of consumer and commercial accounts, as well as revenues for reimbursable items. The loss of one of the Company's large clients could have a material adverse effect on the Company's financial position, results of operations and cash flows.

#### Operating Segments

TSYS' services are provided through three operating segments: Issuer Solutions, Merchant Solutions and Consumer Solutions. Refer to Note 8 in the Notes to Unaudited Consolidated Financial Statements for more information on the Company's operating segments.

Table of Contents

## Issuer Solutions

The Company's Issuer Solutions segment has many long-term customer contracts with card issuers providing account processing and output services for printing and embossing items. These contracts generally require advance notice prior to the end of the contract if a client chooses not to renew. Additionally, some contracts may permit early termination upon the occurrence of certain events such as a change in control. The termination fees paid upon the occurrence of such events are designed primarily to cover balance sheet exposure related to items such as contract assets and contract cost assets associated with the contract and, in some cases, may cover a portion of lost future revenue and profit. Although these contracts may be terminated upon certain occurrences, the contracts provide the segment with a steady revenue stream since a vast majority of the contracts are honored through the contracted expiration date.

These services are provided throughout the period of each account's use, starting from a card-issuing client processing an application for a card. Services may include processing the card application, initiating service for the cardholder, processing each card transaction for the issuing retailer or financial institution and accumulating the account's transactions. Fraud management services monitor the unauthorized use of accounts which have been reported to be lost, stolen, or which exceed credit limits. Fraud detection systems help identify fraudulent transactions by monitoring each account holder's purchasing patterns and flagging unusual purchases. Other services provided include customized communications to cardholders, information verification associated with granting credit, debt collection and customer service.

TSYS' revenues in its Issuer Solutions segment are primarily derived from electronic payment processing. There are certain basic core services directly tied to accounts on file ("AOF") and transactions. These are provided to all of TSYS' processing clients. The core services begin with AOF.

The core services include housing an AOF, authorizing transactions (authorizations), accumulating monthly transactional activity (transactions) and providing a monthly statement (statement generation). From these core services, TSYS' clients also have the option to use fraud and portfolio management services which are based on authorizations processed and AOF, respectively. Collectively, these services are considered volume-based revenues.

Below is a summary of AOF for the Company's Issuer Solutions segment:

(in millions)	As of September 30,			Percent Change	
	2018	2017			
AOF					
Consumer	499.3	474.7	5.2	%	

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

Commercial	55.6	52.8	5.3	
Other	39.5	34.6	14.3	
Traditional AOF <sup>1</sup>	594.4	562.1	5.8	
Prepaid/Stored Value <sup>2</sup>	17.1	50.6	(66.3)	
Government Services <sup>3</sup>	98.0	92.1	6.4	
Commercial Card Single-Use <sup>4</sup>	114.2	92.5	23.4	
Total AOF	823.7	797.3	3.3	%

<sup>1</sup> Traditional accounts include consumer, retail, commercial, debit and other accounts. These accounts are grouped together due to the tendency to have more transactional activity than prepaid, government services and single-use accounts.

<sup>2</sup> Prepaid does not include Consumer Solutions accounts. These accounts tend to have less transactional activity than the traditional accounts. Prepaid and stored value cards are issued by firms through retail establishments to be purchased by consumers to be used at a later date. These accounts tend to be the least active of all accounts on file.

<sup>3</sup> Government services accounts are disbursements of student loan accounts issued by the Department of Education, which have minimal activity.

<sup>4</sup> Commercial card single-use accounts are one-time use accounts issued by firms to book lodging and other travel related expenses.

Non-volume related revenues include processing fees which are not directly associated with AOF and transactional activity, such as certain value added products and services, custom programming and certain other services, which are only offered to TSYS' processing clients.

Table of Contents

Additionally, certain clients license the Company's processing systems and process in-house. Since the accounts are processed outside of TSYS for licensing arrangements, the AOF and other volumes are not available to TSYS. Thus, volumes reported by TSYS do not include volumes associated with licensing.

Output and managed services include offerings such as card production, statement production, correspondence and call center support services.

The Issuer Solutions segment provides payment processing and related services to clients based in the United States and internationally. Growth in revenues and operating profit in this segment is derived from retaining and growing the core business and improving the overall cost structure. Growing the core business comes primarily from an increase in account usage, growth from existing clients and sales to new clients and the related account conversions. This segment has two major customers for the three and nine months ended September 30, 2018.

Below is a summary of the Issuer Solutions segment:

(in thousands, except key indicators)	Three months ended September 30,			Nine months ended September 30,			
	2018	2017	Percent Change	2018	2017	Percent Change	
Volume-based revenues	\$ 213,076	200,270	6.4 %	\$ 627,572	588,922	6.6 %	
Non-volume related revenues:							
Processing fees	77,694	79,105	(1.8)	239,884	229,666	4.4	
Value-added, custom programming, licensing and other	74,657	61,846	20.7	217,939	187,531	16.2	
Output and managed services	68,905	59,853	15.1	193,526	174,971	10.6	
Total non-volume related revenues	221,256	200,804	10.2	651,349	592,168	10.0	
Net revenue <sup>1</sup>	\$ 434,332	401,074	8.3	\$ 1,278,921	1,181,090	8.3	
Adjusted segment operating income <sup>2</sup>	\$ 154,107	147,758	4.3	\$ 456,588	428,909	6.5	
Adjusted segment operating margin <sup>3</sup>	35.5 %	36.8 %		35.7 %	36.3 %		
Key indicators (in millions):							
AOF				823.7	797.3	3.3	
Traditional AOF				594.4	562.1	5.8	

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

Transactions	6,154.7	5,494.9	12.0	17,752.7	15,712.1	13.0
--------------	---------	---------	------	----------	----------	------

<sup>1</sup> Net revenue is defined as total revenues less reimbursable items (such as postage), as well as, merchant acquiring interchange and payment network fees charged by the card associations or payment networks that are recorded by TSYS as expense.

<sup>2</sup> Adjusted segment operating income excludes acquisition intangible amortization and expenses associated with Corporate Administration and Other.

<sup>3</sup> Adjusted segment operating margin equals adjusted segment operating income divided by net revenue.

For both the three and nine months ended September 30, 2018, approximately 49.1% of net revenue was driven by the volume of AOF and transactions processed and approximately 50.9% was derived from non-volume based revenues.

The increase in net revenue for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, was driven by organic growth partially offset by a decrease in net revenue associated with the adoption of ASC 606.

Movements in foreign currency exchange rates as compared to the U.S. dollar can result in foreign denominated financial statements being translated into more or fewer U.S. dollars, which impacts the comparison to prior periods when the U.S. dollar was stronger or weaker.



Table of Contents

Segment net revenue for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, included a decrease of \$1.9 million and an increase of \$13.5 million, respectively, associated with currency translation.

## Merchant Solutions

The Merchant Solutions segment provides merchant processing and related services to clients based primarily in the United States. Merchant Solutions revenues are derived from providing processing services, acquiring solutions, related systems and support services to merchant acquirers and merchants. Revenues from merchant services include processing all payment forms including credit, debit, prepaid, electronic benefit transfer and electronic check for merchants of all sizes across a wide array of market verticals. Merchant Solutions include authorization and capture of transactions; clearing and settlement of transactions; information reporting services related to transactions; and merchant billing services. This segment has no major customers for the three and nine months ended September 30, 2018.

The Merchant Solutions segment's results are driven by dollar sales volume and the authorization and capture transactions processed at the point-of-sale ("POS"). This segment's authorization and capture transactions are primarily through Internet connectivity.

Below is a summary of the Merchant Solutions segment:

(in thousands, except key indicators)	Three months ended September 30,			Nine months ended September 30,		
	2018	2017	Percent Change	2018	2017	Percent Change
Net revenue <sup>1</sup>	\$ 346,309	281,819	22.9 %	\$ 1,010,101	820,968	23.0 %
Adjusted segment operating income <sup>2</sup>	\$ 125,153	103,275	21.2	\$ 359,983	296,551	21.4
Adjusted segment operating margin <sup>3</sup>	36.1 %	36.6 %		35.6 %	36.1 %	
Key indicators:						
Dollar sales volume (in millions)	\$ 40,910.2	31,478.2	30.0	\$ 118,539.0	91,726.1	29.2
POS transactions (in millions)	1,533.9	1,260.9	21.7	4,371.9	3,622.2	20.7
	\$ 0.226	0.223	1.0	\$ 0.231	0.227	1.9

Net revenue per POS  
transaction

- <sup>1</sup> Net revenue is defined as total revenues less reimbursable items (such as postage), as well as, merchant acquiring interchange and payment network fees charged by the card associations or payment networks that are recorded by TSYS as expense.
- <sup>2</sup> Adjusted segment operating income excludes acquisition intangible amortization and expenses associated with Corporate Administration and Other.
- <sup>3</sup> Adjusted segment operating margin equals adjusted segment operating income divided by net revenue.

For the three months ended September 30, 2018, approximately 93.4% of net revenue was influenced by several factors, including volumes related to transactions and dollar sales volume. The remaining 6.6% of this segment's net revenue was derived from value added services, chargebacks, managed services, investigation and risk and collection services performed. For the nine months ended September 30, 2018, approximately 93.8% of net revenue was influenced by several factors, including volumes related to transactions and dollar sales volume. The remaining 6.2% of this segment's net revenue was derived from value added services, chargebacks, managed services, investigation and risk and collection services performed.

The increase in net revenue and adjusted segment operating income for the three months and nine months ended September 30, 2018, as compared to the same periods in 2017, was driven by \$47.7 million and \$135.4 million, respectively, of revenues related to acquisitions and higher processing volumes, product fees and processing fees.

Table of Contents

## Consumer Solutions

The Consumer Solutions segment provides GPR prepaid cards, payroll cards, demand deposit accounts and other financial service solutions to the underbanked and other consumers and businesses in the United States. The segment's products provide customers with access to depository accounts insured by the Federal Deposit Insurance Corporation ("FDIC") with a menu of pricing and features specifically tailored to their needs. The Consumer Solutions segment has an extensive distribution and reload network including financial service centers and other retail locations throughout the United States, and is a program manager for FDIC-insured depository institutions that issue the products that the segment develops, promotes and distributes. The Consumer Solutions segment currently has active agreements with six issuing banks.

The Consumer Solutions segment markets its products through multiple distribution channels, including alternative financial service providers, traditional retailers, direct-to-consumer and online marketing programs, and contractual relationships with corporate employers. This segment has no major customers and one major third-party distributor for the three and nine months ended September 30, 2018.

The Consumer Solutions segment's revenues primarily consist of a portion of the service fees and interchange revenues received by the segment's issuing banks and others in connection with the programs managed by this segment. Customers are charged fees for transactions including fees for PIN and signature-based purchase transactions made using their cards, for ATM withdrawals or other transactions conducted at ATMs, for balance inquiries, and monthly maintenance fees among others. Customers are also charged fees associated with additional features and services offered in connection with certain products including the use of courtesy overdraft protection, bill payment options, custom card designs and card-to-card transfers of funds initiated through call centers. The Consumer Solutions segment also earns revenues from a portion of the interchange fees remitted by merchants when customers make purchase transactions using their products. Subject to applicable law, interchange fees are fixed by card associations and network organizations.

Below is a summary of the Consumer Solutions segment:

(in thousands, except key indicators)	Three months ended September 30,				Nine months ended September 30,			
	2018	2017	Percent Change		2018	2017	Percent Change	
Net revenue <sup>1</sup>	\$ 195,810	179,918	8.8	%	\$ 606,591	560,448	8.2	%
Adjusted segment operating income <sup>2</sup>	\$ 49,503	48,560	1.9		\$ 149,089	143,251	4.1	
Adjusted segment operating margin <sup>3</sup>	25.3	% 27.0	%		24.6	% 25.6	%	

Key indicators (in millions):

Gross dollar volume <sup>4</sup>	\$ 8,053.2	7,242.3	11.2	\$ 26,083.7	24,455.1	6.7
Number of active cards <sup>5</sup>				4.9	4.7	5.3
Number of active cards with direct deposit <sup>6</sup>				2.5	2.3	8.1
Percentage of active cards with direct deposit				50.6	% 49.3	%

<sup>1</sup> Net revenue is defined as total revenues less reimbursable items (such as postage), as well as merchant acquiring interchange and payment network fees charged by the card associations or payment networks that are recorded by TSYS as expense.

<sup>2</sup> Adjusted segment operating income excludes acquisition intangible amortization and expenses associated with Corporate Administration and Other.

<sup>3</sup> Adjusted segment operating margin equals adjusted segment operating income divided by net revenue.

<sup>4</sup> Gross dollar volume represents the total dollar volume of debit transactions and cash withdrawals made using Consumer Solutions products.

<sup>5</sup> Number of active cards represents the total number of cards that have had a PIN or signature-based purchase transaction, a point-of-sale load transaction or an ATM withdrawal within three months of the date of determination, adjusted to remove prepaid cards that consumers upgraded to a demand deposit account during the period.

<sup>6</sup> Number of active cards with direct deposit represents the number of active cards that have had a direct deposit load within three months of the date of determination, adjusted to remove prepaid cards that consumers upgraded to a demand deposit account during the period.

Table of Contents

For the three months ended September 30, 2018, 71.5% of revenues were derived from service fees charged to customers and 28.5% of revenues were derived from interchange and other revenues. For the nine months ended September 30, 2018, 70.8% of revenues were derived from service fees charged to customers and 29.2% of revenues were derived from interchange and other revenues. Service fee revenues are driven by the number of active cards and in particular by the number of cards with direct deposit. Customers with direct deposit generally initiate more transactions and generate more revenues than those that do not take advantage of this feature. Interchange revenues are driven by gross dollar volume. Substantially all of the Consumer Solutions segment revenues were volume driven as they were driven by the active card and gross dollar volume indicators.

Segment net revenue for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, increased \$15.9 million and \$46.1 million, respectively. Service fee revenue increased \$14.2 million and \$42.7 million, or 11.3% and 11.1%, respectively. This increase was substantially driven by an increase in the number of active cards during the nine months ended September 30, 2018. Revenues from interchange and other services increased \$1.7 million and \$3.4 million, or 3.1% and 2.0%, respectively. While gross dollar volume increased 11.2% and 6.7% during the three and nine months ended September 30, 2018, as compared to the same periods in 2017, interchange and other revenues were negatively impacted during this period related to the adoption of ASC 606.

On January 25, 2018, the Consumer Financial Protection Bureau (“CFPB”) announced that it had finalized updates to its 2016 prepaid rule. The CFPB’s 2016 prepaid rule put in place requirements for treatment of funds on lost or stolen cards, error resolution and investigation, upfront fee disclosures, access to account information, and overdraft features if offered in conjunction with prepaid accounts. The changes announced by the CFPB adjust requirements for resolving errors on unregistered accounts, provide greater flexibility for credit cards linked to digital wallets, and extend the effective date of the rule by one year to April 1, 2019. Assuming no changes to the rule and before taking into consideration the mitigating effects of TSYS’ business expansion and product diversification strategies for the Consumer Solutions segment, the Company currently expects that the Company’s 2019 net revenue will be negatively impacted by approximately \$60 - \$65 million, with an estimated negative impact to adjusted diluted EPS of \$0.17 - \$0.19. TSYS expects to offset one-third to one-half of the expected negative financial impact of the rule, from both a net revenue and an adjusted diluted EPS perspective. TSYS will continue to review and interpret the rule and analyze its expected impact on the Consumer Solutions segment’s business. The estimated net revenue and adjusted diluted EPS impact set forth above is subject to risks and uncertainties such as the success of TSYS’ business expansion and product diversification strategies for the Consumer Solutions segment which success will depend on, among other things, the rate of adoption of the Company’s new products (both by consumers and the Company’s distribution partners), the rate of utilization of the various product features by cardholders, and overall market and regulatory dynamics. The estimated impact of the rule on the Company’s 2019 financial performance could vary based on these and other factors.

Operating Expenses

The Company's operating expenses were \$799.4 million and \$2.4 billion for the three and nine months ended September 30, 2018, respectively, compared to \$1.0 billion and \$3.1 billion for the same periods in 2017. The Company's operating expenses consist of cost of services and selling, general and administrative expenses. Cost of services describes the direct expenses incurred in performing a particular service for the Company's customers, including the cost of reimbursable items and direct labor expense in putting the service in saleable condition. Selling, general and administrative expenses are incurred in selling or marketing and for the direction of the enterprise as a whole, including accounting, legal fees, sales, investor relations and mergers and acquisitions.

Operating expenses for the three and nine months ended September 30, 2018 decreased \$248.5 million and \$697.4 million, respectively, mainly due to the adoption of ASC 606 and the net presentation of interchange and payment network fees. See Note 2 in the Notes to Unaudited Consolidated Financial Statements for further discussion of the Company's adoption of ASC 606 as of January 1, 2018. The decrease was partially offset by an increase in operating expenses related to acquisitions as well as increased acquisition expenses and amortization of acquisition intangibles.

Table of Contents

The Company's cost of services were \$624.4 million and \$1.9 billion for the three and nine months ended September 30, 2018, respectively, which were decreases of 30.5% and 29.7%, respectively, compared to the same periods last year. The decrease in cost of services for the three and nine months ended September 30, 2018 is due to the adoption of ASC 606 and the presentation of interchange and payment network fees on a net basis. The Company's selling, general and administrative expenses were \$175.0 million and \$541.6 million for the three and nine months ended September 30, 2018, respectively, increases of 17.1% and 18.7%, respectively, compared to the same periods last year. The increase in selling, general, and administrative costs for the three and nine months ended September 30, 2018 is the result of an increase in acquisition expenses and amortization of acquisition intangibles.

The Company's transaction and integration expenses related to acquisitions were \$3.6 million and \$21.5 million for the three and nine months ended September 30, 2018, respectively. These expenses consist of costs related to the completion of the acquisitions such as legal, accounting and professional fees, share-based compensation, as well as, personnel costs for severance and retention.

Operating Income

Operating income increased 8.2% and 9.4%, for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017. The Company's operating profit margins for the three and nine months ended September 30, 2018, were 21.3% and 20.4%, respectively, compared to 16.0% and 15.3% for the same periods last year. TSYS' operating margin increased for the three and nine months ended September 30, 2018, as compared to the same periods in 2017, due primarily to the adoption of ASC 606 and the presentation of interchange and payment network fees on a net basis.

Nonoperating Income (Expense)

Nonoperating income (expense) consists of interest income, interest expense and gains and losses on currency translation and transactions. Net nonoperating expense increased for the three and nine months ended September 30, 2018, as compared to the same periods in 2017. The increase in net nonoperating expense for the three and nine months ended September 30, 2018 was due primarily to increased interest expense.

The following table provides a summary of nonoperating expenses, net:

Edgar Filing: TOTAL SYSTEM SERVICES INC - Form 10-Q

(in thousands)	Three months ended September 30,			Nine months ended September 30,		
	2018	2017	Percent Change	2018	2017	Percent Change
Interest expense <sup>1</sup>	\$ (42,072)	(29,107)	(44.5) %	\$ (122,114)	(89,338)	(36.7) %
Interest income	979	606	61.6	3,249	1,527	nm
Currency translation and transaction gains (losses), net	187	(427)	nm	295	(1,250)	nm
Other	(388)	93	nm	(1,536)	281	nm
Total	\$ (41,294)	(28,835)	(43.2)	\$ (120,106)	(88,780)	(35.3)

nm = not meaningful

<sup>1</sup> Interest expense includes interest on Senior Notes of \$32.8 million and \$89.0 million for the three and nine months ended September 30, 2018, respectively, and \$25.5 million and \$76.5 million for the same periods in 2017.

Interest expense for the three and nine months ended September 30, 2018, increased \$13.0 million and \$32.8 million, respectively, compared to the same periods in 2017. The increase in interest expense for the three months and nine months ended September 30, 2018 was primarily the result of increased debt financing related to the acquisition of Cayan. Additionally, the increase in interest expense is attributable to higher interest rates associated with the 4.000% and 4.450% Senior Notes issued in May 2018 compared to the 2.375% Senior Notes that were paid off at maturity on June 1, 2018.

Occasionally, the Company will provide financing to its subsidiaries in the form of an intercompany loan, which is required to be repaid in U.S. dollars. For its subsidiaries whose functional currency is other than the



Table of Contents

U.S. dollar, the translated balance of the financing (liability) is adjusted upward or downward to match the U.S. dollar obligation (receivable) on the Company's financial statements. The upward or downward adjustment is recorded as a gain or loss on foreign currency translation in the Company's consolidated statements of income.

The Company records foreign currency translation adjustments on foreign-denominated balance sheet accounts. The Company maintains several cash accounts denominated in foreign currencies. As the Company translates the foreign-denominated cash balances into U.S. dollars, the translated cash balance is adjusted upward or downward depending upon the foreign currency exchange movements. The upward or downward adjustment is recorded as a currency translation and transaction gain or loss on foreign currency translation in the Company's consolidated statements of income.

The balance of the Company's foreign-denominated cash accounts subject to risk of translation gains or losses as of September 30, 2018, was approximately \$14.1 million, the majority of which is denominated in U.S. dollars and Euros. The net asset account balance subject to foreign currency exchange rates between the local currencies and the U.S. dollar as of September 30, 2018 was \$49.8 million.

## Income Taxes

For a detailed discussion regarding income taxes, refer to Notes 1 and 13 in the Notes to Consolidated Financial Statements and "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations" which are included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC. See also Note 7 in the Notes to Unaudited Consolidated Financial Statements for additional information on income taxes.

Below is a summary of income tax expense:

(in thousands)	Three months ended September 30,			Nine months ended September 30,		
	2018	2017	Percent Change	2018	2017	Percent Change
Income tax expense	\$ 31,112	54,628	(43.0) %	\$ 86,662	153,917	(43.7) %
Effective income tax rate	17.8 %	32.0 %		17.6 %	32.7 %	

The primary reasons for the lower effective income tax rate for the three months ended September 30, 2018 as compared to the same period last year are the lower 2018 statutory Federal income tax rate as enacted by the Tax Cuts and Jobs Act of 2017 (“Tax Act”), and favorable variances in discrete items related to 2017 return to provision true-up adjustments and changes in unrecognized tax benefits from uncertain tax positions. The primary reasons for the lower effective income tax rate for the nine months ended September 30, 2018 as compared to the same period last year are the lower 2018 statutory Federal income tax rate as enacted by the Tax Act, and favorable variances in discrete items related to excess tax benefits from share-based compensation and 2017 return to provision true-up adjustments.

In the normal course of business, TSYS is subject to examinations from various tax authorities. These examinations may alter the timing or amount of taxable income or deductions or the allocation of income among tax jurisdictions.

TSYS continually monitors and evaluates the potential impact of current events and circumstances on the estimates and assumptions used in the analysis of its income tax positions, and accordingly, TSYS’ effective tax rate may fluctuate in the future.

No provision for U.S. federal and state income taxes has been made in the Company’s current year consolidated financial statements for those non-U.S. subsidiaries whose earnings are considered to be permanently reinvested. The amount of undistributed earnings considered to be “reinvested” which may be subject to tax upon distribution was approximately \$112.2 million as of September 30, 2018. Although TSYS does not intend to repatriate these earnings, a distribution of these non-U.S. earnings in the form of

Table of Contents

dividends, or otherwise, may subject the Company to withholding taxes payable to some of the various non-U.S. countries.

## Equity in Income of Equity Investments

Below is a summary of TSYS' share of income from its interest in equity investments:

(in thousands)	Three months ended September 30,			Nine months ended September 30,				
	2018	2017	Percent Change	2018	2017	Percent Change		
Equity in income of equity investments, net of tax	\$ 12,383	8,497	45.7	%	\$ 35,313	30,919	14.2	%

The increase in equity income for the three and nine months ended September 30, 2018, compared to the same period in 2017, is primarily the result of increased operating results associated with China UnionPay Data Services Co., LTD.

## Net Income

The following table provides a summary of net income and EPS:

(in thousands, except per share data)	Three months ended September 30,			Nine months ended September 30,				
	2018	2017	Percent change	2018	2017	Percent Change		
Net income	\$ 155,960	124,726	25.0	%	\$ 441,497	348,345	26.7	%
Net income attributable to noncontrolling interests	-	(1,631)	(100.0)		(1,261)	(4,368)	(71.1)	
Net income attributable to TSYS common shareholders	\$ 155,960	123,095	26.7		\$ 440,236	343,977	28.0	
Basic EPS attributable to TSYS common	\$ 0.85	0.67	28.0		\$ 2.42	1.87	29.4	

shareholders1							
Diluted EPS attributable to TSYS common shareholders1	\$ 0.85	0.66	28.1	\$ 2.40	1.85	29.3	

<sup>1</sup> Basic and diluted EPS is computed based on the two-class method in accordance with the guidance under GAAP. Refer to Note 11 in the Notes to Unaudited Consolidated Financial Statements for more information on EPS.

#### Non-GAAP Measures

Management evaluates the Company's operating performance based on a constant currency basis, operating margin on a net revenue basis, adjusted EBITDA, adjusted earnings, adjusted diluted EPS and free cash flow which are all non-generally accepted accounting principles (non-GAAP) measures. TSYS also uses these non-GAAP financial measures to evaluate and assess TSYS' financial performance against budget.

Although non-GAAP financial measures are often used to measure TSYS' operating results and assess its financial performance, they are not necessarily comparable to similarly titled measures of other companies due to potential inconsistencies in the method of calculation.

TSYS believes that its provision of non-GAAP financial measures provides investors with important key financial performance indicators that are utilized by management to assess TSYS' operating results, evaluate the business and make operational decisions on a prospective, going-forward basis. Hence, management provides disclosure of non-GAAP financial measures to give shareholders and potential investors an opportunity to see TSYS as viewed by management, to assess TSYS with some of the same tools that management utilizes internally and to be able to compare such information with prior periods. TSYS believes that inclusion of non-GAAP financial measures provides investors with additional information to help them

Table of Contents

better understand its financial statements just as management utilizes these non-GAAP financial measures to understand the business, manage budgets and allocate resources.

The following tables provide a reconciliation of GAAP to the Company's non-GAAP financial measures:

## Constant Currency Comparison

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
<b>Consolidated</b>				
Total revenues (GAAP)	\$ 1,015,371	1,247,576	3,010,121	3,654,676
Foreign currency impact <sup>1</sup>	1,908	—	(14,679)	—
Constant currency <sup>2</sup> (non-GAAP)	\$ 1,017,279	1,247,576	2,995,442	3,654,676
Net revenue (non-GAAP)	\$ 964,594	852,759	2,856,639	2,529,719
Foreign currency impact <sup>1</sup>	1,822	—	(13,691)	—
Constant currency <sup>2</sup> (non-GAAP)	\$ 966,416	852,759	2,842,948	2,529,719
Operating income (GAAP)	\$ 215,983	199,692	612,952	560,123
Foreign currency impact <sup>1</sup>	(15)	—	(5,322)	—
Constant currency <sup>2</sup> (non-GAAP)	\$ 215,968	199,692	607,630	560,123
<b>Issuer Solutions</b>				
Segment net revenue (GAAP)	\$ 434,332	401,074	1,278,921	1,181,090
Foreign currency impact <sup>1</sup>	1,931	—	(13,575)	—
Constant currency <sup>2</sup> (non-GAAP)	\$ 436,263	401,074	1,265,346	1,181,090

<sup>1</sup> Reflects the impact of calculated changes in foreign currency rates from the comparable period.

<sup>2</sup> Reflects current period results on a non-GAAP basis as if foreign currency rates did not change from the comparable prior year period

## Net Revenue and Operating Margin on a Net Revenue Basis

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Operating income (GAAP) (a)	\$ 215,983	199,692	612,952	560,123
Total revenues (GAAP) (b)	\$ 1,015,371	1,247,576	3,010,121	3,654,676
Less: reimbursable items, interchange and payment network fees	50,777	394,817	153,482	1,124,957
Net revenue (non-GAAP) (c)	\$ 964,594	852,759	2,856,639	2,529,719
	21.3	% 16.0	% 20.4	% 15.3
				%

Operating margin (as reported) (GAAP)  
(a)/(b)

Operating margin on a net revenue basis  
(non-GAAP) (a)/(c)

22.4	%	23.4	%	21.5	%	22.1	%
------	---	------	---	------	---	------	---

Table of Contents

## Adjusted EBITDA

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net income (GAAP) (a)	\$ 155,960	124,726	441,497	348,345
Adjust for:				
Less: Equity in income of equity investments	(12,383)	(8,497)	(35,313)	(30,919)
Add: Income tax expense	31,112	54,628	86,662	153,917
Add: Interest expense, net	41,093	28,501	118,865	87,811
Add: Depreciation and amortization	101,332	100,284	310,010	303,821
Add: Client incentive/contract asset amortization <sup>1</sup>	7,302	-	20,887	-
Add: Contract cost asset amortization <sup>1</sup>	8,592	-	27,830	-
Less/Add: (Gain)/loss on foreign currency translation	(187)	427	(295)	1,250
Add/Less: Other nonoperating expenses (income)	388	(93)	1,536	(281)
Add: Share-based compensation	12,392	8,407	32,916	28,462
Add: Cayan and TransFirst M&A and integration expenses <sup>2</sup>	2,887	1,052	19,836	10,086
Add: Litigation, claims, judgments or settlements <sup>3</sup>	-	26	-	1,904
Adjusted EBITDA (non-GAAP) (b)	\$ 348,488	309,461	1,024,431	904,396
Total revenues (GAAP) (c)	\$ 1,015,371	1,247,576	3,010,121	3,654,676
Net income margin on total revenues (GAAP) (a)/(c)	15.4	% 10.0	% 14.7	% 9.5
Net revenue (non-GAAP) (d)	\$ 964,594	852,759	2,856,639	2,529,719
Adjusted EBITDA margin on net revenue (non-GAAP) (b)/(d)	36.1	% 36.3	% 35.9	% 35.8

<sup>1</sup> Client incentive and contract asset amortization are no longer included in depreciation and amortization due to the adoption of ASC 606 on January 1, 2018.

<sup>2</sup> Costs associated with the Cayan and TransFirst acquisitions which are included in selling, general and administrative expenses and nonoperating expenses.

<sup>3</sup> Litigation settlement or settlement discussions with counterparties and related legal expenses.

Table of Contents

## Adjusted Earnings and Adjusted Diluted Earnings Per Share

(in thousands, except per share data)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Income attributable to TSYS common shareholders from continuing operations (GAAP)	\$ 155,960	123,095	440,236	343,977
Adjust for amounts attributable to TSYS common shareholders:				
Add: Acquisition intangible amortization	57,554	50,704	182,373	156,489
Add: Share-based compensation	12,392	8,404	32,913	28,455
Add: Cayan and TransFirst M&A and integration expenses <sup>1</sup>	2,887	1,052	19,836	10,025
Add: Litigation, claims, judgments or settlements <sup>2</sup>	-	26	-	1,904
Less: Tax impact of adjustments <sup>3</sup>	(16,381)	(20,614)	(51,563)	(67,702)
Adjusted earnings (non-GAAP)	\$ 212,412	162,667	623,795	473,148
Diluted EPS - Income from continuing operations attributable to TSYS common shareholders:				
As reported (GAAP)	\$ 0.85	0.66	2.40	1.85
Adjusted diluted EPS (non-GAAP)	\$ 1.16	0.88	3.40	2.55
Weighted average diluted shares	183,846	185,809	183,601	185,472

<sup>1</sup> Costs associated with the Cayan and TransFirst acquisitions which are included in selling, general and administrative expenses and nonoperating expenses.

<sup>2</sup> Litigation claims, judgments, settlements or settlement discussions and related legal expenses.

<sup>3</sup> Certain of these merger and acquisition costs are nondeductible for income tax purposes. Income tax impact includes a discrete item as a result of the acquisition.

## Free Cash Flow

(in thousands)	Nine months ended	
	September 30,	
	2018	2017
Net cash provided by operating activities (GAAP)	\$ 752,508	659,428
Capital expenditures	(140,029)	(109,359)
Free cash flow (non-GAAP)	\$ 612,479	550,069

## Financial Position, Liquidity and Capital Resources

## Cash Flows



The consolidated statements of cash flows detail the Company's cash flows from operating, investing and financing activities. TSYS' primary method of funding its operations and growth has been cash generated from current operations. TSYS has occasionally used borrowed funds to supplement financing of capital expenditures and acquisitions.

50

---

Table of Contents

## Cash Flows From Operating Activities

(in thousands)	Nine months ended	
	September 30,	
	2018	2017
Net income	\$ 441,497	348,345
Depreciation and amortization	310,010	303,821
Provisions for cardholder losses	50,911	39,036
Share-based compensation	32,916	28,462
Provisions for bad debt expenses and billing adjustments	7,451	7,835
Charges for transaction processing provisions	4,694	5,719
Amortization of debt issuance costs	3,668	3,247
Deferred income tax expense (benefit)	21,173	(46,435)
Equity in income of equity investments	(35,313)	(30,919)
Other noncash items and charges, net	25,406	23,763
Net change in current and other assets and current and other liabilities	(109,905)	(23,446)
Net cash provided by operating activities	\$ 752,508	659,428

TSYS' main source of funds is derived from operating activities, specifically net income. The change in depreciation and amortization is mainly the result of acquisitions partially offset by the adoption of ASC 606. Net change in current and other assets and current and other liabilities includes accounts receivable, prepaid expenses, other current assets and other assets, accounts payable, accrued salaries and employee benefits, contract assets, contract cost assets, other current liabilities and other liabilities. The change in accounts receivable as of September 30, 2018, as compared to September 30, 2017, is the result of timing of collections. The change in accounts payable and other liabilities for the same period is the result of the timing of payments of vendor invoices. The change in accrued salaries and employee benefits is due primarily to changes in incentive bonuses and benefits paid in the first nine months ended September 30, 2018 compared to the same period in 2017.

## Impact of adoption of ASC 606

TSYS makes cash payments for processing rights, third-party development costs and other direct salary-related costs in connection with converting new clients to the Company's processing systems. Upon the Company's adoption of ASC 606 as of January 1, 2018, costs to obtain or fulfill a contract are classified as contract cost assets and payments for processing rights or signing incentives are classified as contract assets in the Company's consolidated balance sheets. See Notes 2 and 4 in the Notes to Unaudited Consolidated Financial Statements.

The decrease in additions to contract costs assets for the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017 is primarily attributable to payments for processing rights that are included in the changes in contract assets and liabilities in the operating activities section of the Company's consolidated statements of cash flows upon the Company's adoption of ASC 606 as of January 1, 2018.

Table of Contents

## Cash Flows From Investing Activities

(in thousands)	Nine months ended	
	September 30,	
	2018	2017
Cash used in acquisitions, net of cash acquired	\$ (1,051,629)	-
Purchases of property and equipment	(77,841)	(42,572)
Additions to licensed computer software from vendors	(32,496)	(23,114)
Additions to internally developed computer software	(29,692)	(22,011)
Other investing activities	(5,670)	(1,436)
Additions to contract acquisition costs	-	(21,662)
Net cash used in investing activities	\$ (1,197,328)	(110,795)

The primary uses of cash for investing activities in 2018 were for acquisitions, purchases of property and equipment, the purchase of licensed computer software and internal development of computer software. The primary uses of cash for investing activities in 2017 were for purchases of property and equipment, additions to contract acquisition costs, internal development of computer software and the purchase of licensed computer software.

## Cash Flows From Financing Activities

(in thousands)	Nine months ended	
	September 30,	
	2018	2017
Principal payments on long-term borrowings, capital lease obligations and license agreements	\$ (2,807,187)	(415,788)
Purchase of noncontrolling interest	(126,000)	(70,000)
Dividends paid on common stock	(70,897)	(55,151)
Subsidiary dividends paid to noncontrolling shareholders	(3,778)	(5,216)
Repurchase of common stock under plans and tax withholding	(443)	(27,895)
Debt issuance costs	(16,004)	-
Proceeds from borrowings of long-term debt	3,477,000	-
Proceeds from exercise of stock options	31,024	15,499
Net cash provided by (used in) financing activities	\$ 483,715	(558,551)

The main uses of cash for financing activities in 2018 were principal payments on long-term borrowings, the purchase of the remaining fifteen percent interest in Central Payment Co., LLC ("CPAY"), capital lease obligations and license agreements, and the payment of dividends. The main source of cash provided by financing activities in 2018 is the

proceeds from borrowing of long-term debt and exercises of stock options. The main source of cash provided by financing activities in 2017 was the proceeds from exercises of stock options. The main uses of cash for financing activities in 2017 were principal payments on long-term borrowings, capital lease obligations and license agreements, the purchase of an additional ten percent interest in CPAY, and the payment of dividends.

Refer to Note 5 in the Notes to Unaudited Consolidated Financial Statements for more information on borrowings.

#### Dividends

Dividends on common stock of \$70.9 million and \$55.2 million were paid during the nine months ended September 30, 2018 and 2017, respectively. The Company increased its quarterly dividend from \$0.10 per share to \$0.13 per share in July 2017. For the nine months ended September 30, 2018, the Company paid dividends of \$0.39 per share compared to \$0.30 per share for the nine months ended September 30, 2017.

## Table of Contents

### Stock Repurchase

For a detailed discussion regarding the Company's stock repurchase plan, see "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations," which is included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC.

The Company did not purchase any shares under the plan during the nine months ended September 30, 2018 or 2017. The Company has 10.5 million shares available to be purchased under the plan.

### Foreign Operations

TSYS operates internationally and is subject to adverse movements in foreign currency exchange rates. On June 23, 2016, the United Kingdom ("U.K.") held a referendum in which voters approved an exit from the European Union ("E.U."), commonly referred to as "Brexit." As a result, global markets were adversely impacted, including currencies, and resulted in a decline in the value of the British pound, as compared to the U.S. dollar and other currencies. Uncertainty over the terms of the withdrawal of the U.K. from the E.U. may create global economic uncertainty, and have unknown social and geopolitical impact, which may adversely affect the Company's business, results of operations and financial condition. TSYS has not entered into foreign exchange forward contracts to reduce its exposure to foreign currency rate changes. TSYS continues to analyze potential hedging instruments to safeguard it from significant foreign currency translation risks.

TSYS maintains operating cash accounts outside the United States. Refer to Note 4 in the Notes to Unaudited Consolidated Financial Statements for more information on cash and cash equivalents. TSYS has adopted the permanent reinvestment exception under GAAP with respect to future earnings of certain foreign subsidiaries. While some of the foreign cash is available to repay intercompany financing arrangements, some remaining amounts may not be presently available to fund domestic operations and obligations without paying withholding taxes upon its repatriation. Demand on the Company's cash has increased as a result of its strategic initiatives. TSYS funds these initiatives through a balance of internally generated cash, external sources of capital and, when advantageous, access to foreign cash in a tax efficient manner. Where local regulations limit an efficient intercompany transfer of amounts held outside of the U.S., TSYS will continue to utilize these funds for local liquidity needs. Under current law, balances available to be repatriated to the U.S. may be subject to foreign withholding taxes. Pursuant to the Tax Act, TSYS has not provided for the U.S. federal tax liability on these amounts for financial statement purposes. TSYS utilizes a variety of tax planning and financing strategies with the objective of having its worldwide cash available in the locations where it is needed.

### Impact of Inflation

Although the impact of inflation on its operations cannot be precisely determined, the Company believes that by controlling its operating expenses, and by taking advantage of more efficient computer hardware and software, it can minimize the impact of inflation.

#### Working Capital

TSYS may seek additional external sources of capital in the future. The form of any such financing will vary depending upon prevailing market and other conditions and may include short-term or long-term borrowings from financial institutions or the issuance of additional equity and/or debt securities such as industrial revenue bonds. However, there can be no assurance that funds will be available on terms acceptable to TSYS. Management expects that TSYS will continue to be able to fund a significant portion of its capital expenditure needs through internally generated cash in the future, as evidenced by TSYS' current ratio of 2.6:1. As of September 30, 2018, TSYS had working capital of \$732.7 million compared to working capital of \$90.2 million as of December 31, 2017.

#### Legal Proceedings

Refer to Note 15 of the Company's audited financial statements for the year ended December 31, 2017, which are included as Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended

Table of Contents

December 31, 2017, as filed with the SEC, for a discussion regarding commitments and contingencies including legal proceedings. Also, for more information regarding the Company's legal proceedings, refer to Note 10 in the Notes to Unaudited Consolidated Financial Statements.

Forward-Looking Statements

Certain statements contained in this filing which are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act (the Act). These forward-looking statements include, among others: (i) TSYS' expectation with respect to the effect of recent accounting pronouncements; (ii) TSYS' expectation that it will be able to fund a significant portion of its capital expenditure needs through internally generated cash in the future; (iii) TSYS' belief with respect to lawsuits, claims and other complaints; (iv) TSYS' expectation with respect to certain tax matters, and the assumptions underlying such statements; (v) TSYS' expectation with respect to the impact of the CFPB's rule pertaining to prepaid financial products on its Consumer Solutions segment and TSYS' 2018 net revenue and adjusted diluted EPS, and TSYS' business expansion and product diversification strategies. In addition, certain statements in future filings by TSYS with the Securities and Exchange Commission, in press releases, and in oral and written statements made by or with the approval of TSYS which are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenue, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans and objectives of TSYS or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "expects," "intends," "targeted," "estimates," "projects," "plans," "may," "could," "should," and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying these statements.

These statements are based upon the current beliefs and expectations of TSYS' management and are subject to significant risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements. A number of important factors could cause actual results to differ materially from those contemplated by the Company's forward-looking statements. Many of these factors are beyond TSYS' ability to control or predict. These factors include, but are not limited to:

- the material breach of security of any of TSYS' systems and software;
- TSYS incurs expenses associated with the signing of a significant client;
- organic growth rates for TSYS' existing clients are lower than anticipated whether as a result of unemployment rates, card delinquencies and charge off rates or otherwise or attrition rates of existing clients are higher than anticipated;
- conversions and deconversions of client portfolios may not occur as scheduled;
- risks associated with foreign operations, including adverse developments with respect to foreign currency exchange rates, and in particular with respect to the current environment, adverse developments with respect to foreign currency exchange rates as a result of the United Kingdom's decision to leave the European Union (Brexit);
- adverse developments with respect to entering into contracts with new clients and retaining current clients;



consolidation in the financial services and other industries, including the merger of TSYS clients with entities that are not TSYS processing clients, the sale of portfolios by TSYS clients to entities that are not TSYS processing clients and financial institutions which are TSYS clients otherwise ceasing to exist;

- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act on TSYS and its clients;

Table of Contents

- adverse developments with respect to the payment card industry in general, including a decline in the use of cards as a payment mechanism;
- the impact of potential and completed acquisitions, particularly the completed Cayan and TransFirst acquisitions, including the costs associated therewith, their being more difficult to integrate than anticipated, and the inability to achieve the anticipated growth opportunities and other benefits of the acquisitions;
- the costs and effects of litigation, investigations or similar matters or adverse facts and developments relating thereto;
- the impact of the application of and/or changes in accounting principles;
- TSYS' inability to timely, successfully and cost-effectively improve and implement processing systems to provide new products, increased functionality and increased efficiencies;
- TSYS' reliance on financial institution sponsors;
- changes occur in laws, rules, regulations, credit card association rules, prepaid industry rules, or other industry standards affecting TSYS and its clients that may result in costly new compliance burdens on TSYS and its clients and lead to a decrease in the volume and/or number of transactions processed or limit the types and amounts of fees that can be charged to customers, and in particular the CFPB's rule regarding prepaid financial products;
  - The success of TSYS' business expansion and product diversification strategies for the Consumer Solutions segment which success will depend on, among other things, the rate of adoption of the Company's new products (both by consumers and the Company's distribution partners), the rate of utilization of the various product features by cardholders, and overall market and regulatory dynamics.
- TSYS' ability to obtain and protect its own patents and intellectual property and also avoid liability for infringement of third party rights;
  - the effect of current domestic and worldwide economic and geopolitical conditions;
- the impact on TSYS' business, as well as on the risks set forth above, of various domestic or international military or terrorist activities or conflicts;
- the potential for TSYS' systems and software to contain undetected errors, viruses or defects;
- other risk factors described in the "Risk Factors" and other sections of TSYS' Annual Report on Form 10-K for the fiscal year ended December 31, 2017 and other filings with the Securities and Exchange Commission; and
- TSYS' ability to manage the foregoing and other risks.

These forward-looking statements speak only as of the date on which they are made and TSYS disclaims any obligation to update any forward-looking statement as a result of new information, future developments or otherwise except as required by law.

Subsequent Events

Management performed an evaluation of the Company's activity as of the date these consolidated financial statements were issued and has concluded that there are no significant subsequent events requiring disclosure.



Table of Contents

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

## Foreign Exchange Risk

The Company is exposed to foreign exchange risk because it has assets, liabilities, revenues and expenses denominated in foreign currencies other than the U.S. dollar. These currencies are translated into U.S. dollars at current exchange rates, except for revenues, costs and expenses and net income, which are translated at the average exchange rate for each reporting period. Net exchange gains or losses resulting from the translation of assets and liabilities of foreign operations, net of tax, are accumulated in a separate section of shareholders' equity entitled "accumulated other comprehensive loss, net."

Currently, the Company does not use financial instruments to hedge exposure to exchange rate changes.

The following table presents the carrying value of the net assets of TSYS' foreign operations in U.S. dollars as of September 30, 2018:

	As of September 30, 2018
(in thousands)	
Europe	\$ 202,017
China	128,846
Cyprus	44,156
Other	16,446

The Company provides financing to its international operations through intercompany loans that require the operation to repay the financing in amounts denominated in currencies other than the local currency. The functional currency of the operation is the respective local currency. As it translates the foreign currency denominated financial statements into U.S. dollars, the translated balance of the financing (liability) is adjusted upward or downward to match the obligation (receivable) on its financial statements. The upward or downward adjustment is recorded as a gain or loss on foreign currency translation.

TSYS records foreign currency translation adjustments associated with other balance sheet accounts. The Company maintains several cash accounts denominated in foreign currencies, primarily in U.S. dollars and Euros. As TSYS translates the foreign-denominated cash balances into U.S. dollars, the translated cash balance is adjusted upward or

downward depending upon the foreign currency exchange movements. The upward or downward adjustment is recorded as a gain or loss on foreign currency translation in the consolidated statements of income.

TSYS recorded net translation gains of approximately \$0.2 million and \$0.3 million for the three and nine months ended September 30, 2018, respectively, relating to the translation of cash and other balance sheet accounts. The balance of the Company's foreign-denominated cash accounts subject to risk of translation gains or losses as of September 30, 2018, was approximately \$14.1 million, the majority of which was denominated in U.S. dollars and Euros.

The net asset account balance subject to foreign currency exchange rates between the local currencies and the U.S. dollar as of September 30, 2018, was \$49.8 million. The following table presents the potential effect on income before income taxes of hypothetical shifts in the foreign currency exchange rate between the local currencies and the U.S. dollar of plus-or-minus 100 basis points, 500 basis points and 1,000 basis points based on the net asset account balance of \$49.8 million as of September 30, 2018.

(in thousands)	Effect of basis point change					
	Increase in basis point of			Decrease in basis point of		
	100	500	1,000	100	500	1,000
Effect on income before income taxes	\$ 498	2,492	4,984	(498)	(2,492)	(4,984)

Table of Contents

Interest Rate Risk

TSYS is also exposed to interest rate risk associated with the investing of available cash and the use of debt. TSYS invests available cash in conservative short-term instruments and is subject to changes in interest rates.

The Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC, contains a discussion of interest rate risk and the Company's debt obligations that are sensitive to changes in interest rates.

Item 4. Controls and Procedures.

We have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this quarterly report as required by Rule 13a-15 of the Securities Exchange Act of 1934, as amended ("Exchange Act"). This evaluation was carried out under the supervision and with the participation of the Company's management, including its chief executive officer and chief financial officer. Based on this evaluation, the chief executive officer and chief financial officer concluded that as of September 30, 2018, TSYS' disclosure controls and procedures were designed and operating effectively to ensure that the information required to be disclosed by TSYS in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and were also designed and operating effectively to ensure that the information required to be disclosed in the reports that TSYS files or submits under the Exchange Act is accumulated and communicated to management, as appropriate to allow timely decisions regarding required disclosure.

TSYS completed the acquisitions of Cayan Holdings LLC in January 2018 and also substantially all of the assets of iMobile3, LLC in June 2018. TSYS is currently evaluating the Cayan and iMobile3 accounting and reporting processes with TSYS' framework of internal control over financial reporting.

TSYS adopted the new revenue guidance under Accounting Standards Update 2014-09 (ASC 606) as of January 1, 2018. The adoption of this guidance required the implementation of new accounting processes, procedures and internal controls over financial reporting surrounding the adoption of the standard, periodic reporting and expanded disclosures. Additionally, on January 1, 2018, the Company implemented a new revenue software solution to facilitate compliance with the standard.

No other changes in TSYS' internal control over financial reporting occurred during the period covered by this report that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II — OTHER INFORMATION

Item 1. Legal Proceedings.

For information regarding TSYS' legal proceedings, refer to Note 10 of the Notes to Unaudited Consolidated Financial Statements which is incorporated by reference into this item.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, one should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, which could materially affect the Company's financial position, results of operations or cash flows. The risks described in the Company's Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially adversely affect the Company's financial position, results of operations or cash flows.

There have been no material changes in the Company's risk factors from those disclosed in the Company's 2017 Annual Report on Form 10-K.

Table of Contents

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

(in thousands, except per share data)	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans of Programs
July 2018	-	\$ -	9,500	10,500
August 2018	4	93.49	9,500	10,500
September 2018	-	-	9,500	10,500
Total	4	\$ 93.49		

<sup>1</sup> Denotes a total of 3,866 shares in August withheld for payment of taxes.

<sup>2</sup> In January 2015, TSYS' Board of Directors approved a stock repurchase plan to repurchase up to 20 million shares of TSYS stock. The shares may be purchased from time to time at prices considered appropriate. There is no expiration date for the plan.

## Item 6. Exhibits.

## a) Exhibits

Exhibit Number	Description
31.1	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document



101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

TOTAL SYSTEM SERVICES, INC.

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.

TOTAL SYSTEM SERVICES, INC.

Date: November 6, 2018 by: /s/ M. Troy Woods  
M. Troy Woods  
Chairman, President and Chief Executive Officer

Date: November 6, 2018 by: /s/ Paul M. Todd  
Paul M. Todd  
Senior Executive Vice President and  
Chief Financial Officer