

## Financial Highlights 1995 Annual Report

In \$ Thousands, Except Per Share Amounts	1994	1995
Year Ended September 30		
Revenues	\$74,063	<b>\$114,888</b>
Operating Income (Loss)	(29,085)	<b>9,423</b>
Net Income (Loss)	(33,538)	<b>3,800</b>
Income (Loss) Per Share	(3.32)	<b>.33</b>
Earnings Before Interest, Taxes, Depreciation and Amortization	14,223	<b>22,325</b>

As of September 30

Working Capital	\$1,975	<b>\$38,666</b>
Total Assets	58,677	<b>100,142</b>
Long-term Obligations	22,788	<b>318</b>
Stockholders' Equity (Deficit)	(32,392)	<b>59,697</b>
Backlog	67,180	<b>82,112</b>

### Supplemental Information (1)

In \$ Thousands, Except Per Share Amounts	1993	1994	1995	% Change 1994 to 1995
Year Ended September 30				
Pro Forma Revenues	\$71,158	\$92,893	<b>\$114,888</b>	23.7
Pro Forma Operating Income	5,367	10,145	<b>15,888</b>	56.6
Pro Forma Net Income	3,374	6,635	<b>10,441</b>	57.4
Pro Forma Net Income Per Share	.28	.55	<b>.84</b>	52.7

1. *Transaction Systems acquired ACI and ACIL on December 31, 1993. The above supplemental information reflects the combination of TSA, ACI and ACIL results of operations data for the three years presented. In addition, the above results of operations data exclude one-time or acquisition-related expenses including amortization of purchased software, purchased contracts in progress, purchased research and development, goodwill amortization, interest expense and extraordinary loss. The total of these expenses were \$8.3 million, \$43.1 million and \$10.8 million in 1993, 1994 and 1995 respectively. In addition to the exclusion of these one-time or acquisition-related expenses, the above pro forma results of operations were computed using an effective income tax rate of 38%.*

To Our Shareholders: Right Time, Right Place

## **Our Venture Into Electronic Commerce Began 20 Years Ago**

The roots of Transaction Systems Architects extend back to a shared automated teller machine network established in Lincoln, Nebraska in 1970's. That network ran on software developed by our subsidiary, Applied Communications, Inc.

Today, our company has products running on more than 1,000 computer systems in 58 countries on six continents. Our headquarters are still located on the prairie but our operations include offices in the United Kingdom, Singapore, Tokyo, Australia, Bahrain, Brazil, Germany, Norway and South Africa.

The solutions we offer have expanded well beyond that first automated teller machine network in Nebraska. Transaction Systems' products now facilitate a host of transactions central to electronic commerce including those from new emerging technologies involving home banking and reloadable stored-value smart cards.

In fiscal 1995 we established new records in several key financial areas. Revenues on a pro forma basis were \$114.9 million, an increase of 23.7 percent over the previous fiscal year. Operating income on a pro forma basis was \$15.9 million, an increase of 56.6 percent over the prior year. Our operating margin on a pro forma basis grew from 10.9 percent in fiscal 1994 to 13.8 percent in fiscal 1995. Pro forma net income was \$10.4 million, \$.84 per share (fully diluted), an increase of 52.7 percent over fiscal 1994.

## **The Right Time and the Right Place for Growth**

Technology advances, customer demands for convenience and the presence of technically-sophisticated consumers in the marketplace have caused the number of electronic transactions to increase in nearly every economy in the world. Because our software pricing is volume sensitive, these trends are growth drivers for our business.

Also, as transaction volumes increase, the private and public networks that serve as highways for them become more complex. Consumers can now perform self-service banking functions at automated teller machines that include everything from account statements on demand to loan applications. Wireless point-of-sale terminals used by merchants to gain operational efficiencies and sharpen marketing programs greet customers at curbside and tableside. In addition, smart phones and personal computers now give individuals the ability to bank and shop anytime, anywhere.

Our years of experience serving leading institutions around the world have created a product set built to handle high transaction volumes twenty-four hours a day, seven days a week. Our software architecture is constructed for today's complex electronic payment environment. Our products are compatible with dozens of different devices and communication protocols. We have interfaces built for more than 100 regional, national and international networks.

The fact that many institutions around the world still run their payment networks on in-house systems driven with software developed in the late 1970's represents opportunities for us. Increasing transaction volumes, growing network complexities and regulatory pressures make the maintenance of these systems costly and time consuming. The need to remain competitive by bringing new products and services to market quickly adds to the stress faced by in-house development staffs. Transaction Systems' products deliver operational efficiency and competitive advantages to institutions facing these challenges.

### **Strategy for 1996: Complement Growth with Stability and Visibility**

Since 1991 we have built a base of recurring revenues using a monthly license fee pricing model. This model offers the customer a software license for a monthly fee that is paid for as long as that customer uses our software.

In fiscal 1995 we more than doubled the amount of monthly license fees in our recurring revenue base. This strategy provides us with a level of stability uncommon in software companies.

We finished fiscal 1995 with \$82.1 million in backlog. Backlog includes non-recurring and recurring revenues the company expects to recognize in the coming twelve months. Backlog provides us with a visibility that reaches across four quarters at any point in time.

We believe the stability of recurring revenues and visibility provided by our backlog are key to delivering value to our shareholders.

We appreciate your interest in and support of Transaction Systems Architects, Inc. We believe this is the right time and right place for a company like ours. We hope you feel the same.

Growth Trends: That Was Then, This is Now

### **Times Are Changing**

Today most of the world purchases goods and services using cash and checks. However, advances in technology, consumer demands for convenience and a shift in the generational curve have placed these conventional payment methods under attack.

Advances in technology, particularly improvements in price performance by computer hardware manufacturers, have made it cost effective for institutions and corporations to use technology to process payments. This rapid evolution of technology creates the potential for increased transaction volumes as debit, credit and smart cards are used with automated teller machines, point-of-sale terminals, personal computers and smart phones to automate commerce.

Increases in consumer demands for convenience have made it necessary for institutions and corporations to provide access to credit and debit accounts from anywhere in the world at any time of day. For example, many individuals traveling internationally are no longer willing to carry cash or checks. They prefer to use their bank cards and international networks to withdraw money from their accounts, as needed, in the currency of the countries they are visiting.

New access points, such as personal computers used in home banking, are further expanding the consumer's definition of convenience. Jupiter Communications LLC, a research and publishing firm headquartered in New York, projects that by the year 2000 more than 12.9 million people will use PC-based home banking services in the U.S., up from 700,000 in 1995. According to a 1995 study by the Bank Administration Institute, 40 percent of the households in the U.S. are likely to use some form of home banking by 1999.

A shift in generations is accelerating the acceptance of technology as a part of daily life. Young adults entering the workforce today are familiar with and comfortable using a variety of tools to conduct electronic commerce. These end users are not likely to be intimidated by the idea of purchasing goods and services on public networks.

### **How the Company Benefits**

Why do these trends matter to the stockholders of Transaction Systems Architects, Inc.?

Transaction Systems' software is designed to move transactions from access points -- automated teller machines, point-of-sale terminals, personal computers, smart phones and other devices -- through very complex, high-volume payment networks for online authorization against

a consumer's deposits or credit limit.

The company's software is licensed primarily using a volume-sensitive pricing model. Growth in the number of transactions processed on electronic payment networks increases the company's revenue through the sale of additional software licenses, maintenance and services.

Today the growth in electronic payments is occurring primarily on private networks owned by institutions and corporations. In the future more and more of these transactions will flow across public networks like the Internet, America Online and others. Ultimately, these transactions, like those that travel on private networks, must find their way to the consumer's accounts. Transaction Systems' software is used to provide access to these accounts.

### **Other Factors to Consider**

As the trends described above cause transaction volumes to grow, other factors are likely to increase the complexity of electronic payment networks. Transaction Systems' products help institutions address these complexities.

For example, bank consolidation has created large, geographically dispersed payment networks. The proliferation of devices (e.g., automated teller machines, point-of-sale terminals, personal computers, screen phones) and consumer insistence on 24-hours-a-day, seven-days-a-week availability make system enhancement, configuration and management more difficult. Government regulations, as well as requirements established by vendors such as MasterCard and Visa, have created additional challenges for banks and retailers.

In addition, the growth of public networks and PC-based software designed to automate functions such as bill payment and home shopping have caused control of the customer relationship to be a concern for institutions. New marketing programs designed to generate customer loyalty and fee-based income increase the demand for electronic payment networks that offer more features and functions.

Transaction Systems' products represent a world standard for online transaction processing supporting approximately 40 types of devices, 40 communications protocols and 100 interfaces to regional, national and international networks. The company offers solutions that run on multiple platforms including Tandem computers, IBM mainframes, Stratus systems, RISC/UNIX servers and Microsoft's Windows NT.

Transaction Systems' software is imprinted by the needs of the largest

institutions in the world. Meeting the needs of these customers requires the company to provide solutions that reduce the time-to-market for new services, offer advance features and functions, are robust enough to handle large transaction volumes and remain current with changes in regulations, interchanges, protocols and devices.

These benefits help banks and retailers maintain their competitive edge in a marketplace characterized by constant change.

## Company Overview

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### **A Market Leader**

Transactions Systems Architects, Inc. is the parent company of Applied Communications, Inc. and U.S. Software, Inc. Applied Communications develops electronic payments software for the Tandem computer platform. U.S. Software designs similar solutions for use on IBM mainframes, Stratus systems and RISC/UNIX servers.

Transaction Systems subsidiaries are not new to the electronic payments marketplace. Applied Communications has been in business for 20 years and U.S. Software products have been running on customers' systems for more than a decade. The company's market share is significant in countries where it has maintained an active presence for several years.

In the United States, Transaction Systems' solutions are used by 92 of the top 150 banks. In Canada, four of the five largest financial institutions run the company's software and in the United Kingdom, five of the six leading banks have Transaction Systems' products.

### **Positioned to Grow**

Significant opportunities exist for the company in several countries where it has had a limited presence, such as Japan, Germany, Brazil, South Africa, France, Italy and Spain. Some of these countries are home to the largest banking institutions in the world.

In many cases, the systems and networks used by these banks run on software developed and maintained today by teams of in-house developers. Transaction Systems believes these in-house systems are at risk from the growing transaction volumes and network complexities faced by these institutions who must supply customers with convenience and flexibility to remain competitive.

### **Expansion in Key Markets**

In April 1994, the company expanded its operations in Tokyo by hiring a team of Japanese software developers. In October 1995, Transaction Systems acquired M.R. GmbH, a German software company with a staff of approximately 30 technical and support people. Both of these operations extend the company's sales and service presence in these two significant banking markets.

In addition to these acquisitions, Transaction Systems entered into a joint venture in Brazil in 1994 and in South Africa in 1995 to help expand its ability to market products and services in these countries. The company has a 51 percent majority in each joint venture.

## **Sales and Support**

The company's products and services are sold and supported through three channels: the Americas, Europe/Middle East/Africa and Asia/Pacific. Approximately 90 percent of all revenues are derived from direct sales. In fiscal 1995 the percentage of the company's revenue by region was: Americas Domestic (United States only) 47 percent, Americas International 16 percent, Europe/Middle East/Africa 27 percent and Asia/Pacific 10 percent.

The Americas division, headquartered in Omaha, Nebraska, is responsible for sales and support throughout North and South America. More than 250 of Transaction Systems customers are in the Americas.

Mergers and acquisitions have continued the trend of consolidation among financial institutions in the United States. This trend generally proves favorable for the company since the merger of banks generally results in more complex networks and higher transaction volumes.

*American Banker* reported 75 mergers and acquisitions among U.S. banks in the first half of calendar 1995. Twenty-eight involved banks using products from Transaction Systems. In 26 of the 28 transactions, the company's software was in use at the acquiring bank. In the other two mergers, Transaction Systems solutions were running at both institutions.

The Europe, Middle East and Africa division is headquartered near London, England, with branch offices located in Norway, Germany, Bahrain and South Africa. More than 150 of Transaction Systems' customers are located in this area.

Potential growth for the company in this region not only exists in replacing the in-house systems run by the larger banks but also in the emerging economies of Eastern Europe.

Transaction Systems' acquisition of M.R. GmbH provides a platform for penetrating Germany, one of the largest banking markets in the region. The company has also sold its products several times in the last 12 months to countries within the Commonwealth of Independent States (CIS).

The Asia/Pacific division is headquartered in Singapore with branch offices located in Tokyo and Australia. More than 75 of the company's customers are located in the Asia/Pacific region.

Though the Asia/Pacific division accounts for the smallest percentage of Transaction Systems' revenues, it is the fastest growing region. Sales of systems into emerging markets such as China and India along with the company's increased presence in countries with mature payment infrastructures such as Japan and Australia have created this growth trend.

## **Competitors**

Transaction Systems markets its products and services to the top financial institutions in the world as well as to leading processors, retailers and petroleum companies. Its primary focus is on the largest banks in the world. According to data gathered by the company's Corporate Information Center, approximately 43 percent of the largest 1,000 banks in the world use payments software developed and maintained in-house. An estimated 23 percent of these 1,000 banks use third-party processors. Approximately one third use software designed and supported by companies like Transaction Systems.

Of the banks using vendor software, 153 (45 percent) use products from Transaction Systems. According to the company's estimates, products from its two primary competitors are used by less than 15 percent of these leading institutions using vendor software. No other competitor has more than one percent. Throughout fiscal 1994 and 1995, Transaction Systems won more than 60 percent of its competitive situations.

## **The Move from In-House Systems**

Over the past five years, more banks have decided to move from in-house systems to software developed and supported by companies like Transaction Systems. The decision to abandon in-house systems often is due to the difficulties created by increasing transaction volumes, growing network complexities and delays in the time it takes for internal staffs to develop new products or services. The movement away from in-house developed payment systems is expected to continue as the demands placed on electronic payment networks increase.

The company provides institutions facing these challenges with software and services designed to meet the competitive needs of the largest banks in the world.

## Business Strategies

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The company's goal is to be the leading global provider of electronic payments and electronic commerce solutions. To achieve this objective, Transaction Systems will pursue the following strategies:

**Leverage Electronic Payments And Electronic Commerce Opportunities Wherever They Occur** - Transaction Systems and its subsidiaries have been facilitating electronic commerce by providing consumers and companies access to their money for two decades.

As technology advances are met with broader acceptance by the younger consumer base, electronic payments and electronic commerce will spread into industries and niches not previously seen as the traditional markets for the company's solutions. Transaction Systems will pursue opportunities in these non-traditional markets by using its core product strengths and fostering strategic partnerships.

Transaction Systems is in conversation with a number of the companies working to deploy the products and services necessary to meet the needs of individuals participating in electronic commerce around the world. Through development and marketing agreements, the company hopes to shape the standards used in this new wave of electronic transactions.

**Strengthen Customer Relationships** - More than 75 percent of the company's annual revenues come from its customer base. These revenues are derived from the following:

- \* The sale of new products;
- \*The purchase of additional software licenses due to increases in transaction volumes;
- \* The payment of maintenance fees;
- \* The use of technical services;
- \* The need for additional device interfaces and communication protocols.

Transaction Systems monitors the quality of its products and services by conducting regular satisfaction surveys as well as involving its customers

in user groups and joint development projects. The company's customer retention rate exceeds 95 percent.

**Continue To Expand Internationally** - Transaction Systems invests approximately 10 percent of its revenues annually to build its international infrastructure with the establishment of sales and support offices worldwide, through joint ventures, by acquisitions and via distributor/agent relationships.

In fiscal 1995, 53 percent of the company's revenues came from outside of the United States. Significant growth opportunities exist for Transaction Systems in countries with emerging electronic payment networks or countries where institutions primarily use aging, internally developed software.

**Grow The Product Set** - The largest single component of Transaction Systems' revenues comes from software license fees. The company works closely with customers, partners and vendors to identify industry trends and deliver new products and product modules.

Market interest in home banking and smart cards has created opportunities for Transaction Systems. Twelve customers purchased the company's recently introduced home banking product in fiscal 1995.

Transaction Systems is working with leaders in the home banking industry, such as Visa Interactive, to define the standards and interfaces to be used in processing the transactions generated by consumers using online banking products and services.

In addition, Transaction Systems is participating in a number of reloadable stored-value smart card pilots around the world including: Visa's 1996 Summer Olympics project, the SmartCash program in Delaware and the Mondex initiative in the United Kingdom.

**Diversify Hardware Platforms** - Through the use of middleware, client/server architectures and object-oriented design, Transaction Systems continues to offer solutions to customers that lower the cost of ownership, reduce risk, provide a quicker time to market and deliver platform independence.

Today the company offers software products that operate on a number of different hardware platforms. Transaction Systems' commitment is to solutions that leverage the attributes of scalability, flexibility, compatibility and portability.

**Build Recurring Revenues** - To improve profit margins, revenue

stability and operational visibility, Transaction Systems continues to actively pursue sources of recurring revenue. The company's current sources for recurring revenue include monthly software license fees, maintenance fees and facilities management contracts. At the end of fiscal 1995, the company's recurring revenues totaled \$53.1 million, an increase of 31 percent over fiscal 1994.

Since 1991, Transaction Systems has been offering customers a monthly license fee arrangement. Under this agreement, customers pay a monthly fee, in addition to maintenance, for as long as they use the software. For accounting purposes, the revenue from this type of license is recognized ratably on a monthly basis.

Under all licensing arrangements offered by the company, customers must license additional software if they upgrade their systems to handle increased transaction volumes. Expanding or networking disparate systems (e.g., in the event of a merger or acquisition) also may require a customer to license additional software.

New opportunities in electronic commerce, strong customer relationships, international expansion, a growing product set, hardware platform diversity and a commitment to recurring revenues will serve as the foundation for Transaction Systems growth in 1996.