

**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: **June 30, 2003**

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.

(Exact name of registrant as specified in its charter)

Georgia

58-1493818

(State or other jurisdiction of incorporation or organization)

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

1600 First Avenue, Post Office Box 1755, Columbus, Georgia 31902

(Address of principal executive offices)

(Zip Code)

(706) 649-2310

(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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS
DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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: August 12, 2003

Common Stock, \$.10 par value

196,777,820



**TOTAL SYSTEM SERVICES, INC.
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TOTAL SYSTEM SERVICES, INC.
Part I – Financial Information
Consolidated Balance Sheets
(Unaudited)

| | June 30, 2003 | December 31, 2002 |
|---|--------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents (includes \$5.5 million and \$85.7 million on deposit with a related party at 2003 and 2002, respectively) | \$ 48,175,270 | 109,171,206 |
| Restricted cash (includes \$8.9 million and \$4.0 million on deposit with a related party at 2003 and 2002, respectively) | 8,942,822 | 4,035,052 |
| Accounts receivable, net of allowance for doubtful accounts and billing adjustments of \$7.4 million and \$8.0 million at 2003 and 2002, respectively | 137,679,005 | 121,439,387 |
| Deferred income tax assets | 10,128,318 | 8,785,539 |
| Prepaid expenses and other current assets | 27,139,434 | 22,547,590 |
| Total current assets | 232,064,849 | 265,978,774 |
| Property and equipment, less accumulated depreciation and amortization of \$125.3 million and \$127.8 million at 2003 and 2002, respectively | 218,950,001 | 120,835,260 |
| Computer software, less accumulated amortization of \$172.6 million and \$149.6 million at 2003 and 2002, respectively | 204,971,145 | 200,297,026 |
| Contract acquisition costs | 129,433,972 | 123,728,968 |
| Equity investments, net | 57,867,209 | 54,181,246 |
| Goodwill, net | 29,611,695 | 3,619,178 |
| Other assets | 20,048,073 | 14,227,058 |
| Total assets | \$ 892,946,944 | 782,867,510 |

TOTAL SYSTEM SERVICES, INC.
Consolidated Balance Sheets (continued)
(Unaudited)

| | June 30, 2003 | December 31, 2002 |
|--|--------------------------|----------------------|
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 17,457,940 | 10,365,836 |
| Accrued salaries and employee benefits | 24,177,980 | 43,314,882 |
| Current portion of long-term debt and obligations under capital leases | 293,994 | 68,110 |
| Billings in excess of costs on uncompleted contracts | 28,472,591 | - |
| Other current liabilities (includes \$3.3 million and \$2.9 million payable to related parties at 2003 and 2002, respectively) | 70,511,274 | 60,232,889 |
| Total current liabilities | 140,913,779 | 113,981,717 |
| Long-term debt and obligations under capital leases, excluding current portion (includes \$20.2 million payable to a related party at 2003) | 20,548,133 | 67,354 |
| Other accounts payable | 187,500 | 562,500 |
| Deferred income tax liabilities | 74,601,683 | 63,306,186 |
| Total liabilities | 236,251,095 | 177,917,757 |
| Minority interest in consolidated subsidiary | 3,013,021 | 2,743,863 |
| Shareholders' equity: | | |
| Common stock - \$.10 par value. Authorized 600,000,000 shares; 197,254,087 and 197,254,087 issued at 2003 and 2002, respectively; 196,577,820 and 197,049,470 outstanding at 2003 and 2002, respectively | 19,725,409 | 19,725,409 |
| Additional paid-in capital | 35,103,615 | 35,143,089 |
| Accumulated other comprehensive income | 2,675,997 | 1,052,897 |
| Treasury stock | (12,086,795) | (3,316,703) |
| Retained earnings | 608,264,602 | 549,601,198 |
| Total shareholders' equity | 653,682,828 | 602,205,890 |
| Total liabilities and shareholders' equity | \$ 892,946,944 | 782,867,510 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

TOTAL SYSTEM SERVICES, INC.
Consolidated Statements of Income
(Unaudited)

| | Three months ended June 30, | |
|--|--------------------------------|-------------|
| | 2003 | 2002 |
| Revenues: | | |
| Electronic payment processing services (includes \$4.4 million and \$4.8 million from related parties for 2003 and 2002, respectively) | \$ 177,305,600 | 153,578,171 |
| Other services (includes \$1.8 million and \$1.7 million from related parties for 2003 and 2002, respectively) | 25,755,106 | 27,986,697 |
| Revenues before reimbursable items | 203,060,706 | 181,564,868 |
| Reimbursable items (includes \$2.2 million and \$2.9 million from related parties for 2003 and 2002, respectively) | 54,637,703 | 60,040,871 |
| Total revenues | 257,698,409 | 241,605,739 |
| Expenses: | | |
| Salaries and other personnel expense | 83,599,736 | 73,588,309 |
| Net occupancy and equipment expense | 50,407,026 | 41,718,384 |
| Other operating expenses (includes \$2.2 million and \$2.2 million to related parties for 2003 and 2002, respectively) | 24,312,057 | 27,984,461 |
| Gain on disposal of equipment, net | (13,860) | (252) |
| Expenses before reimbursable items | 158,304,959 | 143,290,902 |
| Reimbursable items | 54,637,703 | 60,040,871 |
| Total expenses | 212,942,662 | 203,331,773 |
| Operating income | 44,755,747 | 38,273,966 |
| Nonoperating income (expense): | | |
| Interest income, net (includes \$255,000 and \$239,000 from related parties for 2003 and 2002, respectively) | 1,213,082 | 988,823 |
| Gain on foreign currency translation, net | 1,787,791 | 185,648 |
| Total nonoperating income (expense) | 3,000,873 | 1,174,471 |
| Income before income taxes, minority interest and equity in income of joint ventures | 47,756,620 | 39,448,437 |
| Income taxes | 18,107,800 | 14,153,870 |
| Minority interest in consolidated subsidiary's net income | (142,167) | (46,744) |
| Equity in income of joint ventures | 4,800,344 | 4,904,417 |
| Net income | \$ 34,306,997 | 30,152,240 |
| Basic earnings per share | \$ 0.17 | 0.15 |
| Diluted earnings per share | \$ 0.17 | 0.15 |
| Weighted average common shares outstanding | 196,703,341 | 197,003,560 |
| Increase due to assumed issuance of shares related to stock options outstanding | 504,355 | 687,234 |
| Weighted average common and common equivalent shares outstanding | 197,207,696 | 197,690,794 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

TOTAL SYSTEM SERVICES, INC.
Consolidated Statements of Income
(Unaudited)

| | Six months ended | |
|--|-----------------------|-------------|
| | June 30, | |
| | 2003 | 2002 |
| Revenues: | | |
| Electronic payment processing services (includes \$8.9 million and \$9.0 million from related parties for 2003 and 2002, respectively) | \$ 345,131,988 | 296,735,398 |
| Other services (includes \$3.3 million and \$3.4 million from related parties for 2003 and 2002, respectively) | 50,807,759 | 55,645,131 |
| Revenues before reimbursable items | 395,939,747 | 352,380,529 |
| Reimbursable items (includes \$4.7 million and \$4.9 million from related parties for 2003 and 2002, respectively) | 113,111,816 | 117,148,216 |
| Total revenues | 509,051,563 | 469,528,745 |
| Expenses: | | |
| Salaries and other personnel expense | 159,696,112 | 142,320,355 |
| Net occupancy and equipment expense | 102,026,826 | 85,948,531 |
| Other operating expenses (includes \$4.5 million and \$4.4 million to related parties for 2003 and 2002, respectively) | 46,328,584 | 49,864,380 |
| (Gain) loss on disposal of equipment, net | (35,389) | 1,593 |
| Expenses before reimbursable items | 308,016,133 | 278,134,859 |
| Reimbursable items | 113,111,816 | 117,148,216 |
| Total expenses | 421,127,949 | 395,283,075 |
| Operating income | 87,923,614 | 74,245,670 |
| Nonoperating income (expense): | | |
| Interest income, net (includes \$485,000 and \$461,000 from related parties for 2003 and 2002, respectively) | 1,851,373 | 1,357,026 |
| Gain on foreign currency translation, net | 1,161,602 | (3,580) |
| Total nonoperating income (expense) | 3,012,975 | 1,353,446 |
| Income before income taxes, minority interest and equity in income of joint ventures | 90,936,589 | 75,599,116 |
| Income taxes | 33,622,119 | 27,410,613 |
| Minority interest in consolidated subsidiary's net income | (259,775) | (32,818) |
| Equity in income of joint ventures | 8,988,294 | 9,378,092 |
| Net income | \$ 66,042,989 | 57,533,777 |
| Basic earnings per share | \$ 0.34 | 0.29 |
| Diluted earnings per share | \$ 0.33 | 0.29 |
| Weighted average common shares outstanding | 196,875,450 | 196,983,384 |
| Increase due to assumed issuance of shares related to stock options outstanding | 367,050 | 752,343 |
| Weighted average common and common equivalent shares outstanding | 197,242,500 | 197,735,727 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

TOTAL SYSTEM SERVICES, INC.
Consolidated Statements of Cash Flows
(Unaudited)

| | Six months ended | |
|---|----------------------|---------------------|
| | June 30, | |
| | 2003 | 2002 |
| Cash flows from operating activities: | | |
| Net income | \$ 66,042,989 | 57,533,777 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Minority interest in consolidated subsidiary's net income | 259,775 | 32,818 |
| (Gain) loss on foreign currency translation, net | (1,161,602) | 3,580 |
| Equity in income of joint ventures | (8,988,294) | (9,378,092) |
| Depreciation and amortization | 45,597,579 | 34,760,724 |
| Charges for bad debt and billing adjustments | (97,048) | 4,827,845 |
| Charges for transaction processing | 2,163,863 | 6,914,710 |
| Deferred income tax expense | 8,177,577 | 4,973,482 |
| (Gain) loss on disposal of equipment, net | (35,389) | 1,593 |
| (Increase) decrease in: | | |
| Accounts receivable | (11,335,359) | (11,209,208) |
| Prepaid expenses and other assets | (2,051,339) | 2,985,626 |
| Increase (decrease) in: | | |
| Accounts payable | 4,596,774 | (12,239,959) |
| Accrued salaries and employee benefits | (19,179,469) | (19,579,529) |
| Billings in excess of costs on uncompleted contracts | 28,472,591 | - |
| Other current liabilities | (1,798,404) | 16,504,796 |
| Net cash provided by operating activities | <u>110,664,244</u> | <u>76,132,163</u> |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (107,431,941) | (7,815,326) |
| Additions to computer software | (29,032,897) | (35,643,850) |
| Proceeds from disposal of equipment | 66,043 | 8,180 |
| Cash acquired in acquisition | 4,442,163 | 2,858,384 |
| Cash used in acquisition | (36,000,000) | - |
| Dividends received from joint ventures | 5,277,523 | 17,855,119 |
| Increase in contract acquisition costs | (13,378,765) | (27,683,763) |
| Net cash used in investing activities | <u>(176,057,874)</u> | <u>(50,421,256)</u> |

TOTAL SYSTEM SERVICES, INC.
Consolidated Statements of Cash Flows (continued)
(Unaudited)

| | Six months ended June 30, | |
|--|------------------------------|-------------|
| | 2003 | 2002 |
| Cash flows from financing activities: | | |
| Purchase of common stock | (9,485,289) | - |
| Proceeds from issuance of long-term debt | 20,233,983 | - |
| Principal payments on capital lease obligations | (52,168) | (50,232) |
| Dividends paid on common stock | (6,896,740) | (5,875,326) |
| Proceeds from exercise of stock options | 636,797 | 204,550 |
| Net cash provided by (used in) financing activities | 4,436,583 | (5,721,008) |
| Effect of exchange rate changes on cash and cash equivalents | (38,889) | (1,614,638) |
| Net (decrease) increase in cash and cash equivalents | \$ (60,995,936) | 18,375,261 |
| Cash and cash equivalents at beginning of year | 109,171,206 | 58,658,500 |
| Cash and cash equivalents at end of period | \$ 48,175,270 | 77,033,761 |
| Cash paid for interest | \$ 29,664 | 20,475 |
| Cash paid for income taxes (net of refunds received) | \$ 25,905,862 | 11,506,407 |

Significant noncash transaction: In January 2002, the Company acquired TSYS Total Debt Management, Inc. through the issuance of 2,175,000 shares of common stock with a market value of \$43.5 million.

See accompanying Notes to Unaudited Consolidated Financial Statements.

TOTAL SYSTEM SERVICES, INC.
Notes to Unaudited Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements represent the accounts of Total System Services, Inc.[®] (TSYS[®] and the Company); its wholly owned subsidiaries, Columbus Depot Equipment CompanySM (CDECSM), Columbus Productions, Inc.SM (CPI), TSYS Canada, Inc.SM (TCI), TSYS Total Debt Management, Inc. (TDM), ProCard, Inc. (ProCard), TSYS Japan Co., Ltd. (Japan Co.), Enhancement Services Corporation (ESC) and TSYS Technology Center, Inc. (TTC); and its majority owned foreign subsidiary, GP Network Corporation (GP Net). These financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with generally accepted accounting principles. 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 consolidated financial statements and related notes appearing in the Company's 2002 annual report previously filed on Form 10-K.

Note 2 - Supplementary Balance Sheet Information

Cash and cash equivalent balances are summarized as follows:

| | <u>June 30, 2003</u> | <u>December 31, 2002</u> |
|--|-----------------------------|--------------------------|
| Cash and cash equivalents in domestic accounts | \$ 10,075,569 | \$ 84,462,671 |
| Cash and cash equivalents in foreign accounts | 38,099,701 | 24,708,535 |
| Total | <u>\$ 48,175,270</u> | <u>\$ 109,171,206</u> |

The Company maintains accounts outside the United States denominated in U.S. dollars, Euros, British Pounds Sterling, Canadian dollars and Japanese Yen.

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

| | <u>June 30, 2003</u> | <u>December 31, 2002</u> |
|------------------|-----------------------------|--------------------------|
| Prepaid expenses | \$ 10,869,937 | \$ 8,228,801 |
| Other | 16,269,497 | 14,318,789 |
| Total | <u>\$ 27,139,434</u> | <u>\$ 22,547,590</u> |

Significant components of contract acquisition costs are summarized as follows:

| | <u>June 30, 2003</u> | <u>December 31, 2002</u> |
|-------------------------------------|------------------------------|--------------------------|
| Payments for processing rights, net | \$ 87,645,940 | \$ 89,740,749 |
| Conversion costs, net | 41,788,032 | 33,988,219 |
| Total | <u>\$ 129,433,972</u> | <u>\$ 123,728,968</u> |

Notes to Consolidated Financial Statements (continued)

Amortization related to payments for processing rights, which is recorded as a reduction of revenues, was \$3.4 million and \$2.6 million for the three months ended June 30, 2003 and 2002, respectively. Amortization related to payments for processing rights was \$6.3 million and \$5.0 million for the six months ended June 30, 2003 and 2002, respectively.

Amortization expense related to conversion costs, which is recorded in other operating expenses, was \$1.5 million and \$799,000 for the three months ended June 30, 2003 and 2002, respectively. Amortization expense related to conversion costs, which is recorded in other operating expenses, was \$2.8 million and \$1.6 million for the six months ended June 30, 2003 and 2002, respectively.

Significant components of other current liabilities are summarized as follows:

| | <u>June 30, 2003</u> | <u>December 31, 2002</u> |
|-----------------------------------|----------------------|--------------------------|
| Accrued expenses | \$ 21,315,447 | \$ 16,590,984 |
| Customer postage deposits | 12,966,514 | 16,054,531 |
| Deferred revenues | 11,687,886 | 8,554,131 |
| Client liabilities | 8,711,518 | 3,629,663 |
| Transaction processing provisions | 5,308,024 | 5,347,010 |
| Dividends payable | 3,931,556 | 3,448,709 |
| Other | 6,590,329 | 6,607,861 |
| Total | <u>\$ 70,511,274</u> | <u>\$ 60,232,889</u> |

Note 3 - Comprehensive Income

Comprehensive income for TSYS consists of net income and foreign currency translation adjustments recorded as a component of shareholders' equity.

Comprehensive income for the three months ended June 30 is as follows:

| | <u>2003</u> | <u>2002</u> |
|--|----------------------|----------------------|
| Net income | \$ 34,306,997 | \$ 30,152,240 |
| Other comprehensive income: | | |
| Foreign currency translation adjustments, net of tax | 2,784,467 | 4,012,931 |
| Comprehensive income | <u>\$ 37,091,464</u> | <u>\$ 34,165,171</u> |

Comprehensive income for the six months ended June 30 is as follows:

| | <u>2003</u> | <u>2002</u> |
|--|----------------------|----------------------|
| Net income | \$ 66,042,989 | \$ 57,533,777 |
| Other comprehensive income: | | |
| Foreign currency translation adjustments, net of tax | 1,623,100 | 3,002,496 |
| Comprehensive income | <u>\$ 67,666,089</u> | <u>\$ 60,536,273</u> |

Notes to Consolidated Financial Statements (continued)

The income tax effects allocated to and the cumulative balance of accumulated other comprehensive income are as follows:

| | Balance at December 31, 2002 | Pretax amount | Tax effect | Balance at June 30, 2003 |
|---|---------------------------------|------------------|------------|-----------------------------|
| Foreign currency translation adjustments | \$1,052,897 | 2,696,025 | 1,072,925 | \$2,675,997 |

Note 4 – Segment Reporting and Major Customers

The Company reports selected information about operating segments in accordance with Statement of Financial Accounting Standards No. 131 (SFAS 131). The Company's segment information reflects the information that the chief operating decision makers (CODMs) use to make resource allocation and strategic decisions. The CODMs at TSYS consist of the chief executive officer, the president and the four executive vice presidents.

Through online accounting and electronic payment processing systems, Total System Services, Inc. provides electronic payment processing and other related services to card-issuing institutions in the United States, Mexico, Canada, Honduras, Europe and the Caribbean. The reportable units are segmented based upon geographic locations. Domestic-based processing services include electronic payment processing services and other services provided from the United States. Domestic-based processing services segment includes the financial results of TSYS, excluding its foreign branch offices, and the following subsidiaries: CDEC, CPI, TDM, ProCard, ESC and TTC. International-based processing services include electronic payment processing and other services provided outside the United States. International-based processing services include the financial results of TCI, GP Net, Japan Co. and TSYS' branch offices in Europe and Japan.

| Operating Segments | Domestic-based processing services | International-based processing services | Consolidated |
|---|---------------------------------------|--|-----------------------|
| At June 30, 2003 | | | |
| Identifiable assets | \$ 885,273,008 | 97,655,200 | \$ 982,928,208 |
| Intersegment eliminations | (89,975,234) | (6,030) | (89,981,264) |
| Total assets | \$ 795,297,774 | 97,649,170 | \$ 892,946,944 |
| At December 31, 2002 | | | |
| Identifiable assets | \$ 777,509,354 | 92,145,647 | \$ 869,655,001 |
| Intersegment eliminations | (86,787,491) | - | (86,787,491) |
| Total assets | \$ 690,721,863 | 92,145,647 | \$ 782,867,510 |
| Three Months Ended June 30, 2003 | | | |
| Total revenue | \$ 237,848,431 | 20,484,556 | \$ 258,332,987 |
| Intersegment revenue | (1,395) | (633,183) | (634,578) |
| Revenue from external customers | \$ 237,847,036 | 19,851,373 | \$ 257,698,409 |
| Depreciation and amortization | \$ 20,942,023 | 2,553,008 | \$ 23,495,031 |
| Segment operating income | \$ 41,485,249 | 3,270,498 | \$ 44,755,747 |
| Income taxes | \$ 16,731,700 | 1,376,100 | \$ 18,107,800 |

Notes to Consolidated Financial Statements (continued)

| Operating Segments | Domestic-based processing services | International-based processing services | Consolidated |
|---|---------------------------------------|--|-----------------------|
| Three Months Ended June 30, 2003 | | | |
| Equity in income of joint ventures | \$ 4,550,422 | 249,922 | \$ 4,800,344 |
| Net income | \$ 32,181,065 | 2,125,932 | \$ 34,306,997 |
| Three Months Ended June 30, 2002 | | | |
| Total revenue | \$ 225,483,732 | 16,669,193 | \$ 242,152,925 |
| Intersegment revenue | (155,714) | (391,472) | (547,186) |
| Revenue from external customers | \$ 225,328,018 | 16,277,721 | \$ 241,605,739 |
| Depreciation and amortization | \$ 16,053,179 | 2,088,332 | \$ 18,141,511 |
| Segment operating income | \$ 36,863,704 | 1,410,262 | \$ 38,273,966 |
| Income taxes | \$ 13,482,758 | 671,112 | \$ 14,153,870 |
| Equity in income of joint ventures | \$ 4,690,640 | 213,777 | \$ 4,904,417 |
| Net income | \$ 29,146,925 | 1,005,315 | \$ 30,152,240 |
| Six Months Ended June 30, 2003 | | | |
| Total revenue | \$ 470,967,776 | 39,195,258 | \$ 510,163,034 |
| Intersegment revenue | (2,790) | (1,108,681) | (1,111,471) |
| Revenue from external customers | \$ 470,964,986 | 38,086,577 | \$ 509,051,563 |
| Depreciation and amortization | \$ 40,548,084 | 5,049,495 | \$ 45,597,579 |
| Segment operating income | \$ 82,965,962 | 4,957,652 | \$ 87,923,614 |
| Income taxes | \$ 31,629,444 | 1,992,675 | \$ 33,622,119 |
| Equity in income of joint ventures | \$ 8,491,890 | 496,404 | \$ 8,988,294 |
| Net income | \$ 62,987,288 | 3,055,701 | \$ 66,042,989 |
| Six Months Ended June 30, 2002 | | | |
| Total revenue | \$ 438,882,817 | 31,742,566 | \$ 470,625,383 |
| Intersegment revenue | (307,169) | (789,469) | (1,096,638) |
| Revenue from external customers | \$ 438,575,648 | 30,953,097 | \$ 469,528,745 |
| Depreciation and amortization | \$ 30,672,404 | 4,088,300 | \$ 34,760,724 |
| Segment operating income | \$ 72,643,360 | 1,062,310 | \$ 74,245,670 |
| Income taxes | \$ 26,633,918 | 776,695 | \$ 27,410,613 |
| Equity in income of joint ventures | \$ 8,917,081 | 461,011 | \$ 9,378,092 |
| Net income | \$ 56,560,706 | 973,071 | \$ 57,533,777 |

Revenues for domestic-based processing services include electronic payment processing and other services provided from the United States to clients domiciled in the United States or other countries. Revenues from international-based processing services include electronic payment processing and other services provided outside the United States to clients domiciled outside the United States.

Notes to Consolidated Financial Statements (continued)

The following geographic area data represent revenues for the three and six months ended June 30, 2003 and 2002, respectively, based on the domicile of customers.

| (Dollars in millions) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------|-----------------------------|-------|---------------------------|-------|
| | 2003 | 2002 | 2003 | 2002 |
| United States | \$ 209.0 | 206.7 | 417.6 | 403.3 |
| Canada | 19.1 | 11.0 | 35.1 | 21.1 |
| Europe | 16.9 | 13.8 | 32.4 | 26.0 |
| Mexico | 9.1 | 7.1 | 17.1 | 13.1 |
| Japan | 2.9 | 2.5 | 5.8 | 4.9 |
| Other | 0.7 | 0.5 | 1.1 | 1.1 |
| Totals | \$ 257.7 | 241.6 | 509.1 | 469.5 |

The Company maintains property and equipment in the United States, Europe, Canada and Japan. The following geographic area data represent net property and equipment balances by region:

| (Dollars in millions) | At June 30, | At December 31, |
|-----------------------|-------------|-----------------|
| | 2003 | 2002 |
| United States | \$ 191.0 | 97.0 |
| Europe | 25.8 | 22.1 |
| Japan | 2.0 | 1.6 |
| Canada | 0.2 | 0.1 |
| Totals | \$ 219.0 | 120.8 |

Major Customers

For the three months ended June 30, 2003, the Company had two major customers which accounted for approximately 30.2%, or \$77.7 million, of total revenues. For the three months ended June 30, 2002, TSYS had two major customers that accounted for 35.0%, or \$82.0 million, of total revenues. Revenues from major customers for the periods reported are attributable to the domestic-based processing services segment.

| Revenue (Dollars in millions) | Three Months Ended June 30, | | | | | |
|----------------------------------|-----------------------------|---------------------|----|---------|---------------------|----|
| | 2003 | | | 2002 | | |
| | Dollars | % of Total Revenues | | Dollars | % of Total Revenues | |
| Customer One | \$ 49.2 | 19.1 % | \$ | 48.0 | 19.9 % | \$ |
| Customer Two | 28.5 | 11.1 | | 34.0 | 14.1 | |
| Totals | \$ 77.7 | 30.2 % | \$ | 82.0 | 35.0 % | \$ |

For the six months ended June 30, 2003, the Company had two major customers which accounted for approximately 30.1%, or \$153.0 million, of total revenues. For the six months ended June 30, 2002, TSYS had two major customers that accounted for 33.9%, or \$159.5 million, of total revenues. Revenues from major customers for the periods reported are attributable to the domestic-based processing services segment.

Notes to Consolidated Financial Statements (continued)

| Revenue (Dollars in millions) | Six Months Ended June 30, | | | | | |
|----------------------------------|---------------------------|---------------------|---|----------|---------------------|---|
| | 2003 | | | 2002 | | |
| | Dollars | % of Total Revenues | | Dollars | % of Total Revenues | |
| Customer One | \$ 96.0 | 18.9 | % | \$ 90.8 | 19.3 | % |
| Customer Two | 57.0 | 11.2 | | 68.7 | 14.6 | |
| Totals | \$ 153.0 | 30.1 | % | \$ 159.5 | 33.9 | % |

Note 5 – Stock-Based Compensation

The Company maintains stock-based compensation plans for purposes of incenting and retaining employees. The Company accounts for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25 (APB 25), “Accounting for Stock Issued to Employees,” and related Interpretations. Under APB 25, TSYS does not recognize compensation expense for a stock option grant if the exercise price is equal to or greater than the fair market value of the common stock on the grant date. The following table illustrates the effect on net income and earnings per share for the three months ended June 30, 2003 and 2002, respectively, if the Company had applied the fair value recognition provisions of SFAS No. 123 (SFAS 123), “Accounting for Stock-Based Compensation,” to stock-based employee compensation granted in the form of TSYS and Synovus Financial Corp. (Synovus) stock options.

| | June 30, 2003 | June 30, 2002 |
|--|---------------|---------------|
| Net income, as reported | \$ 34,306,997 | \$ 30,152,240 |
| Stock-based employee compensation expense determined under the fair value based method for all awards, net of related income tax effects | 1,221,827 | 1,765,285 |
| Net income, as adjusted | \$ 33,085,170 | \$ 28,386,955 |
| Earnings per share: | | |
| Basic – as reported | \$ 0.17 | \$ 0.15 |
| Basic – as adjusted | \$ 0.17 | \$ 0.14 |
| Diluted – as reported | \$ 0.17 | \$ 0.15 |
| Diluted – as adjusted | \$ 0.17 | \$ 0.14 |

The following table illustrates the effect on net income and earnings per share for the six months ended June 30, 2003 and 2002, respectively, if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation granted in the form of TSYS and Synovus stock options.

| | June 30, 2003 | June 30, 2002 |
|--|---------------|---------------|
| Net income, as reported | \$ 66,042,989 | \$ 57,533,777 |
| Stock-based employee compensation expense determined under the fair value based method for all awards, net of related income tax effects | 2,474,644 | 3,241,388 |
| Net income, as adjusted | \$ 63,568,345 | \$ 54,292,389 |

Notes to Consolidated Financial Statements (continued)

Earnings per share:

| | | | | |
|-----------------------|----|-------------|----|-------------|
| Basic – as reported | \$ | <u>0.34</u> | \$ | <u>0.29</u> |
| Basic – as adjusted | \$ | <u>0.32</u> | \$ | <u>0.28</u> |
| Diluted – as reported | \$ | <u>0.33</u> | \$ | <u>0.29</u> |
| Diluted – as adjusted | \$ | <u>0.32</u> | \$ | <u>0.27</u> |

Note 6 – Long-Term Debt

On June 30, 2003, TSYS obtained a \$45.0 million long-term line of credit from a banking affiliate of Synovus. The line is an automatic draw down facility. The interest rate for the line of credit is the London Interbank Offered Rate (LIBOR) plus 150 basis points. In addition, there is a charge of 15 basis points on any funds unused. The line of credit is unsecured debt and includes the covenants requiring the Company to maintain certain minimum financial ratios. At June 30, 2003, TSYS had a draw of \$20.2 million on the line of credit.

Note 7 - Supplementary Cash Flow Information

Cash flows used in additions to computer software for the six months ended June 30, 2003 and 2002 are summarized as follows:

| | <u>June 30, 2003</u> | <u>June 30, 2002</u> |
|--------------------|----------------------|----------------------|
| Purchased programs | \$ 19,999,560 | \$ 19,749,510 |
| Developed software | <u>9,033,337</u> | <u>15,894,340</u> |
| Total | <u>\$ 29,032,897</u> | <u>\$ 35,643,850</u> |

Cash flows used in additions to contract acquisition costs for the six months ended June 30, 2003 and 2002 are summarized as follows:

| | <u>June 30, 2003</u> | <u>June 30, 2002</u> |
|--------------------------------|----------------------|----------------------|
| Conversion costs | \$ 10,378,765 | \$ 6,142,625 |
| Payments for processing rights | <u>3,000,000</u> | <u>21,541,138</u> |
| Total | <u>\$ 13,378,765</u> | <u>\$ 27,683,763</u> |

Note 8 –Recent Accounting Pronouncements

In June 2001, the FASB issued Statement No. 143 (SFAS 143), “Accounting for Asset Retirement Obligations.” SFAS 143 requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets.

The Company also records a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company adopted SFAS 143 on January 1, 2003. The adoption of SFAS 143 did not have a material effect on the Company’s financial position, results of operations or cash flows.

Notes to Consolidated Financial Statements (continued)

In April 2002, the FASB issued Statement No. 145 (SFAS 145), “Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections.” SFAS 145 amends existing guidance on reporting gains and losses on the extinguishment of debt to prohibit the classification of the gain or loss as extraordinary, as the use of such extinguishments have become part of the risk management strategy of many companies. SFAS 145 also amends SFAS No. 13 to require sale-leaseback accounting for certain lease modifications that have economic effects similar to sale-leaseback transactions. The provisions of the Statement related to the rescission of Statement No. 4 are applied in fiscal years beginning after May 15, 2002. The provisions of the Statement related to Statement No. 13 were effective for transactions occurring after May 15, 2002. The adoption of SFAS 145 did not have a material effect on the Company’s financial position, results of operations or cash flows.

In June 2002, the FASB issued Statement No. 146 (SFAS 146), “Accounting for Costs Associated with Exit or Disposal Activities.” SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue 94-3, “Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity.” The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of SFAS 146 did not have a material effect on the Company’s financial position, results of operations or cash flows.

In November 2002, the FASB issued Interpretation No. 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34.” This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. Interpretation No. 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and did not have a material effect on the Company’s financial statements. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has one lease guarantee.

To assist Vital Processing Services L.L.C. (Vital) in leasing its corporate facility, the Company and Visa U.S.A. (Visa) are guarantors, jointly and severally, for the lease payments on Vital’s Tempe facility. The lease on the facility expires in July 2007. The total future minimum lease payments remaining at June 30, 2003 is \$5.9 million. If Vital fails to perform its obligations with regard to the lease, TSYS and Visa will be required to perform in the same manner and to same extent as is required by Vital.

At the November 21, 2002 Emerging Issues Task Force (EITF) meeting, the Task Force ratified as a consensus the tentative conclusions it reached at the October 25, 2002 EITF meeting regarding Emerging Issues Task Force 00-21 (EITF 00-21), “Accounting for Revenue Arrangements with Multiple Deliverables.” EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Those activities may involve the delivery or performance of multiple products, services, and/or rights to use assets, and performance may occur at different points in time or over different periods of time. The arrangements are often

Notes to Consolidated Financial Statements (continued)

accompanied by initial installation, initiation, or activation services and generally involve either a fixed fee or a fixed fee coupled with a continuing payment stream. The continuing payment stream generally corresponds to the continuing performance and may be fixed, variable based on future performance, or composed of a combination of fixed and variable payments. EITF 00-21 addresses how to account for those arrangements. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Entities may also elect to report the change in accounting as a cumulative effect adjustment, in which case disclosure should be made in periods subsequent to the date of initial application of the amount of recognized revenue that was previously included in the cumulative effect adjustment. Management has determined that based on its evaluation, the adoption of EITF 00-21 did not impact the Company's financial position, results of operations or cash flows.

In December 2002, the FASB issued Statement No. 148 (SFAS 148), "Accounting for Stock-Based Compensation – Transition and Disclosure, an amendment of FASB Statement No. 123." SFAS 148 amends FASB Statement No. 123 (SFAS 123), "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included in the notes to the consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. For enterprises such as the Company with a variable interest in a variable interest entity created before February 1, 2003, the Interpretation is applied to the enterprise in the first fiscal year or interim period after June 15, 2003.

In 2002, the Company renewed its operating lease agreement with a special purpose entity (SPE) for the Company's corporate campus. On April 30, 2003, the Company provided written notice that it intended to terminate the lease agreement for the Company's corporate campus. On June 30, 2003, the Company terminated the operating lease agreement and purchased the corporate campus for \$93.5 million with a combination of cash and long-term debt financing through a banking affiliate of Synovus.

Note 9 – Acquisition

On April 28, 2003, TSYS completed the acquisition of Enhancement Services Corporation (ESC) for \$36.0 million in cash. The Company is in the process of completing the purchase price allocation and has preliminarily allocated approximately \$26.0 million to goodwill, approximately \$8.2 million to intangibles and the remaining amount to the net assets acquired. ESC provides targeted loyalty consulting and travel, as well as gift card and merchandise reward programs to more than 40 national and regional financial institutions in the United States. The Company believes the acquisition of ESC enhances TSYS' processing services by adding distinct value differentiation for TSYS and its clients. ESC operates as a separate subsidiary of TSYS.

Notes to Consolidated Financial Statements (continued)

Presented below are the pro forma consolidated results of TSYS' operations for the three months and six months ended June 30, 2003 and 2002, respectively, as though the acquisition of ESC had occurred at the beginning of 2002.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------|-----------------------------|-------------|---------------------------|-------------|
| | 2003 | 2002 | 2003 | 2002 |
| Revenues | \$ 261,883,927 | 244,115,320 | 517,430,763 | 441,913,301 |
| Net income | 34,224,148 | 29,789,382 | 66,556,234 | 47,626,727 |
| Basic earnings per share | .17 | .15 | .34 | .24 |
| Diluted Earnings per share | .17 | .15 | .34 | .24 |

TOTAL SYSTEM SERVICES, INC.
Item 2 - Management's Discussion and Analysis of Financial
Condition and Results of Operations

Financial Review

This Financial Review provides a discussion of critical accounting policies, related party transactions, and off-balance sheet arrangements. This Financial Review also discusses the results of operations, financial condition, 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.

Critical Accounting Policies

TSYS' (The Company's) financial position, results of operations and cash flows are impacted by the accounting policies the Company has adopted. In order to get a full understanding of the Company's financial statements, one must have a clear understanding of the accounting policies employed.

Risks and Uncertainties and Use of Estimates: Factors that could affect the Company's future operating results and cause actual results to vary materially from expectations include, but are not limited to, lower than anticipated growth from existing customers, an inability to attract new customers and grow internationally, loss of one of the Company's major customers or other significant clients, an inability to grow through acquisitions or successfully integrate acquisitions, an inability to control expenses, technology changes, financial services consolidation, change in regulatory mandates, a decline in the use of cards as a payment mechanism, a decline in the financial stability of the Company's clients and uncertain economic conditions. Negative developments in these or other risk factors could have a material adverse effect on the Company's financial position, results of operations and cash flows.

The Company has prepared the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. In preparing financial statements, it is necessary for management to make assumptions and estimates affecting the amounts reported in the consolidated financial statements and related notes. These estimates and assumptions are developed based upon all information available. Actual results can differ from estimated amounts.

A summary of the Company's critical accounting policies follows:

Accounts Receivable: Accounts receivable balances are stated net of allowances for doubtful accounts and billing adjustments of \$7.4 million and \$8.0 million at June 30, 2003 and December 31, 2002, respectively. The allowance represents 5.1% and 6.2% of total accounts receivable at June 30, 2003 and December 31, 2002, respectively. TSYS' client base mainly consists of financial institutions and other card issuers such as retailers. A substantial amount of the Company's account receivable balances are current, and the average number of days sales outstanding in accounts receivable at June 30, 2003 and December 31, 2002 was 51 days and 49 days, respectively. Because TSYS invoices clients for services monthly in arrears, accounts receivable balances includes services for one month of billings not yet invoiced.

TSYS records allowances for doubtful accounts when it is probable that the accounts receivable balance will not be collected. When estimating the allowances for doubtful accounts, the Company takes into consideration such factors as its day-to-day knowledge of the financial position of specific clients, the industry and size of its clients, the overall composition of its accounts receivable aging, prior

Critical Accounting Policies (continued)

history with specific customers of accounts receivable write-offs and prior history of allowances in proportion to the overall receivable balance. This analysis includes an ongoing and continuous communication with its largest clients and those clients with past due balances. A financial decline of any one of the Company's large clients could have an adverse and material effect on collectibility of receivables and thus the adequacy of the allowance for doubtful accounts.

Increases in the allowance for doubtful accounts are recorded as charges to bad debt expense and are reflected in other operating expenses in the Company's consolidated statements of income. Write-offs of uncollectible accounts are charged against the allowance for doubtful accounts.

TSYS records allowances for billing adjustments for actual and potential billing discrepancies. When estimating the allowance for billing adjustments, the Company considers its overall history of billing adjustments, as well as its history with specific clients and known disputes. Increases in the allowance for billing adjustments are recorded as a reduction of revenues in the Company's consolidated statements of income and actual adjustments to invoices are charged against the allowance for billing adjustments.

Revenue Recognition: The Company's electronic payment processing revenues are derived from long-term processing contracts with financial and nonfinancial institutions and are recognized as the services are performed. Electronic payment processing revenues are generated primarily from charges based on the number of accounts on file, transactions and authorizations processed, statements mailed, and other processing services for cardholder accounts on file. Most of these contracts have prescribed annual revenue minimums. The terms of processing contracts generally range from three to ten years in length.

On March 3, 2003, the Company announced that Bank One selected TSYS to upgrade its credit card processing. Under the long term software licensing and services agreement, TSYS will provide electronic payment processing services to Bank One's credit card accounts for at least two years starting in mid 2004 (excluding statement and card production services), and then TSYS will license a modified version of its TS2 consumer and commercial software to Bank One under a perpetual license with a six year payment term. The Company uses the percentage-of-completion accounting method for its agreement with Bank One. TSYS began recognizing revenue in March 2003.

The Company's other service revenues are derived from recovery collections work, bankruptcy process management, legal account management, skip tracing, commercial printing activities and customer relationship management services, such as call center activities for card activation and balance transfer requests. The contract terms for these services are generally shorter in nature. Revenue is recognized on these other services either on a per unit or a fixed price basis. The Company uses the percentage-of-completion method of accounting for its fixed price contracts.

Contract Acquisition Costs: The Company capitalizes contract acquisition costs related to signing or renewing long-term contracts. These costs, primarily consisting of cash payments for rights to provide processing services and internal conversion and software development costs, are amortized using the straight-line method over the contract term beginning when the client's cardholder accounts are converted and producing revenues. All costs incurred prior to a signed agreement are expensed as incurred.

Critical Accounting Policies (continued)

The amortization of contract acquisition costs associated with cash payments is recorded net of revenues in the Company's consolidated statements of income. The amortization of contract acquisition costs associated with conversion activity is recorded as other operating expenses in the Company's consolidated statements of income. The Company evaluates the carrying value of contract acquisition costs for impairment for each customer on the basis of whether these costs are fully recoverable 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.

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 estimates of future cash flows differ from actual results.

Software Development Costs: The Company develops software that is used in providing electronic payment processing and other services to clients. Software development costs are capitalized once technological feasibility of the software product has been established. Costs incurred prior to establishing technological feasibility are expensed as incurred. Technological feasibility is established when the Company has completed a detailed program design and has determined that a product can be produced to meet its design specifications, including functions, features and technical performance requirements. Capitalization of costs ceases when the product is available to clients for general use. The Company evaluates the unamortized capitalized costs of software development as compared to the net realizable value of the software product which is determined by future undiscounted net cash flows. The amount by which the unamortized software development costs exceed the net realizable value is written off in the period that such determination is made. Software development costs are amortized using the greater of (1) the straight-line method over its estimated useful life, which ranges from three to ten years or (2) the ratio of current revenues to total anticipated revenue over its useful life.

The Company also develops software that is used internally. These software development costs are capitalized based upon Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Internal-use software development costs are capitalized once (a) preliminary project stage is completed, (b) management authorizes and commits to funding a computer software project, and (c) it is probable that the project will be completed and the software will be used to perform the function intended. Costs incurred prior to meeting the qualifications are expensed as incurred. Capitalization of costs ceases when the project is substantially complete and ready for its intended use. Internal-use software development costs are amortized using an estimated useful life of three to seven years. Software development costs may become impaired in situations where development efforts are abandoned due to the viability of the planned project becoming doubtful or due to technological obsolescence of the planned software product.

Transaction Processing Provisions: The Company has recorded estimates to accrue for contract contingencies (performance penalties) and processing errors. A significant number of the Company's contracts with large clients contain service level agreements which can result in TSYS incurring performance penalties if contractually required service levels are not met. When providing these accruals, the Company takes into consideration such factors as the prior history of performance penalties and processing errors incurred, actual contractual penalties inherent in the Company's contracts, progress towards milestones and known processing errors not covered by insurance.

Critical Accounting Policies (continued)

These accruals are included in other current liabilities in the accompanying consolidated balance sheets. Increases and decreases in transaction processing provisions are charged to other operating expenses in the Company's consolidated statements of income and payments or credits for performance penalties and processing errors are charged against the accrual.

Impairment of Long-lived Assets and Intangibles: The Company reviews long-lived assets, such as property and equipment and intangibles subject to amortization, such as contract acquisition costs and computer software, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and would no longer be depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet.

Related Party Transactions

The Company provides electronic payment processing and other services to its parent company, Synovus Financial Corp. (Synovus), and its affiliates, and for Vital Processing Services L.L.C. (Vital). The services are performed under contracts that are similar to its contracts with other customers. The Company believes the terms and conditions of transactions between the Company and these related parties are comparable to those which could have been obtained in transactions with unaffiliated parties. The Company's margins with respect to related party transactions are comparable to margins recognized in transactions with unrelated third parties. The amounts related to these transactions are disclosed on the face of TSYS' consolidated financial statements.

In 2000, the Board of Directors of Vital approved a plan to allow its owners to set aside 2 million units held by the owners to make awards to key management of Visa and TSYS. In June 2000, TSYS awarded six of its key executives an aggregate of 800,000 Vital restricted stock units for their role in the development, growth and success of Vital. The units were to vest over a 36-month cliff-vesting schedule. The award of 800,000 units was made in anticipation of Vital becoming a publicly traded company.

Because Vital is not expected to become a publicly traded company in the foreseeable future, TSYS management, with approval from the Compensation Committee, repurchased the Vital restricted units from the Company's six key executives in June 2003. The purchase price for the restricted shares of \$3.85 per unit was based upon an independent, third party valuation of Vital conducted as of May 31, 2003. The Company recognized compensation expense throughout the entire vesting period. Semiannually, the Company received an independent third party evaluation of Vital throughout the vesting period and adjusted compensation expense accordingly. Through December 2002, the Company recognized \$3.0 million as compensation expense. After adjusting for the revised evaluations in 2003, TSYS recognized \$80,000 as compensation expense in 2003. With the repurchase of the units, TSYS will maintain its 50% ownership in Vital.

Related Party Transactions (continued)

In connection with the purchase of the campus discussed below, TSYS obtained a \$45.0 million long-term line of credit from a banking affiliate of Synovus. The line is an automatic draw down facility. The interest rate for the line of credit is the London Interbank Offered Rate (LIBOR) plus 150 basis points. In addition, there is a charge of 15 basis points on any funds unused. At June 30, 2003, TSYS had a draw of \$20.2 million on the line of credit. As the LIBOR rate changes, TSYS will be subject to interest rate risk.

Off-Balance Sheet Arrangements

Operating Leases: As a method of funding its operations, TSYS employs noncancelable operating leases for computer equipment, software and facilities. These leases allow the Company to provide the latest technology while avoiding the risk of ownership because of potential rapid technological obsolescence. Neither the assets nor obligations related to these leases are included on the balance sheet. One of the Company's most significant leases was its synthetic lease for its corporate campus.

Synthetic Lease: In 1997, the Company entered into an operating lease agreement with a special purpose entity (SPE) for the Company's corporate campus. The business purpose of the SPE was to provide a means of financing the Company's corporate campus. The assets and liabilities of the SPE consisted solely of the cost of the building and the loans from a consortium of banks. The cost of the building and the outstanding principal balance of the debt included on the financial statements of the SPE both approximated \$93.5 million. The lease, which was guaranteed by Synovus, provided for substantial residual value guarantees. The amount of the Company's residual value guarantee relative to the assets under this lease was approximately \$81.4 million. In accordance with accounting principles, no asset or obligation was recorded on the Company's consolidated balance sheets.

The terms of this lease financing arrangement required, among other things, that the Company maintain certain minimum financial ratios and provide certain information to the lessor. TSYS was also subject to interest rate risk associated with the lease on its campus facilities because of the short-term variable rate nature of the SPE's debt.

In 2002, the Company renewed its operating lease agreement with the SPE for the Company's corporate campus. If the synthetic lease was not restructured, FASB Interpretation No. 46 would require TSYS to consolidate the SPE effective with the reporting period beginning July 1, 2003. On April 30, 2003, the Company provided written notice that it intended to terminate the lease agreement for the Company's corporate campus. On June 30, 2003, the Company terminated the lease agreement and purchased the corporate campus for \$93.5 million with a combination of cash and long-term debt financing through a banking affiliate of Synovus.

Results of Operations

The following table sets forth certain revenue and expense items as a percentage of total revenues and the percentage increases or decreases in those items for the three months ended June 30, 2003 and 2002:

Results of Operations (continued)

| | Percentage of Total Revenues | | Percentage Change in Dollar Amounts |
|--|---------------------------------|-------------|--|
| | <u>2003</u> | <u>2002</u> | <u>2003 vs. 2002</u> |
| Revenues: | | | |
| Electronic payment processing services | 68.8 % | 63.5 % | 15.4 % |
| Other services | 10.0 | 11.6 | (8.0) |
| Revenues before reimbursable items | 78.8 | 75.1 | 11.8 |
| Reimbursable items | 21.2 | 24.9 | (9.0) |
| Total revenues | 100.0 | 100.0 | 6.7 |
| Expenses: | | | |
| Salaries and other personnel expense | 32.4 | 30.5 | 13.6 |
| Net occupancy and equipment expense | 19.6 | 17.3 | 20.8 |
| Other operating expenses | 9.4 | 11.5 | (13.1) |
| Expenses before reimbursable items | 61.4 | 59.3 | 10.5 |
| Reimbursable items | 21.2 | 24.9 | (9.0) |
| Total expenses | 82.6 | 84.2 | 4.7 |
| Operating income | 17.4 | 15.8 | 16.9 |
| Nonoperating income | 1.1 | 0.5 | nm |
| Income before income taxes, minority interest and equity in income of joint ventures | 18.5 | 16.3 | 21.1 |
| Income taxes | 7.0 | 5.8 | 27.9 |
| Minority interest in consolidated subsidiary's net income | (0.1) | (0.0) | nm |
| Equity in income of joint ventures | 1.9 | 2.0 | (2.1) |
| Net income | 13.3 % | 12.5 % | 13.8 % |

nm = not meaningful

The following table sets forth certain revenue and expense items as a percentage of total revenues and the percentage increases or decreases in those items for the six months ended June 30, 2003 and 2002:

| | Percentage of Total Revenues | | Percentage Change in Dollar Amounts |
|--|---------------------------------|-------------|--|
| | <u>2003</u> | <u>2002</u> | <u>2003 vs. 2002</u> |
| Revenues: | | | |
| Electronic payment processing services | 67.8 % | 63.2 % | 16.3 % |
| Other services | 10.0 | 11.9 | (8.7) |
| Revenues before reimbursable items | 77.8 | 75.0 | 12.4 |
| Reimbursable items | 22.2 | 25.0 | (3.4) |
| Total revenues | 100.0 | 100.0 | 8.4 |
| Expenses: | | | |
| Salaries and other personnel expense | 31.4 | 30.3 | 12.2 |
| Net occupancy and equipment expense | 20.0 | 18.3 | 18.7 |

Results of Operations (continued)

| | Percentage of Total Revenues | | Percentage Change in Dollar Amounts |
|--|---------------------------------|---------------|--|
| | 2003 | 2002 | 2003 vs. 2002 |
| Other operating expenses | <u>9.1</u> | <u>10.6</u> | (7.1) |
| Expenses before reimbursable items | <u>60.5</u> | <u>59.2</u> | 10.7 |
| Reimbursable items | <u>22.2</u> | <u>25.0</u> | (3.4) |
| Total expenses | <u>82.7</u> | <u>84.2</u> | 6.5 |
| Operating income | <u>17.3</u> | <u>15.8</u> | 18.4 |
| Nonoperating income | <u>0.6</u> | <u>0.3</u> | nm |
| Income before income taxes, minority interest and equity in income of joint ventures | <u>17.9</u> | <u>16.1</u> | 20.3 |
| Income taxes | <u>6.6</u> | <u>5.8</u> | 22.7 |
| Minority interest in consolidated subsidiary's net income | <u>(0.1)</u> | <u>0.0</u> | nm |
| Equity in income of joint ventures | <u>1.8</u> | <u>2.0</u> | (4.2) |
| Net income | <u>13.0</u> % | <u>12.3</u> % | 14.8 % |

nm = not meaningful

Revenues

TSYS' revenues are derived from providing electronic payment processing and related services to financial and nonfinancial institutions, generally under long-term processing contracts. TSYS' services are provided through the Company's cardholder systems, TS2 and TS1, to financial institutions and other organizations throughout the United States, Mexico, Canada, Honduras, the Caribbean and Europe. The Company currently offers merchant services to financial institutions and other organizations in Japan through its majority owned subsidiary, GP Net, and in the United States through its joint venture, Vital. Total revenues increased \$16.1 million and \$39.5 million, or 6.7% and 8.4%, during the three and six months ended June 30, 2003, compared to the same periods in 2002. Excluding reimbursable items, revenues increased \$21.5 million and \$43.6 million, or 11.8% and 12.4%, during the three and six months ended June 30, 2003, respectively, compared to the same periods in 2002.

Electronic Payment Processing Services

Electronic payment processing revenues are generated primarily from charges based on the number of accounts on file, transactions and authorizations processed, statements mailed, credit bureau reports, cards embossed and mailed, and other processing services for cardholder accounts on file. Cardholder accounts on file include active and inactive consumer credit, retail, debit, stored value, student loan and commercial card accounts. Due to the number of cardholder accounts processed by TSYS and the expanding use of cards as well as increases in the scope of services offered to clients, revenues relating to electronic payment processing services have continued to grow. Revenues from electronic payment processing services increased \$23.7 million and \$48.4 million, or 15.4% and 16.3%, for the three and six months ended June 30, 2003, respectively, compared to the same periods in 2002.

Results of Operations (continued)

Due to the seasonal nature of credit card transactions, TSYS' revenues and results of operations have generally increased in the fourth quarter of each year because of increased transaction and authorization volumes during the traditional holiday shopping season. Furthermore, growth or a decline in card portfolios of existing clients, the conversion of cardholder accounts of new clients to the Company's processing platforms, and the loss of cardholder accounts impact the results of operations from period to period. Another factor, among others, which may affect TSYS' revenues and results of operations from time to time is the sale by a client of its business, its card portfolio or a segment of its accounts to a party which processes cardholder accounts internally or uses another third-party processor.

Processing contracts with large clients, representing a significant portion of the Company's total revenues, generally provide for discounts on certain services based on the size and activity of clients' portfolios. Therefore, electronic payment processing revenues and the related margins are influenced by the client mix relative to the size of client card portfolios, as well as the number and activity of individual cardholder accounts processed for each client. Consolidation among financial institutions has resulted in an increasingly concentrated client base, which results in a changing client mix toward larger clients. Consolidation in either the financial services or retail industries, a change in the economic environment in the retail sector, or a change in the mix of payments between cash and cards could favorably or unfavorably impact TSYS' financial condition, results of operations and cash flows in the future.

The Company provides services to its clients including processing consumer, retail, commercial, debit and stored-value cards, as well as student loan account processing. Consumer cards include Visa, MasterCard and American Express credit cards. Debit/Stored value accounts include debit cards and stored value cards. Government services/EBT accounts on file consist mainly of student loan processing accounts. Retail cards include private label and gift cards. Commercial cards include purchasing cards, corporate cards and fleet cards for employees. The following table summarizes TSYS' accounts on file (AOF) by portfolio type as of:

| AOF by Type (in millions) | June 30, 2003 | | June 30, 2002 | | % Change |
|------------------------------|---------------|-------|---------------|-------|----------|
| | AOF | % | AOF | % | |
| Consumer | 145.0 | 55.2 | 121.8 | 53.8 | 19.0 |
| Retail | 82.6 | 31.5 | 80.6 | 35.6 | 2.5 |
| Commercial | 20.3 | 7.7 | 18.8 | 8.3 | 8.0 |
| Debit/Stored Value | 7.9 | 3.0 | 5.0 | 2.2 | 58.0 |
| Government services/EBT | 6.7 | 2.6 | 0.5 | 0.1 | nm |
| Total | 262.5 | 100.0 | 226.7 | 100.0 | 15.8 |

nm = not meaningful

Average cardholder accounts on file for the three months ended June 30, 2003 were 260.7 million, an increase of approximately 13.8% over the average of 229.1 million for the same period in 2002. Average cardholder accounts on file for the six months ended June 30, 2003 were 256.4 million, an increase of approximately 10.5% over the average of 232.1 million for the same period in 2002. Cardholder accounts on file at June 30, 2003 were 262.5 million, a 15.8% increase compared to the 226.7 million accounts on file at June 30, 2002. The change in cardholder accounts on file from June 2002 to June 2003 included the deconversion and purging of 9.5 million accounts, the addition of

Results of Operations (continued)

approximately 23.8 million accounts attributable to the internal growth of existing clients, and approximately 21.5 million accounts for new clients.

TSYS expects to continue expanding its market share in the consumer, debit, retail and commercial card arenas. The Company's future growth is dependent upon new clients, international expansion and continued internal growth of clients' portfolios.

TSYS is a major third-party processor of retail cards. Traditional retail card operations are increasing the activity of their card portfolios by converting inactive accounts to Visa/MasterCard consumer cards. TSYS is able to provide its extensive electronic payment processing tools and techniques, as well as value-added functionality, to traditional retail card operations allowing better segmentation and potentially increased profitability for customers. TSYS does not receive as much revenue from retail cards, on a per account basis, as it does from consumer cards because consumer cards traditionally generate more transactions. Retail cards are generally limited to a particular location or retail chain. Consumer cards are widely accepted at numerous retail outlets.

In March 2003, Sears announced that it was evaluating strategic alternatives for the company's private label and MasterCard portfolio. In July, Sears and Citicorp announced an agreement for the proposed sale by Sears to Citicorp of the Sears credit card and financial services businesses by the end of 2003. Sears and Citicorp are both customers of TSYS, and TSYS considers its relationships with both companies to be very positive.

TSYS and Sears are parties to a 10-year agreement, which was renewed in January of 2000, under which TSYS provides transaction processing for more than 78 million Sears accounts. The TSYS/Sears processing agreement as it relates to the Sears retail and MasterCard portfolios expires on April 30, 2010. During the six month period ending June 30, 2003, TSYS' revenues from the TSYS/Sears agreement represented 6.50% of TSYS' consolidated revenues. The agreement includes provisions for termination for convenience prior to its expiration upon the payment of a termination fee. This termination fee is not fixed, but is reduced annually the closer the termination date is to the expiration date of the agreement. The TSYS/Sears agreement also grants to Sears the one-time right to market test TSYS' pricing and functionality after May 1, 2004. Potential results of such market test, in which TSYS will be a participant, include continuation of the processing agreement under its existing terms, continuation of the processing agreement under mutually agreed modified terms, or termination of the processing agreement after May 1, 2006 without a termination fee.

At this point in time, TSYS has not had any formal discussions with Citicorp about Citicorp's future plans for the Sears portfolios. TSYS believes that many aspects of the TSYS/Sears processing agreement are unique to its relationship with Sears, and TSYS intends to address those issues in future conversations and negotiations with Citicorp. The impact of the proposed transaction between Sears and Citicorp on the financial position, results of operations and cash flows of TSYS cannot be determined at this time.

TSYS has a dominant market share position in the domestic Visa and MasterCard commercial card processing arena. Future growth in this area is dependent upon increased card activity with more purchasing by businesses being transacted electronically and additional firms realizing the benefits of converting their paper-based purchasing systems to electronic transactions using commercial cards.

Results of Operations (continued)

In April 2002, the Company announced that it had entered into a five-year agreement with Accenture valued in excess of \$120 million to provide processing services for the U.S. Department of Education. TSYS began processing all student loan originations for the Department of Education on April 26, 2002, and was processing 6.6 million student loan accounts at June 30, 2003. The agreement also involves converting all existing student loan accounts to TSYS' new stand-alone platform during several phases. The conversion phases are scheduled to be completed in the third quarter of 2003, and TSYS estimates it will be processing a total of approximately 12 million student loan accounts after completion of these conversions.

TSYS processes debit and stored value cards. At June 30, 2003, TSYS was processing 7.9 million debit and stored value accounts, a 58.0% increase, or 2.9 million accounts, compared to 5.0 million at June 30, 2002. The majority of the increase relates to one client adding approximately 1.7 million stored value accounts.

TSYS provides processing services to its clients worldwide. TSYS plans to continue to expand its service offerings to other countries in the future. The following table summarizes TSYS' AOF by area based on the domicile of processing clients as of:

| AOF by Area (in millions) | June 30, 2003 | | June 30, 2002 | | % Change |
|------------------------------|---------------|-------|---------------|-------|----------|
| | AOF | % | AOF | % | |
| Domestic | 217.3 | 82.8 | 197.8 | 87.8 | 9.8 |
| Foreign | 45.2 | 17.2 | 28.9 | 12.2 | 56.5 |
| Total | 262.5 | 100.0 | 226.7 | 100.0 | 15.8 |

The Company's electronic payment processing service revenues are also impacted by the use of optional value added products and services of TSYS' processing systems. Value added products and services are optional features each client can choose to subscribe to in order to potentially increase the financial performance of its portfolio. Value added products and services include: risk management tools and techniques, such as credit evaluation, fraud detection and prevention, and behavior analysis tools; and revenue enhancement tools and customer retention programs, such as loyalty programs and bonus rewards. These revenues can increase or decrease over time as clients subscribe or unsubscribe for these services. For the three months ended June 30, 2003 and 2002, value added products and services represented 13.9% and 12.9%, or \$35.9 million and \$31.2 million, of total revenues, respectively. Revenues from value added products and services, which includes some reimbursable items paid to third-party vendors, increased 15.0%, or \$4.7 million, for the three months ended June 30, 2003, compared to the same period in 2002.

For the six months ended June 30, 2003 and 2002, value added products and services represented 14.0% and 12.2%, or \$71.3 million and \$57.2 million, of total revenues, respectively. Revenues from value added products and services, which includes some reimbursable items paid to third-party vendors, increased 24.7%, or \$14.2 million, for the six months ended June 30, 2003, compared to the same period in 2002.

On March 3, 2003, the Company announced that Bank One selected TSYS to upgrade its credit card processing. Under the long term software licensing and services agreement, TSYS will provide electronic payment processing services to Bank One's credit card accounts for at least two years starting

Results of Operations (continued)

in mid 2004 (excluding statement and card production services), and then TSYS will license a modified version of its TS2 consumer and commercial software to Bank One under a perpetual license with a six year payment term. The Company uses the percentage-of-completion accounting method for its agreement with Bank One and recognizes revenues in proportion to costs incurred. The impact upon 2003 earnings will be slightly positive. The 2004 earnings per share (EPS) contribution from the Bank One agreement is expected to range from \$0.03 to \$0.04. Beginning in 2005 and continuing thereafter through the payment term of the license, the EPS contribution of the Bank One agreement is expected to exceed \$0.04 on an annual basis.

Other Services

Revenues from other services consist primarily of revenues generated by TSYS' wholly owned subsidiaries. Revenues from other services decreased \$2.2 million, or 8.0%, in the second quarter of 2003, compared to the second quarter of 2002. Revenues from other services decreased \$4.8 million, or 8.7%, for the first six months of 2003, compared to the same period in 2002. The decline in other services revenues related to a decline in call center and business process management revenues related to decreased business from a client in the subprime credit business and the loss of business of a major airline client.

On April 28, 2003, TSYS completed the acquisition of Enhancement Services Corporation (ESC) for \$36.0 million in cash. ESC provides targeted loyalty consulting and travel, as well as gift card and merchandise reward programs to more than 40 national and regional financial institutions in the United States. The Company believes the acquisition of ESC enhances TSYS processing services by adding distinct value differentiation for TSYS and its clients. For the second quarter of 2003, TSYS' revenues include \$3.0 million related to ESC's revenues and are included in other services.

Major Customers

A significant amount of the Company's revenues is derived from long-term contracts with large clients, including certain major customers. For the three months ended June 30, 2003, the Company had two major customers. The two major customers for the quarter ended June 30, 2003 accounted for approximately 30.2%, or \$77.7 million, of total revenues. For the three months ended June 30, 2002, TSYS had two major customers that accounted for 35.0%, or \$82.0 million, of total revenues. The loss of one of the Company's major customers, or other significant clients, could have a material adverse effect on the Company's financial position, results of operations and cash flows.

For the six months ended June 30, 2003, the Company had two major customers. The two major customers for the six months ended June 30, 2003 accounted for approximately 30.1%, or \$153.0 million, of total revenues. For the six months ended June 30, 2002, TSYS had two major customers that accounted for 33.9%, or \$159.5 million, of total revenues. The loss of one of the Company's major customers, or other significant clients, could have a material adverse effect on the Company's financial position, results of operations and cash flows.

Reimbursable Items

Reimbursable items decreased \$5.4 million and \$4.0 million, or 9.0% and 3.4%, for the three and six months ended June 30, 2003, respectively, as compared to the same periods last year. The majority of reimbursable items relates to the Company's domestic-based clients and is primarily costs associated with postage. The decrease in 2003 is related to services provided to a major client that mailed less statements in 2003 compared to 2002, and therefore required less postage.

Results of Operations (continued)

Operating Expenses

Total expenses increased 4.7% and 6.5% for the three and six months ended June 30, 2003, respectively, compared to the same periods in 2002. Excluding reimbursable items, total expenses increased 10.5% and 10.7% for the three and six months ended June 30, 2003, compared to the same periods in 2002. The increases in operating expenses are attributable to changes in each of the expense categories as described below.

Salaries and other personnel expenses increased \$10.0 million and \$17.4 million, or 13.6% and 12.2%, for the three and six months ended June 30, 2003, respectively, compared to the same periods in 2002. The change in employment expenses is associated with the growth in the number of employees, normal salary increases and related benefits, as well as lower levels of employment costs categorized as software development and contract acquisition costs. The average number of employees in the second quarter of 2003 increased to 5,421, which increased 2.1% compared to 5,311 in the same period in 2002. The average number of employees for the first six months of 2003 increased to 5,304, which approximates the 5,298 in the same period in 2002. During the second quarter, TSYS added approximately 220 employees associated with the ESC acquisition and the creation of a wholly-owned subsidiary named TSYS Technology Center, Inc. (TTC) in Boise, Idaho. Initially employing 77 team members, the TTC team members will support technology efforts throughout TSYS, including government services, customer care, programming, and systems development. At July 31, 2003, TSYS had 5,516 full-time and 216 part-time employees.

Net occupancy and equipment expense increased \$8.7 million and \$16.1 million, or 20.8% and 18.7%, for the three and six months ended June 30, 2003, respectively, over the same periods in 2002. Due to rapidly changing technology in computer equipment, TSYS' equipment needs are achieved to a large extent through operating leases. Computer equipment and software rentals, which represent the largest component of net occupancy and equipment expense, increased approximately \$4.6 million and \$6.2 million for the first three and six months ended June 30, 2003, respectively, compared to the same periods of 2002. Depreciation and amortization increased \$4.0 million and \$8.8 million during the three and six months ended June 30, 2003, respectively, compared to the same periods in 2002. The increase in depreciation and amortization is the result of the amortization of additional software acquired in 2002, as well as, the amortization of developed software placed in service after June 30, 2002.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. For enterprises such as the Company with a variable interest in a variable interest entity created before February 1, 2003, the Interpretation is applied to the enterprise no later than the end of the first annual reporting period beginning after June 15, 2003. The Interpretation requires certain disclosures in financial statements issued after January 31, 2003.

In 2002, the Company renewed its operating lease agreement with a special purpose entity (SPE) for the Company's corporate campus. If the synthetic lease was not restructured, Interpretation No. 46 would require TSYS to consolidate the SPE effective with the reporting period beginning July 1, 2003.

Results of Operations (continued)

On April 30, 2003, the Company provided written notice that it intended to terminate the lease agreement for the Company's corporate campus. On June 30, 2003, the Company terminated the lease arrangement and purchased the corporate campus with a combination of cash and long-term debt financing through a banking affiliate of Synovus. As a result of the purchase, net occupancy and equipment expense is not expected to increase because the increase of approximately \$2.6 million annually for depreciation of the building and related equipment will be offset by the decrease in annual rent expense related to the lease. The interest expense associated with the line of credit is discussed below in nonoperating income.

Other operating expenses for the first three and six months of 2003 decreased \$3.7 million and \$3.5 million, or 13.1% and 7.1%, respectively, as compared to the same periods in 2002. Other operating expenses include, among other things, charges for processing errors, contractual commitments and bad debt expense. As described in the Critical Accounting Policies section, management's evaluation of the adequacy of its transaction processing reserves and allowance for doubtful accounts is based on a formal analysis which assesses the probability of losses related to contractual contingencies, processing errors and uncollectible accounts. Increases and decreases in transaction processing provisions and charges for bad debt expense are reflected in other operating expenses. Charges for transaction processing and contractual commitments for the three months ended June 30, 2003 and 2002 were \$194,000 and \$6.3 million, respectively. Charges for transaction processing and contractual commitments for the six months ended June 30, 2003 and 2002 were \$2.2 million and \$6.9 million, respectively.

Operating Income

Operating income increased 16.9% and 18.4% for the three and six months ended June 30, 2003, respectively, over the same periods in 2002. The increase in operating income was the result of the Company's commitment to contain the growth in operating expenses below the growth rate in revenues. The Company's operating profit margin for the second quarter of 2003 was 17.4%, compared to 15.8% for the same period last year. Excluding reimbursable items, the Company's operating profit margin for the three months ended June 30, 2003 was 22.0%, compared to 21.1% for the three months ended June 30, 2002. The Company's focus on expense control was the main reason for the improved margin.

The Company's operating profit margin for the first six months of 2003 was 17.3%, compared to 15.8% for the same period last year. Excluding reimbursable items, the Company's operating profit margin for the six months ended June 30, 2003 was 22.2%, compared to 21.1% for the six months ended June 30, 2002. The Company's focus on expense control was the main reason for the improved margin.

Nonoperating Income

Interest income, net, includes interest income of \$1.2 million and \$17,000 of interest expense for the three months of 2003. During the three months ended June 30, 2002, interest income, net, included interest income of \$996,000 and \$7,000 of interest expense.

Interest income, net, includes interest income of \$1.9 million and \$30,000 of interest expense for the six months ended June 30, 2003. During the six months ended June 30, 2002, interest income, net, included interest income of \$1.4 million and \$20,000 of interest expense.

Results of Operations (continued)

On June 30, 2003, the Company terminated the operating lease agreement and purchased the corporate campus for \$93.5 million with a combination of \$73.3 million in cash and long-term line of credit through a banking affiliate of Synovus. The line is an automatic draw down facility. The interest rate for the line of credit is the London Interbank Offered Rate (LIBOR) plus 150 basis points. In addition, there is a charge of 15 basis points on any funds unused. The line of credit is unsecured debt and includes the covenants requiring the Company to maintain certain minimum financial ratios. At June 30, 2003, TSYS had \$20.2 million outstanding on the line of credit. Interest income, net will be negatively impacted as a result of purchasing the campus.

In July 2002, the Company restructured \$12.6 million of its permanent financing of its UK operation as an intercompany loan. The financing requires the unit to repay the financing in US dollars. The functional currency of the European operations is the British Pound Sterling (BPS). As the Company translates the European financial statements into US dollars, the translated balance of the financing (liability) is adjusted upwards or downwards to match the US-dollar obligation (receivable) on the Company's financial statement. The upwards or downwards adjustment is recorded as a gain or loss on foreign currency translation. As a result of the restructuring, the Company recorded a foreign currency translation gain on the Company's financing with its European operations during the second quarter of 2003 of \$258,000, compared to \$212,000 for the same period last year. For the six months ended June 30, 2003, the Company recorded a gain of \$85,000, compared to \$1,300 for the same period last year. The balance of the financing at June 30, 2003 was approximately \$1.3 million.

The Company also records foreign currency translation adjustments associated with other balance sheet accounts. The Company maintains several cash accounts denominated in foreign currencies, specifically in Euros and BPS. As the Company translates the foreign-denominated cash balances into US dollars, the translated cash balance is adjusted upwards or downwards depending upon the foreign currency exchange movements. The upwards or downwards adjustment is recorded as a gain or loss on foreign currency translation. As those cash accounts have increased, the upwards or downwards adjustments have increased. The majority of the translation gain of \$1.2 million for the first six months of June 30, 2003 relates to the translation of cash accounts. The balance of the foreign-denominated cash accounts subject to risk of translation gains or losses at June 30, 2003 was approximately \$29.4 million, the majority of which is denominated in BPS.

Income Taxes

TSYS' effective income tax rate for the three months ended June 30, 2003 was 34.6%, compared to 32.0% for the same period in 2002. The increase in the effective income tax rate for the three months ended June 30, 2003, as compared to the same period in 2002, is the result of the recognition of certain tax credits in 2002. TSYS' effective income tax rate for the six months ended June 30, 2003 was 33.7%, compared to 32.3% for the same period in 2002. The calculation of the effective tax rate includes minority interest in consolidated subsidiary's net income and equity earnings of joint ventures in pretax income. The Company expects its effective income tax rate for 2003 to be approximately 33-34%.

Equity in Income of Joint Ventures

TSYS' share of income from its equity in joint ventures was \$4.8 million and \$4.9 million for the three months ended June 30, 2003 and 2002, respectively. For the first six months of 2003 and 2002, TSYS' share of income from its equity in joint ventures was \$9.0 million and \$9.4 million, respectively.

Results of Operations (continued)

The decrease for the quarter is attributable mainly to the decrease in Vital's operating results as a result of pricing compression as discussed below.

Vital Processing Services L.L.C. (Vital)

Vital, a limited liability company, is a merchant processing joint venture of TSYS and Visa U.S.A. ("VISA"). The Company is a leader in providing integrated end-to-end electronic transaction processing services primarily to large financial institutions and other merchant acquirers. Vital processes all payment forms including credit, debit, electronic benefit transfer and check truncation for merchants of all sizes across a wide array of retail market segments. The Company's unbundled products and services include: authorization 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 terminal sales and service. Vital's products and services are marketed to merchant acquirers through a direct sales force, which concentrates on developing long-term relationships with existing and prospective clients.

The Company considers Vital to be an integral part of its overall processing operations and an important part of its overall market strategy. Prior to forming the joint venture, TSYS performed back-end merchant processing services for its clients. The revenues and expenses associated with merchant processing were included in operating profits. In the ordinary course of business, TSYS, which still owns the merchant processing software, provides back-end processing services to Vital. For the three months ended June 30, 2003 and 2002, TSYS generated \$5.3 million and \$5.9 million of revenue from Vital, respectively. For the six months ended June 30, 2003 and 2002, TSYS generated \$11.0 million and \$11.0 million of revenue from Vital, respectively.

During the three months ended June 30, 2003, the Company's equity in income of joint ventures related to Vital was \$4.6 million, a 3.0% decrease, or \$140,000, compared to \$4.7 million for the same period last year. During the six months ended June 30, 2003, the Company's equity in income of joint ventures related to Vital was \$8.5 million, a 4.8% decrease, or \$390,000, compared to \$8.9 million for the same period last year.

In 2000, the Board of Directors of Vital approved a plan to allow its owners to set aside 2 million units held by the owners to make awards to key management of Visa and TSYS. In June 2000, TSYS awarded six of its key executives an aggregate of 800,000 Vital restricted stock units for their role in the development, growth and success of Vital. The units were to vest over a 36-month cliff-vesting schedule. The award of 800,000 units was made in anticipation of Vital becoming a publicly traded company.

Because Vital is not expected to become a publicly traded company in the foreseeable future, TSYS management, with approval from the Compensation Committee, repurchased the Vital restricted units from the Company's six key executives in June 2003. The purchase price for the restricted shares of \$3.85 per unit was based upon an independent, third party valuation of Vital conducted as of May 31, 2003. The Company recognized compensation expense throughout the entire vesting period. Semiannually, the Company received an independent third party evaluation of Vital throughout the vesting period and adjusted compensation expense accordingly. Through December 2002, the Company recognized \$3.0 million as compensation expense. After adjusting for the revised evaluations in 2003,

Results of Operations (continued)

TSYS recognized \$80,000 as compensation expense in 2003. With the repurchase of the units, TSYS will maintain its 50% ownership in Vital.

The following is a summary of Vital's consolidated statements of income for the three and six months ended June 30, 2003 and 2002:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------|-----------------------------|--------|---------------------------|---------|
| | 2003 | 2002 | 2003 | 2002 |
| Revenues | \$ 63,021 | 63,528 | 125,640 | 123,204 |
| Operating income | 8,708 | 9,554 | 17,207 | 18,278 |
| Net income | 8,847 | 9,727 | 17,483 | 18,614 |

Vital provides products and services through its merchant services offerings. Vital's revenues are primarily generated from charges based on: the number of transactions processed; the number of merchant accounts on its systems; the number of reports provided (electronic and paper) to acquirers and merchants; and the sale and service of point of sale terminal equipment. Revenues generated by these activities depend upon a number of factors, such as demand for and price of Vital's services, the technological competitiveness of its product offerings, Vital's reputation for providing timely and reliable service, competition within the industry, and general economic conditions.

Processing contracts with large clients, representing a significant portion of Vital's total revenues, generally provide for discounts on certain services based on the volume of transactions processed by the client. Transaction volumes are influenced by both the number and type of merchants. The growth or loss of merchants impacts the results of operations from period to period. Vital's operating results may also be significantly impacted by a customer selling all or a portion of its merchant acquiring business. Consolidation among financial institutions has resulted in an increasingly concentrated client base, which results in revenues being concentrated in a smaller number of clients.

Vital's revenues decreased \$507,000, or 0.8%, and increased \$2.4 million, or 2.0%, for the three and six months ended June 30, 2003, respectively, compared to the same periods in 2002. The decrease in the second quarter of 2003, as compared to the same period in 2002, was primarily the result of price concessions related to the renewal of contracts partially offset by an increase in the number of transactions processed. The increase in 2003 over 2002 for the six month periods was primarily the result of increases in the number of transactions processed (net of price reductions to certain customers) and revenues associated with Vital's terminal deployment business.

Vital's major expense items include salaries and other personnel expense and equipment expense. Salaries and other personnel expense, a significant portion of Vital's operating expenses, consists of the cost of personnel who develop and maintain processing applications, operate computer networks and provide customer support; wages and related expenses paid to sales personnel; non-revenue producing customer support functions and administrative employees and management.

Other expenses consist primarily of the cost of network telecommunications capability; transaction processing systems including depreciation and amortization, maintenance and other system costs; third party service providers including TSYS and VISA; and terminal equipment cost of sales.

Results of Operations (continued)

Vital's cost of services increased \$860,000 and \$3.7 million, or 2.5% and 5.6% for the three months and six months ended June 30, 2003, compared to the same periods in 2002. The increase was primarily a result of increases in: the cost of fees charged by debit network providers; the cost of telecommunication and other third party service providers as a result of increased transaction volumes and terminal equipment cost of sales as a result of increased terminal sales.

Vital has agreements with both TSYS and VISA to provide key services related to its business. Vital is dependent on both TSYS and VISA to perform on their obligations under these agreements. Vital's results of operations could be significantly impacted by material changes in the terms and conditions of the agreements with TSYS and VISA, changes in performance standards and the financial condition of both TSYS and VISA.

Vital, as a limited liability company, is treated similar to a partnership for income tax purposes. As a result, no provision for current or deferred income taxes has been made in Vital's financial statements. Vital's taxable income or loss is reportable on the tax returns of its owners based on their proportionate interest in Vital.

TSYS de México

The Company has a joint venture with a number of Mexican banks and records its 49% ownership in the joint venture using the equity method of accounting. The operation, Total System Services de México, S.A. de C.V. (TSYS de México), prints statements and provides card-issuing support services to the joint venture clients.

During the three months ended June 30, 2003, the Company's equity in income of joint ventures related to TSYS de México was \$250,000, a 16.9% increase, or \$36,000, compared to \$214,000 for the same period last year. During the six months ended June 30, 2003, the Company's equity in income of joint ventures related to TSYS de México was \$496,000, a 7.7% increase, or \$35,000, compared to \$461,000 for the same period last year.

TSYS' electronic payment processing revenues from clients based in Mexico was \$9.1 million for the second quarter ended June 30, 2003, a 28.5% increase over the \$7.1 million for the second quarter ended June 30, 2002. TSYS' electronic payment processing revenues from clients based in Mexico was \$17.1 million for the first six months ended June 30, 2003, a 30.4% increase over the \$13.1 million for the same period in 2002. The increase in revenues is primarily attributable to increased account on file growth of approximately 25.1%.

The Company was notified by its largest client in Mexico that it intends to utilize its internal global platform and did not renew its processing agreement with TSYS when it expired in the first quarter of 2003. However, the client has indicated that the deconversion may be delayed until the third quarter of 2003. This client in Mexico represents approximately 56% of TSYS' revenues from Mexico. As a result, management expects that electronic payment processing revenues for 2003 from Mexico will decrease when compared to electronic payment processing revenues from Mexico for 2002.

TSYS pays TSYS de México a processing support fee for certain client relationship and network services that TSYS de México has assumed from TSYS. TSYS paid TSYS de México a processing support fee of \$184,000 and \$231,000 for the three months ended June 30, 2003 and 2002, respectively.

Results of Operations (continued)

TSYS paid TSYS de México a processing support fee of \$380,000 and \$454,000 for the six months ended June 30, 2003 and 2002, respectively.

Net Income

Net income for the three months ended June 30, 2003 increased 13.8% to \$34.3 million, or basic and diluted earnings per share of \$0.17, compared to \$30.2 million, or basic and diluted earnings per share of \$0.15, for the same period in 2002. The Company's net profit margin for the second quarter of 2003 was 13.3%, compared to 12.5% for the same period last year. Excluding reimbursable items, the Company's net profit margin for the second quarter of 2003 was 16.9%, compared to 16.6% for the three months ended June 30, 2002.

Net income for the six months ended June 30, 2003 increased 14.8% to \$66.0 million, or basic earnings per share of \$0.34, compared to \$57.5 million, or basic earnings per share of \$0.29, for the same period in 2002. For the first six months of 2003, diluted earnings per share was \$0.33 compared to \$0.29 diluted earnings per share for the same period last year. The Company's net profit margin for the six months ended June 30, 2003 was 13.0%, compared to 12.3% for the same period last year. Excluding reimbursable items, the Company's net profit margin for the six months ended June 30, 2003 was 16.7%, compared to 16.3% for the same period in 2002.

Projected Outlook for 2003

TSYS expects its 2003 net income to exceed its 2002 net income by 12-15%. The assumptions underlying 2003's net income forecast are an increase in revenues (excluding reimbursables) between 9-10%, an internal growth rate of accounts on file of existing clients of approximately 11% and a continued focus on expense management.

Liquidity and Capital Resources

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 and the occasional use of borrowed funds to supplement financing of capital expenditures.

Cash Flows From Operating Activities

TSYS' main source of funds is derived from operating activities, specifically net income. During the six months ended June 30, 2003, the Company generated \$110.7 million in cash from operating activities compared to \$76.1 million for the same period last year.

On March 3, 2003, the Company announced that Bank One selected TSYS to upgrade its credit card processing. As part of that agreement, the Company received a \$30 million payment from Bank One, which is included in Billings in Excess of Costs on Uncompleted Contracts on the balance sheet, and is recognizing this payment in accordance with percentage-of-completion accounting.

Cash Flows From Investing Activities

The major uses of cash generated from operations have been the addition of property and equipment, the internal development and purchase of computer software, investments in contract acquisition costs associated with obtaining and servicing new or existing clients, and business

Liquidity and Capital Resources (continued)

acquisitions. The Company used \$176.1 million in cash for investing activities for the six months ended June 30, 2003, compared to \$50.4 million for the same period in 2002.

Property and Equipment

Capital expenditures for property and equipment during the three month period ended June 30, 2003 were \$102.4 million, compared to \$5.0 million during the same period last year. For the first six months of 2003, capital expenditures for property and equipment were \$107.4 million, compared to \$7.8 million during the same period last year. The increase in capital expenditures in 2003 is due to the purchase of the corporate campus as discussed below.

In 2002, the Company renewed its operating lease agreement with a special purpose entity (SPE) for the Company's corporate campus. If the synthetic lease was not restructured, Interpretation No. 46 would require TSYS to consolidate the SPE effective with the reporting period beginning July 1, 2003. On April 30, 2003, the Company provided written notice that it intended to terminate the lease agreement for the Company's corporate campus. On June 30, 2003, the Company terminated the lease arrangement and purchased the corporate campus for \$93.5 million through a combination of cash and long-term debt financing through a banking affiliate of Synovus. As a result of the purchase, net occupancy and equipment expense is not expected to increase because the increase of approximately \$2.6 million annually for depreciation of the building and related equipment will be offset by the decrease in annual rent expense related to the lease.

On July 30, 2003, the Company announced the groundbreaking for a new TSYS data center in Knaresborough, England. The 47,000 square-foot facility will replace the current center in Harrogate, England. It will be built on three acres and includes 15,000 square feet of office space. The new data center is estimated to cost approximately \$30 million and should be completed by the end of the fourth quarter of 2004.

Computer Software

The Company added \$13.5 million to computer software during the three month period ended June 30, 2003, compared to \$19.8 million during the same period last year. For the first six months of 2003, the Company added \$29.0 million to computer software, compared to \$35.6 million during the same period last year. The additions for both periods include purchased computer software and developed computer software as further described below.

Purchased Computer Software

Expenditures for purchased computer software were \$8.5 million for the three months ended June 30, 2003, compared to \$14.0 million for the same period in 2002. For the first six months of 2003, the Company had expenditures for purchased computer software of \$20.0 million compared to \$19.7 million for the same period in 2002. These additions relate to site licenses for mainframe processing systems.

Software Development Costs

Additions to capitalized software development costs, including enhancements to and development of TS2 processing systems, were \$5.1 million for the three month period ending June 30, 2003, compared to \$5.8 million for the same period in 2002. For the first six months of 2003, additions to capitalized software development costs were \$9.0 million compared to \$15.9 million for the same

Liquidity and Capital Resources (continued)

period in 2002. The decline in the amount capitalized as software development costs in 2003, as compared to 2002, is the result of several projects being completed in 2002.

The following is a summary of the additions to software development costs by project for the three and six months ended June 30, 2003 and 2002:

| Software Development Projects (in millions) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|------|------------------------------|------|
| | 2003 | 2002 | 2003 | 2002 |
| TSYS ProphIT | \$ 3.5 | 2.2 | 6.8 | 6.0 |
| Integrated Payments | 0.3 | 0.4 | 0.4 | 2.8 |
| Double Byte | 0.1 | 1.7 | 0.5 | 3.9 |
| TSYS Total Commerce | - | 1.2 | - | 2.2 |
| Other Capitalized Software Development Costs | 1.2 | 0.3 | 1.3 | 1.0 |
| Total | \$ 5.1 | 5.8 | 9.0 | 15.9 |

The Company continues to develop TSYS ProphITSM, a Web-based process management system that provides direct access to account information and other system interfaces to help streamline an organization's business processes. TSYS ProphIT is currently being offered to TSYS' processing clients with expected general release of the core platform in the fourth quarter of 2003. Continued development of TSYS ProphIT provides increased and enhanced functionality to the core platform, to include additional customer service functions. The Company anticipates future integration of TSYS ProphIT into its other platforms beginning in 2004. The Company capitalized approximately \$3.5 million for the three months ended June 30, 2003 on TSYS ProphIT, bringing the total capitalized in 2003 to \$6.8 million. The Company has invested a total of \$22.1 million since the project began.

The Company is developing its Integrated Payments Platform supporting the online and offline debit and stored value markets, giving clients access to all national and regional networks, EBT programs, ATM driving and switching services for online debit processing. The Company capitalized approximately \$298,000 for the three months ended June 30, 2003 on these additional systems, bringing the total capitalized in 2003 to \$425,000. The Company has invested a total of \$7.4 million since the project began. The Company expects to complete the system in phases. Phase 1 is expected to be completed during the third quarter of 2003.

Due to the complexity of the differences between the English language and Asian languages, computer systems require two bytes to store an Asian character compared to one byte in the English language. With the opening of a branch office in Japan to facilitate its marketing of card processing services, TSYS began modifying its current TS2 system to be able to accommodate language and currency differences with Asia, commonly referred to as the "double byte project." During the three months ended June 30, 2003, the Company capitalized \$135,000, bringing the total capitalized in 2003 to \$532,000. The Company has invested a total of \$10.1 million since the project began. The Company

Liquidity and Capital Resources (continued)

has substantially completed the core double-byte architecture and is currently in the testing phase with the double-byte project.

The Company developed a new commercial card system, TSYS Total Commerce, which was built upon the architectural design of TS2. The new system provides enhanced reporting for multi-languages/currencies, and global commercial card processing for multinational corporations on a single platform. The Company has invested a total of \$36.9 million. The Company placed the new system in service in late 2002.

Acquisition

On April 28, 2003, TSYS announced the acquisition of ESC for \$36.0 million in cash. The Company is in the process of completing the purchase price allocation and has preliminarily allocated approximately \$26.0 million to goodwill, approximately \$8.2 million to intangibles and the remaining amount to the net assets acquired. ESC provides targeted loyalty consulting and travel, as well as gift card and merchandise reward programs to more than 40 national and regional financial institutions in the United States. The Company believes the acquisition of ESC enhances TSYS processing services by adding distinct value differentiation for TSYS and its clients.

Contract Acquisition Costs

TSYS makes cash payments for processing rights, third-party development costs and other direct salary related costs in connection with converting new customers to the Company's processing systems. The Company's investments in contract acquisition costs were \$4.6 million for the three months ended June 30, 2003, and \$18.5 million for the three months ended June 30, 2002. The Company did not pay any cash payments for processing rights during the three months ended June 30, 2003. Cash payments for processing rights were \$15.0 million for the three months ended June 30, 2002. During the second quarter of 2002, the Company paid \$14.0 million in cash for processing rights as part of its agreement with one client. Conversion cost additions were \$4.6 million and \$3.5 million for the three months ended June 30, 2003 and 2002, respectively.

The Company's investments in contract acquisition costs were \$13.4 million for the six months ended June 30, 2003, and \$27.7 million for the six months ended June 30, 2002. Cash payments for processing rights were \$3.0 million and \$21.5 million for the six months ended June 30, 2003 and 2002, respectively. Conversion cost additions were \$10.4 million and \$6.2 million for the six months ended June 30, 2003 and 2002, respectively.

Cash Flows From Financing Activities

The major uses of cash for financing activities has been the payment of dividends and the purchase of stock under the stock repurchase plan. The main source of cash from financing activities has been the occasional use of borrowed funds. Net cash provided from investing activities for the six months ended June 30, 2003 was \$4.4 million mainly as a result of proceeds from the issuance of long-term debt. The Company used \$5.7 million in cash for financing activities for the six months ended June 30, 2002 primarily for the payment of cash dividends.

Stock Repurchase Plan

On April 15, 2003, TSYS announced that its board had approved a stock repurchase plan to purchase up to 2 million shares, which represents slightly more than five percent of the shares of TSYS

Liquidity and Capital Resources (continued)

stock held by shareholders other than Synovus. The shares may be purchased from time to time over the next two years at prices considered attractive to management. Repurchased shares will be used for general corporate purposes. Through June 30, 2003, the Company has purchased 512,900 shares at an average cost of \$18.49 per share.

Line of Credit

In connection with the purchase of the campus, TSYS obtained a \$45.0 million long-term line of credit from a banking affiliate of Synovus. The line is an automatic draw down facility. The interest rate for the line of credit is the London Interbank Offered Rate (LIBOR) plus 150 basis points. In addition, there is a charge of 15 basis points on any funds unused. The line of credit is unsecured debt and includes the covenants requiring the Company to maintain certain minimum financial ratios. At June 30, 2003, TSYS had \$20.2 million outstanding on the line of credit.

Dividends

The Company has paid a dividend for 55 consecutive quarters. Dividends on common stock of \$3.5 million were paid during the three months ended June 30, 2003, bringing the total paid in 2003 to \$6.9 million. On April 17, 2003, the Company announced a 14.3% increase in its quarterly dividend from \$0.0175 to \$0.0200 per share. On April 18, 2002, the Company announced a 16.7% increase in its quarterly dividend from \$0.0150 to \$0.0175 per share.

Significant Noncash Transaction

Effective January 1, 2002, TSYS acquired TDM from Synovus in exchange for 2,175,000 newly issued shares of TSYS common stock with a market value of \$43.5 million. TDM now operates as a wholly owned subsidiary of TSYS. This transaction increased Synovus' ownership of TSYS to 81.1% in 2002.

On October 15, 2002 the board of directors of TSYS approved the purchase of ProCard, Inc. (ProCard) from Synovus for \$30.0 million in cash. On November 1, 2002, TSYS completed the acquisition. ProCard is a leading provider of software and Internet tools designed to assist organizations with the management of purchasing, travel and fleet card programs. ProCard's software solutions have been integrated into TSYS' processing solutions and offer TSYS the opportunity to further expand its services to ProCard's clients.

Because the acquisitions of TDM and ProCard were transactions between entities under common control, the Company is reflecting the acquisitions at historical cost in accordance with SFAS 141. In accordance with the provisions of SFAS 141, TSYS restated its financial statements for the periods that Synovus controlled both ProCard and TSYS for the ProCard acquisition only.

Foreign Exchange

TSYS operates internationally and is subject to potentially adverse movements in foreign currency exchange rates. Since December 2000, TSYS has not entered into foreign exchange forward contracts to reduce its exposure to foreign currency rate changes.

Liquidity and Capital Resources (continued)

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 1.6:1. At June 30, 2003, TSYS had working capital of \$91.2 million compared to \$152.0 million at December 31, 2002.

Recent Accounting Pronouncements

In June 2001, the FASB issued Statement No. 143 (SFAS 143), "Accounting for Asset Retirement Obligations." SFAS 143 requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets.

The Company also records a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company adopted SFAS 143 on January 1, 2003. The adoption of SFAS 143 did not have a material effect on the Company's financial position, results of operations or cash flows.

In April 2002, the FASB issued Statement No. 145 (SFAS 145), "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS 145 amends existing guidance on reporting gains and losses on the extinguishment of debt to prohibit the classification of the gain or loss as extraordinary, as the use of such extinguishments have become part of the risk management strategy of many companies. SFAS 145 also amends SFAS No. 13 to require sale-leaseback accounting for certain lease modifications that have economic effects similar to sale-leaseback transactions. The provisions of the Statement related to the rescission of Statement No. 4 are applied in fiscal years beginning after May 15, 2002. The provisions of the Statement related to Statement No. 13 were effective for transactions occurring after May 15, 2002. The adoption of SFAS 145 did not have a material effect on the Company's financial position, results of operations or cash flows.

In June 2002, the FASB issued Statement No. 146 (SFAS 146), "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." The provisions of this Statement are effective for exit or disposal activities that are initiated after December

Recent Accounting Pronouncements (continued)

31, 2002, with early application encouraged. The adoption of SFAS 146 did not have a material effect on the Company's financial position, results of operations or cash flows.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34." This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. Interpretation No. 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and did not have a material effect on the Company's financial statements. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has one lease guarantee.

To assist Vital Processing Services L.L.C. (Vital) in leasing its corporate facility, the Company and Visa U.S.A. (Visa) are guarantors, jointly and severally, for the lease payments on Vital's Tempe facility. The lease on the facility expires in July 2007. The total future minimum lease payments remaining at June 30, 2003 is \$5.9 million. If Vital fails to perform its obligations with regard to the lease, TSYS and Visa will be required to perform in the same manner and to same extent as is required by Vital.

At the November 21, 2002 Emerging Issues Task Force (EITF) meeting, the Task Force ratified as a consensus the tentative conclusions it reached at the October 25, 2002 EITF meeting regarding Emerging Issues Task Force 00-21 (EITF 00-21), "Accounting for Revenue Arrangements with Multiple Deliverables." EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Those activities may involve the delivery or performance of multiple products, services, and/or rights to use assets, and performance may occur at different points in time or over different periods of time. The arrangements are often accompanied by initial installation, initiation, or activation services and generally involve either a fixed fee or a fixed fee coupled with a continuing payment stream. The continuing payment stream generally corresponds to the continuing performance and may be fixed, variable based on future performance, or composed of a combination of fixed and variable payments. EITF 00-21 addresses how to account for those arrangements. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Entities may also elect to report the change in accounting as a cumulative effect adjustment, in which case disclosure should be made in periods subsequent to the date of initial application of the amount of recognized revenue that was previously included in the cumulative effect adjustment. Management has determined that based on its evaluation, the adoption of EITF 00-21 did not impact the Company's financial position, results of operations or cash flows.

In December 2002, the FASB issued Statement No. 148 (SFAS 148), "Accounting for Stock-Based Compensation – Transition and Disclosure, an amendment of FASB Statement No. 123." SFAS 148 amends FASB Statement No. 123 (SFAS 123), "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements. Certain of

Recent Accounting Pronouncements (continued)

the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included in the notes to the consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. For enterprises such as the Company with a variable interest in a variable interest entity created before February 1, 2003, the Interpretation is applied to the enterprise in the first fiscal year or interim period after June 15, 2003.

In 2002, the Company renewed its operating lease agreement with a special purpose entity (SPE) for the Company's corporate campus. On April 30, 2003, the Company provided written notice that it intended to terminate the lease agreement for the Company's corporate campus. On June 30, 2003, the Company terminated the operating lease agreement and purchased the corporate campus for \$93.5 million with a combination of cash and long-term debt financing through a banking affiliate of Synovus.

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, statements regarding the expected expansion of its position in the consumer card, debit card, retail card and commercial card arenas, TSYS' belief with respect to the uniqueness of the TSYS/Sears processing relationship; the projected impact of TSYS' agreement with Bank One for 2004 and 2005 and thereafter through the payment term of the license, the expected growth in net income for the year 2003, the expected completion dates for new processing systems and the assumptions underlying such statements, including, with respect to TSYS' expected increase in net income for 2003; an increase in revenues (excluding reimbursables) between 9-10%; an internal growth rate of accounts of existing clients of approximately 11%; and continued focus on expense management. 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," and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements. A number of important factors could cause actual results to differ materially from those contemplated by the forward-looking statements in this filing. Many of these factors are beyond TSYS' ability to control or predict. The factors include, but are not limited to: (i) delays in converting Bank One to TSYS' platforms; (ii) TSYS is unable to modify

Forward-Looking Statements (continued)

its software to meet Bank One's specifications; (iii) TSYS' software is unable to operate in Bank One's operating environment; (iv) revenues are lower than anticipated; (v) adverse developments with respect to TSYS' sub-prime or retail clients; (vi) lower than anticipated internal growth rates for TSYS' existing clients; (vii) TSYS' inability to control expenses and increase market share; (viii) TSYS' inability to successfully bring new products to market, including, but not limited to stored value products, e-commerce products, loan processing products and other processing services; (ix) the inability of TSYS to grow its business through acquisitions or successfully integrate acquisitions; (x) TSYS' inability to increase the revenues derived from international sources; (xi) adverse developments with respect to entering into contracts with new clients and retaining current clients; (xii) the merger of TSYS clients with entities that are not TSYS clients or the sale of portfolios by TSYS clients to entities that are not TSYS clients; (xiii) TSYS' inability to anticipate and respond to technological changes, particularly with respect to e-commerce; (xiv) adverse developments with respect to the successful conversion of clients; (xv) the absence of significant changes in foreign exchange spreads between the United States and the countries TSYS transacts business in, to include Mexico, United Kingdom, Japan, Canada and the European Union; (xvi) changes in consumer spending, borrowing and saving habits, including a shift from credit to debit cards; (xvii) changes in laws, regulations, credit card association rules or other industry standards affecting TSYS' business which require significant product redevelopment efforts; (xviii) the effect of changes in accounting policies and practices as may be adopted by the Financial Accounting Standards Board or the Securities and Exchange Commission; (xix) the costs and effects of litigation; (xx) adverse developments with respect to the credit card industry in general; (xxi) TSYS' inability to successfully manage any impact from slowing economic conditions or consumer spending; (xxii) the occurrence of catastrophic events that would impact TSYS' or its major customers' operating facilities, communications systems and technology, or that has a material negative impact on current economic conditions or levels of consumer spending; (xxiii) successfully managing the potential both for patent protection and patent liability in the context of rapidly developing legal framework for expansive software patent protection; (xxiv) hostilities increase in the Middle East or elsewhere; (xxv) Vital's earnings are lower than anticipated; and (xxvi) overall market conditions.

Such forward-looking statements speak only as of the date on which such statements are made, and TSYS undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events.

TOTAL SYSTEM SERVICES, INC.

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Exchange Risk

TSYS is exposed to foreign exchange risk because it has assets, liabilities, revenues and expenses denominated in foreign currencies including the Euro, British Pound, Mexican Peso, Canadian Dollar and Japanese Yen. 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 rates for each reporting period. Net exchange gains or losses resulting from the translation of assets and liabilities of TSYS' foreign operations, net of tax, are accumulated in a separate section of shareholders' equity titled accumulated other comprehensive income or loss. The amount of other comprehensive income for the three months ended June 30, 2003 was \$2.8 million, compared to \$4.0 million for the three months ended June 30, 2002. The amount of other comprehensive income for the six months ended June 30, 2003 was \$1.6 million, compared to \$3.0 million for the six months ended June 30, 2002. Currently, TSYS does not use financial instruments to hedge its exposure to exchange rate changes.

The carrying value of the net assets of its foreign operations in Europe, Mexico, Canada and Japan was approximately (in U.S. dollars) \$78.6 million, \$3.3 million, \$184,000 and \$10.3 million, respectively, at June 30, 2003.

The following represents the potential effect on income before income taxes of hypothetical shifts in the foreign currency exchange rate between the British Pound Sterling and the U.S. dollar of plus or minus 100 basis points, 500 basis points and 1,000 points based on the intercompany loan balance of \$1.3 million at June 30, 2003.

| | | 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 | \$ | (13,000) | (65,000) | (130,000) | 13,000 | 65,000 | 130,000 |
| | income taxes | | | | | | |

The Company also records foreign currency translation adjustments associated with other balance sheet accounts. The Company maintains several cash accounts denominated in foreign currencies, specifically in Euros and BPS. As the Company translates the foreign-denominated cash balances into US dollars, the translated cash balance is adjusted upwards or downwards depending upon the foreign currency exchange movements. The upwards or downwards adjustment is recorded as a gain or loss on foreign currency translation. As those cash accounts have increased, the upwards or downwards adjustment have increased. The majority of the translation gain of \$1.2 million for the first six months of June 30, 2003 relates to the translation of cash accounts. The balance of the foreign-denominated cash accounts subject to risk of translation gains or losses at June 30, 2003 was approximately \$29.4 million, the majority of which is denominated in BPS.

TOTAL SYSTEM SERVICES, INC.

Item 3 – Quantitative and Qualitative Disclosures About Market Risk (continued)

The following represents the potential effect on income before income taxes of hypothetical shifts in the foreign currency exchange rate between the British Pound Sterling and the U.S. dollar of plus or minus 100 basis points, 500 basis points and 1,000 points based on the foreign-denominated cash account balance at June 30, 2003.

| | | 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 | \$ | (294,000) | (1,468,000) | (2,935,000) | 294,000 | 1,468,000 | 2,935,000 |

The foreign currency risks associated with other currencies is not significant.

Interest Rate Risk

TSYS is also exposed to interest rate risk associated with the investing of available cash and the long-term debt for the financing on its campus facilities. TSYS invests available cash in conservative short-term instruments and is primarily subject to changes in the short-term interest rates.

In connection with the purchase of the campus, TSYS obtained a \$45.0 million long-term line of credit from a banking affiliate of Synovus. The line is an automatic draw down facility. The interest rate for the line of credit is the London Interbank Offered Rate (LIBOR) plus 150 basis points. In addition, there is a charge of 15 basis points on any funds unused. At June 30, 2003, TSYS had a draw of \$20.2 million on the line of credit. As the LIBOR rate changes, TSYS will be subject to interest rate risk.

The following represents the potential impact for twelve months on income before income taxes of hypothetical shifts in the LIBOR rate of plus or minus 100 basis points, 500 basis points and 1,000 points based on the \$20.2 million long-term debt balance at June 30, 2003.

| | | 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 | \$ | (202,000) | (1,012,000) | (2,023,000) | 202,000 | 1,012,000 | 2,023,000 |

Concentration of Credit Risk

TSYS works to maintain a large and diverse client base across various industries to minimize the credit risk of any one client to TSYS' accounts receivable amounts. In addition, TSYS performs ongoing credit evaluations of its certain clients' and certain suppliers' financial condition. TSYS does, however, have two major customers that account for a large portion of its revenues, which subject it to credit risk.

TOTAL SYSTEM SERVICES, INC.

Item 4 – Management’s Analysis of Disclosure Controls and Procedures

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this quarterly report as requested by Rule 13a-15 of the Securities and Exchange Act of 1934, as amended. This evaluation was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer. Based on this evaluation, these officers have concluded that the design and operation of our disclosure controls and procedures are effective. There have been no changes in TSYS’ internal control over financial reporting which could materially affect, or are reasonably likely to materially affect, external control over financial reporting.

TOTAL SYSTEM SERVICES, INC.
Part II - Other Information

Item 4 - Submission of Matters to a Vote of Security Holders

The annual shareholders' meeting of Total System Services, Inc. was held April 17, 2003. There was one proposal voted on at the meeting.

Proposal I voted on at the meeting was the election of five directors. Following is a tabulation of votes for each nominee:

| <u>NOMINEE</u> | <u>VOTES FOR</u> | <u>WITHHELD AUTHORITY TO VOTE</u> |
|-----------------------|----------------------|---|
| James H. Blanchard | 186,463,994 | 764,380 |
| Richard Y. Bradley | 187,088,349 | 140,025 |
| Walter W. Driver, Jr. | 183,153,231 | 4,075,143 |
| Gardiner W. Garrard | 186,971,654 | 256,720 |
| John P. Illges, III | 187,016,406 | 211,968 |
| W. Walter Miller, Jr. | 187,087,194 | 141,180 |

TOTAL SYSTEM SERVICES, INC.
Part II - Other Information

Item 6 - Exhibits and Reports on Form 8-K

a) Exhibits

| <u>Exhibit Number</u> | <u>Description</u> |
|-----------------------|--|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

b) Forms 8-K since the previous Form 10-Q filing.

1. The report dated July 15, 2003 included the following event:

On July 15, 2003, Total System Services, Inc. ("Registrant") issued a press release and held an investor call and webcast to disclose financial results for the second quarter ended June 30, 2003.

2. The report dated July 25, 2003 included the following event:

On July 25, 2003, Total System Services, Inc. ("Registrant") provided additional details about its current agreement with Sears after Sears and Citicorp announced an agreement for the proposed sale by Sears to Citicorp of the Sears credit card and financial services businesses.

**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: August 12, 2003

by: /s/ Richard W. Ussery

Richard W. Ussery
Chairman of the Board
and Chief Executive Officer

Date: August 12, 2003

by: /s/ James B. Lipham

James B. Lipham
Chief Financial Officer

TOTAL SYSTEM SERVICES, INC.
Exhibit Index

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