1996 Annual Report

1996 TSA ANNUAL REPORT CONTENTS

country's first shared ATM network will be in Mumbai.

HIGH VOLUME DOWN UNDER
AUSTRALIANS have enthusiastically embraced electronic payment methods doubling transaction volumes in the last two years.

GOING FOR THE GOLD
During the VISA Cash project at the Summer Games in Atlanta, the first reload of monetary value on a smart card in the **UNITED STATES** took place.

RETURN TO PORT
TSA participates in these trends benefiting from the growth in electronic payments and electronic commerce by being in the right place at the right time, **AROUND THE WORLD.**

MANAGEMENT'S DISCUSSION
Analysis of financial condition and results of operations.

FINANCIAL STATEMENTS
Index of individual financial statements.

CORPORATE AND SHAREHOLDER INFORMATION
Corporate and shareholder contacts and information.

DIRECTORS AND OFFICERS
A listing of the Board of Directors and Executive Officers.

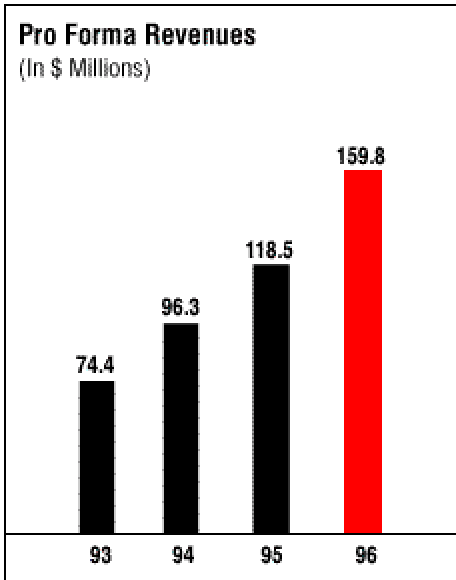
FINANCIAL HIGHLIGHTS (5)

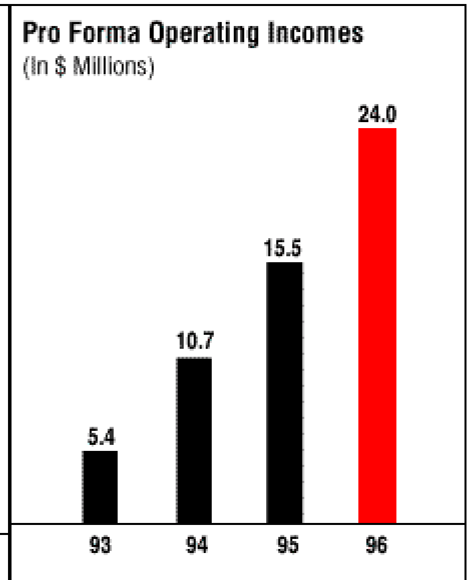
In $ Thousands, Except Per Share Amounts

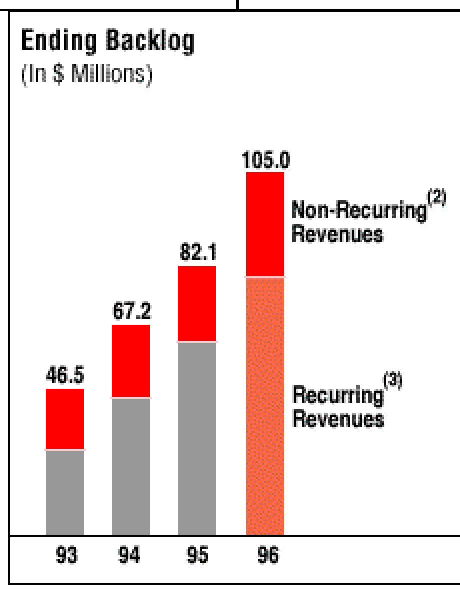
Year Ended September 30	**1996**	1995
Revenues	**$159,784**	$118,473
Operating Income	**20,678**	9,067
Net Income	**12,570**	3,570
Net Income Per Share (4)	**.47**	.15
Earnings Before Interest, Taxes, Depreciation and Amortization	**30,563**	20,882
As of September 30		
Working Capital	**$41,017**	$38,327
Total Assets	**123,159**	101,905
Long-term Obligations	**1,687**	357
Stockholders' Equity	**76,450**	60,356
Backlog	**104,978**	82,112

SUPPLEMENTAL INFORMATION (1)(5)
In $ Thousands, Except Per Share Amounts

	1996	1995	1994	% Change 1995 to 1996
Year Ended September 30				
Pro Forma Revenues	**$159,784**	$118,473	$96,267	34.9
Pro Forma Operating Income	**24,021**	15,532	10,667	54.7
Pro Forma Net Income	**15,546**	10,206	6,927	52.3
Pro Forma Net Income Per Share (4)	**.58**	.41	.28	41.5







(1) Transaction Systems acquired Applied Communications, Inc. (ACI) and Applied Communications, Inc., Limited (ACIL) on December 31, 1993. The above supplemental information reflects the combination of TSA, ACI and ACIL results of operations data for the four 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, $10.8 million and $3.3 million in 1993, 1994, 1995 and 1996 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 percent.

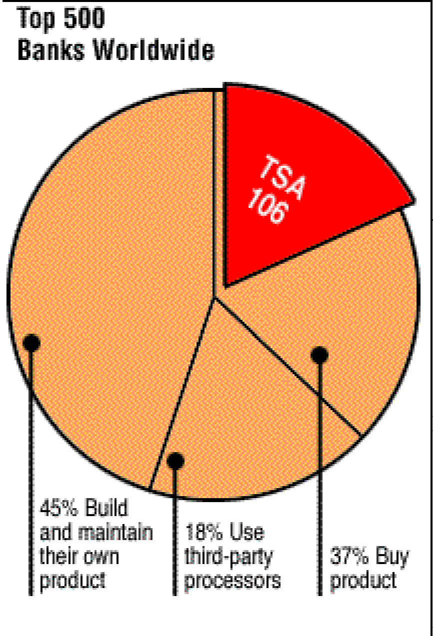
(2) Non-recurring revenues are composed of fees specified in software and service contracts that the Company expects to recognize in the next 12 months.

(3) Recurring revenues include all monthly license fees, maintenance fees and facilities management fees from existing contracts that the Company expects to recognize in the next 12 months.

(4) Adjusted for two for one stock split in the form of a 100% stock dividend occuring July 1, 1996.

(5) Adjusted for the acquisition of Grapevine Systems, Inc., accounted for as a pooling of interests.

LETTER TO SHAREHOLDERS



Corporate Information Center 1996

Ask most people their impression of Nebraska and, once they've stifled a yawn,their reply will have something to do with corn, football and the Strategic Air Command. But there is more to Nebraska - and OMAHA in particular - than first comes to mind.

People making their living on Wall Street will immediately recognize the name Warren Buffet, but how many know he lives in Omaha? In addition to Warren, and almost as successful, is Omaha's Henry Doorly Zoo - world class by anyone's definition.

Our zoo has one of the world's largest free-flight aviaries and North America's largest facility for big cats. It also has an indoor rain forest - the world's largest - that houses more than 125 species of animals living among thousands of exotic plants. (The photograph of me on page five of this report was taken in the rain forest. I will explain the "unique" style of dress in a moment.)

Another area that few people think of when they consider Nebraska is high technology. To amuse visitors, we sometimes call Omaha "The Silicon Prairie." It is more than just a label, though. Omaha is home to companies like Inacom, CSG Systems, American Business Information, First Data and Transaction Systems Architects, Inc. (Nasdaq: TSAI).

Transaction Systems contributes to "The Silicon Prairie" by building software that facilitates electronic commerce. Our products provide consumers and companies access to their money through the processing of transactions involving credit cards, debit cards, smart cards, home banking services, checks, wire transfers and automated clearing and settlement. Our software handled more than 12 billion automated teller machine and point-of-sale transactions last year.

Many of our customers are the largest banks in the world. In fact, 106 of the top 500 banks worldwide (as measured by asset size) use a product built by Transaction Systems. As you can see from the chart on this page, we have plenty of opportunity among these large banks, many of which continue to use software they developed in the late 1970's or early 1980's.

Also, our market niche is expanding with card-based transaction volumes increasing all over the world as growth in the use of cash and checks slows. The chart below documents one aspect of this trend in the United Kingdom. Because our software is priced in a volume-sensitive manner, we have benefited from this trend. In fiscal year 1996 we had revenues of $159.8 million, an increase of 35 percent over last year. Cash from record operating activities for the year totaled $17.7 million, up from

$11.0 million. The company's cash balance at the end of September 1996 was $31.5 million. Our stock split two-for-one on July 1, 1996.

But like the town in which we are headquartered, there is more to Transaction Systems than is immediately obvious. Our existing customers contribute more than 75 percent of our revenues in an average year through the purchase of additional capacity to handle increasing transaction volumes, the payment of maintenance fees and the licensing of new products.

Our preferred pricing model is a monthly license fee which creates recurring revenues that enhance our long-term profitability. As of September 30, our level of monthly license fees had reached an annual run rate of $28 million.

This type of pricing model helped us achieve a pro forma operating income (excluding acquisition-related charges) of $24 million in fiscal year 1996, up from $15.5 million last year. Our operating margin in the fourth quarter of the fiscal year reached 16 percent.

Our approach to revenue recognition - typically recognizing revenue only after the products are installed - helps us maintain a rolling 12-month backlog of business. Our backlog grew 28 percent in fiscal 1996 reaching $105 million as of September 30.

This backlog consisted of $34 million in non-recurring revenues and $71 million in recurring revenues. Backlog provides us with a visibility to our operations enjoyed by few software companies. This visibility allows us to reduce the volatility in our business.

Perhaps one aspect of our company that separates us from other technology companies on the prairie is the scope of our international presence. Our solutions are used on more than 1,250 systems by more than 550 customers in 65 countries on six continents. This year 56 percent of our revenues came from outside the United States. While our U.S. revenues grew at a healthy 23 percent, our revenues in the Europe, Middle East, Africa region and the Asia Pacific region were up 50 and 88 percent, respectively.

Because ours is an international business, we thought you might be interested in a world tour with stops in a few of our key markets. On the tour we will introduce you to the company, some of our leading customers and certain trends that are influencing our business around the globe. I will be the host for this tour. This explains the clothes I am wearing in the picture. The investor relations officer who insisted I wear them is now serving a "special" assignment.

CONSOLIDATION

- **The United States banking arena** includes more than 10,000 financial institutions. Over the last several years, this industry has been characterized by consolidation. When banks merge, they often want to realize efficiencies of scale by combining their payment networks. Because of the complex nature of these networks and the high transaction volumes they must accommodate, this is difficult.

  Because TSA's products are built for high-performance environments and are current with 40 device types, 100 network interfaces and 40 communication protocols, we often help banks faced with mergers address needs surrounding their payment networks. During the fourth quarter of our 1996 fiscal year, 19 bank mergers were completed or nearing completion in the United States. In 15 of those, TSA's software was being used by the acquiring institutions. In the other four cases, our product was installed at both banks involved.

  Consumers accessing their accounts over proprietary and public networks, using devices such as telephones and personal computers, can pay bills and perform a wide range of banking functions on systems using TSA's software.

  The merger of Chemical Bank with Chase Manhattan Bank created an automated teller machine (ATM) network that processes more than 20 million transactions per month. Prior to the merger, Chemical used TSA's products to manage its network. At Chase, five separate ATM networks were in place. Because our software can handle high-transaction volumes in a complex processing

environment, TSA's products were chosen to run the ATM network at the "new" Chase.

The consolidation of banks also has resulted in a competitive environment where thousands of banks must battle for customers in local markets with institutions many times their asset size. These banks often turn to third-party processors for new products and services to remain competitive while controlling costs.

The NEW YORK Cash Exchange (NYCE) Corporation, the largest electronic funds transfer provider in the Northeast, processes payment services for 1,296 financial institutions. When NYCE decided to offer remote banking services to these financial institutions, they licensed TSA's products. Using our solutions, consumers can access the NYCE system via a telephone or personal computer to pay bills and perform banking functions with complete confidence.

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An August 1995 report by Forrester Research in Cambridge, Mass., predicts that online banking will grow from 1.1 million U.S. households to 9.7 million over the next five years.

COMPETITION

- **Because the systems we sell are of strategic importance** to the customers we serve, we have found that a direct presence is key to our success in many parts of the world. In June 1996, we purchased TXN Solution Integrators in Toronto, Ontario, to give us better access to the banks in CANADA .

In countries such as Canada where the landscape is dominated by a few, very large banks, the battle for the consumer comes down to the ability to offer services which differentiate the institutions. To achieve this level of differentiation, large banks will either build software to meet their specific needs or they will purchase products from companies like TSA.

TSA's products allow a bank to differentiate itself with services that maximize the control, choice and convenience offered to

the consumer with ease of access, timeliness of information and responsiveness.

Forty-five percent of the top 500 banks in the world still use home-grown solutions. Many of these institutions are moving away from building their own software because of costs and the long lead times required to bring new products to market. Canadian Imperial Bank of Commerce (CIBC), one of the largest banks in North America, has been a TSA customer for more than 10 years using our products in its automated teller machine and point-of-sale networks.

When CIBC decided to aggressively expand its remote banking services, it chose TSA to provide the product. CIBC's goal was to differentiate itself with remote banking that maximized the control, choice and convenience offered to the consumer with ease of access, timeliness of information and responsiveness.

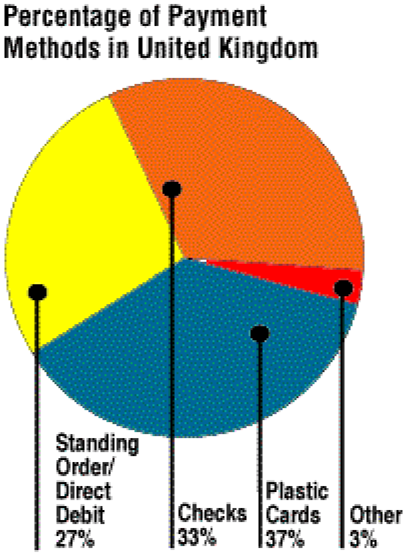
For the bank, this meant establishing the infrastructure to support 24-hour banking by telephone or personal computer and over proprietary, as well as, public networks. This required software that was integrated with its other retail banking services and could handle transactions that arrived at the bank in unpredictable volumes around the clock.

FACING THE FUTURE

- **TSA is not new to the area of electronic payments** and electronic commerce. Our roots extend back to a shared automated teller machine network established in the 1970's through a partnership between our subsidiary Applied Communications, Inc., and a bank in Lincoln, Nebraska. Over more than two decades we have built a level of expertise in our industry that is at the core of our customer relationships today.

NatWest Bank is one of the four largest banks in the UNITED KINGDOM. It has over 2,000 branches and assets in excess of $240 billion. It operates in 33 countries around the world and has approximately 80,000 employees. Its retail banking operation is the second largest in the United Kingdom.

TSA's software is used on point-of-sale networks that may process more than a million transactions in a single day.



TSA's software has been running at NatWest since 1988. Long-term relationships are important to our company since 75 percent of our revenues come from the existing customer base in an average year. This is the result of customers buying additional products and services, licensing additional transaction capacity and paying maintenance fees.

NatWest has designated TSA as its strategic supplier for the bank's next generation of high-volume, mission-critical, online authorization processing. As part of that relationship, TSA provides software and services that help NatWest maintain its commitment to a high standard of customer service delivered on robust and proven electronic payment networks.

When banks select solutions from TSA, they receive products that are current with industry standards and able to meet their specific needs. As part of our commitment to these customers, TSA must have products that meet a range of challenges. Whether the challenges involve a new device type, Year 2000 compliance or transition to a single European currency, TSA helps its customers adjust and respond.

This capability is a competitive advantage for our company. According to information gathered by our Corporate Information Center, over the last three years TSA has won more than 60 percent of all its competitive situations.

According to the Association for Payment Clearing Services (APACS), 82 percent of the adult population in the United Kingdom now holds one or more cards, with 57 percent of adults holding debit cards.

COMBATING FRAUD

- **German consumers traditionally have preferred the use of cash** in their day-to-day transactions. This is reflected in statistics from the early 1990's supplied by the Bank for International Settlement that indicated the number of point-of-sale (POS) terminals per one million inhabitants was 344 in GERMANY compared with 3,054 in Sweden and 3,780 in the United Kingdom. On the other hand, Germany has more automated teller machines (ATMs) per inhabitant.

TSA helps banks address the increase in card use and combat the growth of fraud with products that support online systems and reusable, stored-value smart cards.

Habits are changing in this country though. According to Electronic Payments International, the use of cards for payments in Germany has doubled over the last five years. With this increase in card use has come an increase of fraud.

The majority of retail banking accounts in Germany are held in the savings and cooperative banks. The ATM and POS networks used by these banks are supported by regional processors using software they built themselves or highly customized products bought from vendors but maintained by in-house personnel. Online systems and reusable, stored-value smart cards can help these banks address the increase in card use while combating the growth of fraud.

The Betriebswirtschaftliche Institut der Deutschen Kreditgenossenschaften (BIK) GmbH, a third-party service provider for the cooperative banks, selected TSA's software to drive its online transaction processing for ATM and POS transactions. BIK processes 450,000 online transactions per day, 30 percent of all the transactions in the German card market.

BIK also uses TSA's products to manage the transactions generated by Germany's first national smart-card program, called GeldKarte. TSA's software enables consumers to load value onto their smart cards from special bank terminals and collects transactions from retail outlets at the end of each day for settlement and unspent funds management.

MEETING MARKETING NEEDS

- **Since forming TSA** with the leveraged buyout of Applied Communications, Inc., in December 1993, and acquisition of USSI, Inc., in January 1994, we have maintained a commitment to offer software solutions on multiple hardware platforms.

  Most of Applied Communications' products run on Tandem computers. USSI develops and supports solutions for IBM mainframes, many popular UNIX servers and Stratus hardware. In fiscal 1996, we announced (and have since completed) the acquisition of Open Systems Solutions, Inc. Open Systems'

software manages payments on Microsoft's Windows NT operating system.

Being able to offer software products that run on multiple hardware platforms provides TSA with early entry into emerging markets where payment systems are developing and hardware preferences vary.

The Tandem computer remains the platform of choice for the largest banks in the world because of its ability to support complex, high-volume, scalable networks. However, being able to offer multiple platform solutions provides TSA with early entry into emerging markets where payment systems are developing and hardware preferences vary. For example, in central and eastern Europe, it is not unusual to encounter banks that want their electronic payment solution to run on low-cost UNIX servers.

In POLAND, only one person out of 10 has a bank account and fewer than one in 100 have any type of payment card. The challenge for Polish banks is to extend services to more of the population.

To do so, these institutions are establishing automated retail banking networks. These networks require technology to manage the processing of transactions at the branch, as well as through automated teller machine (ATM) networks.

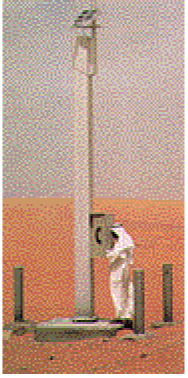
In 1996, Powszechny Bank Gospodarczy S.A., the leading regional bank in central Poland, purchased TSA's UNIX-based software products to drive its ATM network. By implementing an online system, the bank can offer its customers additional products and services.

The goal of platform independence allows TSA to continue to offer institutions solutions that lower the cost of ownership and reduce risk in markets that constantly evolve.

NETWORK FOR A NATION

- **TSA's core products contain** more than 20 million lines of code. This fact alone poses a significant barrier faced by anyone thinking of entering our niche.

These millions of lines of code allow our software to perform three primary functions within high-performance electronic payment



networks. First, our products manage devices. Within a single country there may be many types of automated teller machines (ATMs) or point-of-sale (POS) terminals with which we must communicate. Second, we route transactions switching them across regional, national and international networks to the institutions capable of authorizing them. Third, we often are the software used in the authorization process itself.

TSA's products may be used by a customer to perform any or all of these functions. When used for switching, our software may route most of the electronic transactions in a country.

In **KUWAIT,** The Shared Electronic Banking Services Company (KNET) uses TSA's software to route all the ATM and POS traffic for its eight-member banks. KNET was founded as a means for enhancing the quality of banking services available to the people of Kuwait and to avoid the cost associated with establishing multiple, proprietary networks.

Because the institutions founding KNET recognized a trend toward the electronic delivery of banking services, they needed software capable of handling steadily increasing transaction volumes. Also, as consumer demands for convenience made it necessary to offer access to debit and credit accounts from around the world, connectivity was key.

The two decades of research and development represented in TSA's products allow us to meet these requirements. As the trend toward the use of electronic payments grows around the world, the need for software that can manage, route and authorize increasingly complex transactions will become critical to networks everywhere. Younger consumers, who are not intimidated by technology, entering the workforce may accelerate the need for these capabilities.

- ***Two decades of research and development** allow us to meet the needs of customers who must manage, route and authorize transactions without fail, 24 hours a day, seven days a week.*

EXPANDING PRODUCT SET

- **TSA's reputation is built on software** that can be found in automated teller machine (ATM) and point-of-sale (POS) networks around the world. As the use of electronic payments grows, we

look for ways to expand our product set to meet the needs of institutions and their customers.

Sometimes we achieve this through acquisition. In September 1996, we acquired Grapevine Systems, Inc. Grapevine Systems develops and supports software used to monitor online transaction processing in the securities, health care and manufacturing industries, as well as online services. Our goal is to use our international distribution network to expand the reach of Grapevine's products.

We also grow our solution set through research and development. On average we have invested approximately 10 percent of our revenue in this area during the last few years. This allows us to enhance products and provide new solutions that address trends in the marketplace. An example of this type of initiative is our clearing and settlement product. We have been successful in selling this product in markets such as SINGAPORE where the electronic networks require software that can handle high volumes of clearing and settlement performed in an online environment.

Located at the southern tip of the Malaysian Peninsula, Singapore is a city-state, about the same size as the city of Chicago (633 square kilometers) with a population of 2.9 million, making it one of the most densely populated countries in the world. The Singapore government's program designed to make the country an "intelligent island" by the turn of the century has created a push for a cashless society.

Network for Electronic Transfers (NETS) uses TSA's software to manage the shared ATM and POS transactions for its seven shareholder banks in Singapore. In order to support the country's drive towards automated electronic payments, NETS also licensed TSA's clearing and settlement solution. Our software provides NETS with a high-performance system to manage the flow of funds between the banks that participate in their network.

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    TSA enhances its products and provides new solutions to address the trends of a dynamic marketplace. By extending the product set, TSA grows its business with existing customers.

INFRASTRUCTURE


- **Though TSA is headquartered in the United States,** 56 percent of our revenues came from international markets in fiscal year 1996. In fiscal year 1995, that figure was 51 percent. Europe, Middle East and Africa (EMEA) accounted for 30 percent of the revenues in fiscal 1996 while Asia Pacific accounted for 13 percent of the total. Canada, Mexico, Central America and South America provided the remaining 13 percent.

The growth of our international business helped us achieve a 35 percent increase in revenues in fiscal year 1996. We are investing in an infrastructure to support the needs of customers worldwide.

While the growth in all three of TSA's primary channels - Americas, EMEA and Asia Pacific - exceeded our expectations, it was the growth of our international business that helped us achieve a 35 percent increase in revenues. However, establishing a viable international business requires investment. We cannot meet all of the needs of customers around the world with operations based solely in Nebraska.

For this reason we have reinvested approximately 10 percent of our annual revenues for each of the last several years in building an infrastructure that includes offices in Canada, Mexico, Brazil, Norway, Germany, South Africa, Bahrain, Japan, Australia, Singapore and the United Kingdom. This commitment provides us with the ability to deliver products that help countries half a world away from Omaha ride the wave of electronic payments spreading around the globe.

Four years ago there were fewer than 50 automated teller machines (ATMs) in INDIA. Today, there are still only 200 ATMs in this country of 950 million people. Indian Banks' Association, composed of 27 state-owned institutions, in partnership with the India Switch Company is establishing the nation's first shared ATM network.

The network will be based in Mumbai (formerly Bombay) and will use TSA's software. It will allow consumers to access their account at any of the member banks through any ATM and provide for switching to international networks in the future. Our Singapore office supports this project and gives our company a significant

advantage over competitors who may try to enter this expanding market.

HIGH VOLUME DOWN UNDER

- **Australians are enthusiastic adopters of new technologies.** They have embraced electronic payment methods with open arms, doubling transaction volumes in the last two years according to figures collected by the Reserve Bank. The use of debit cards to pay for goods such as groceries and petroleum has been the primary driver in this trend.

  The number of terminals installed in supermarkets, service stations and other retail outlets around **AUSTRALIA** has increased from 11,500 in 1989 to almost 97,000 in March 1996. Terminals also are being installed in pharmacies, butcher shops and taxis.

  TSA's customer base is not exclusively banks. Retailers - particularly petroleum companies - use TSA's products to manage their payment networks.

  As is the case with other large banks in the world, the Australia and New Zealand Banking Group and Westpac Banking Corporation use TSA's software to manage the growing volumes in their automated teller machine (ATM) and point-of-sale (POS) networks. However, our customer base in Australia, and throughout the world, is not exclusively composed of financial institutions.

  In addition to banks, retailers - particularly petroleum companies - use TSA's products to manage their payment networks. BP Australia and the Australian Petroleum Pty Ltd. have licensed our solutions. U.S. retailers such as Texaco, J. C. Penney and Safeway rely on TSA's products. In Europe, J. Sainsbury and Esso Petroleum are customers.

  The increase in the use of cards in Australia is expected to continue creating a need for merchants to reduce risk, increase the capacity of their networks and provide a broader range of services.

  By the way, ATMs on this island continent are not obsolete. In this decade alone, the number of ATMs has increased steadily as banks

respond to consumer demands for convenience. Many of these machines now have the ability to deliver a full range of services normally provided at the branch.

GOING FOR THE GOLD

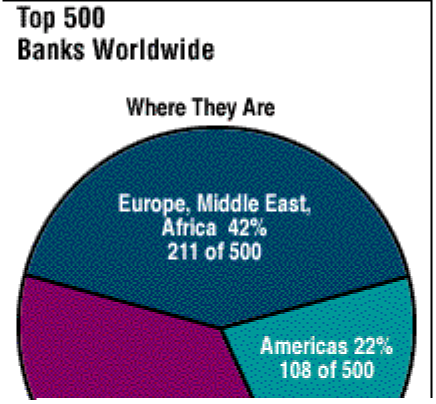
- **The last entry in our travelogue** involves First Union Corporation, the sixth largest banking company in the United States. First Union has been a TSA customer for 11 years using our software in the electronic payment networks that serve their expanding client base. The first reload of monetary value on a smart card in the United States took place on this bank's network using our products.

  These same products were used by First Union for a smart-card pilot conducted during the 1996 Summer Games in ATLANTA, Georgia. The project, which allowed consumers to use VISA Cash stored-value cards, exceeded the expectations set by the sponsors in the first seven days of the Games. In addition to venues around various events, the cards were accepted around metropolitan Atlanta, including fast-food outlets, convenience stores, gas stations and movie theaters.

  TSA monitors the quality of its software by conducting regular satisfaction surveys, as well as involving customers in user groups and joint-development initiatives. Worldwide our customer retention rate exceeds 95 percent.

  The First Union smart-card project received high visibility and our software performed flawlessly. The technology is interesting and many people believe that it will have a dramatic impact on the future. Widespread use may take some time, though. Consumer acceptence and the cost of changing the infrastructure to support this type of payment tool will impact the pace of this change.

  The reason I mentioned First Union has less to do with smart cards and more to do with an award they presented to us in March. The award was given to our subsidiary, Applied Communications, as the outstanding computer software supplier to the bank. According to the news release, the honor was designed to recognize vendors who helped the institution improve its offering of products and services while lowering costs.



Meeting the business needs of customers year in and year out does not occur by accident. TSA closely monitors the quality of its software by conducting regular satisfaction surveys, as well as involving customers in user groups and joint-development projects. The time, resources and money spent in these areas pay dividends. Worldwide, our customer retention rate exceeds 95 percent.

RETURN TO PORT

As we return to the prairie, it is my hope that the TSA 1996 World Tour has been useful to you. While we were not able to stop in every key market or visit each of our important customers, the places we did visit should provide a view to the scope and breadth of our business.

The fact that we are an international technology company headquartered in **OMAHA**, Nebraska, may always seem something of a paradox. However, our approach to business in the coming year will be what you expect from us - pragmatic and straightforward.

We intend to expand our business by focusing on the basics that have served us well to date. We will build long-term shareholder value by continuing to diversify the solutions we offer for the financial services and electronic payment sectors.

This means more products on more platforms delivering core and emerging technologies to financial institutions and other corporations moving money for consumers and companies around the world. This means ongoing re-investment in our worldwide infrastructure. This means maximizing our opportunities and minimizing our risks so that we continue to realize our goal of quarter-on-quarter improvement in our key financial metrics.

Quality is vital and for us it is defined as the means by which we achieve our goals of innovative customer solutions and service excellence in a profitable fashion. Recruiting and retaining the highest caliber of employees is critical to our success. This will require us to find individuals who have strong technical skills and to keep them by providing an environment where the corporate culture is based on a conviction that work should regularly incorporate a bit of fun.

We appreciate your interest in Transaction Systems Architects, Inc. I hope you understand now why we believe our company is in the right place at the right time - around the world. Please contact us if you have questions or need more information.

William E. Fisher
Chairman, President and Chief Executive Officer
Transaction Systems Architects, Inc.

Management Discussion

- **Overview**

The Company was formed on November 2, 1993 for the purpose of acquiring all of the outstanding capital stock of Applied Communications Inc. ("ACI") and Applied Communications Inc. Limited ("ACIL") from Tandem. ACI and ACIL were acquired on December 31, 1993. On January 3, 1994, the Company acquired all of the outstanding common stock of USSI. The acquisitions of ACI, ACIL and USSI, Inc. are hereafter referred to as the "Acquisitions". As a result of the Acquisitions, the Company incurred certain one-time or acquisition related expenses in fiscal 1996, 1995 and 1994. These acquisition related charges included, among others, charges for purchased research and development, purchased contracts in progress, purchased software and goodwill amortization. These expenses are hereafter referred to as the "Acquisition Charges".

On June 3, 1996, the Company acquired substantially all of the net assets of TXN. The acquisition was accounted for as a purchase.

On September 13, 1996, the Company and Grapevine entered into a share exchange agreement which resulted in Grapevine becoming a wholly-owned subsidiary of the Company. The share exchange was accounted for as a pooling of interests. The Company's financial statements have been restated to include the results of Grapevine for all periods presented.

For purposes of the following discussion and analysis, the results of operations of the Predecessors for the three months ended December 31, 1993 have been combined with the results of operations of the Company for the nine months ended September 30, 1994 by adding the corresponding items without adjustment. This computation was done to permit useful comparison between the aggregated twelve months ended September 30, 1996, 1995 and 1994. The combined results of operations for the twelve months ended September 30, 1994 includes nine months of operations of USSI.

The Company provides electronic payments software and related services. During fiscal 1996, 1995 and 1994, 56%, 51% and 49%, respectively, of total revenues resulted from international operations. The Company derived approximately 75%, 74% and 73%, respectively, of its revenues for those same periods from licensing its BASE24 family of software products and providing related services and maintenance. Although the Company believes that the majority of its revenues will continue to come from its existing BASE24 and TRANS24 products over the next several years, the Company has developed and is currently developing other software products and related services. These products are in the areas of network connectivity, middleware, remote banking and ACH.

The following table summarizes revenues by geographic region:

Twelve Months Ended September 30

	1996	1995	1994 (combined)
(in thousands)			
Americas	$91,061	$75,624	$60,196
EMEA	47,267	31,264	26,363
Asia/Pacific	21,456	11,585	9,708
Total revenues	$159,784	$118,473	$96,267

See Note 13 to the Company's Consolidated Financial Statements for additional information relating to geographic regions.

Product Pricing. The Company typically charges a one-time, paid-up-front fee ("PUF") for perpetual usage or an ongoing monthly licensing fee ("MLF") for month-to-month usage of its software products. Under a PUF arrangement, substantially all revenue related to the transaction is recognized when the software is installed (because the customer does not have the ability to cancel the contract), while under a MLF arrangement, the revenue is recognized on a monthly basis (because the customer typically has the ability to cancel its contract at any time). Consequently, under an MLF contract, revenue recognition and cash flow are deferred. A key component of the Company's strategy is to continue to seek to increase MLF revenue. MLF revenue amounted to $20.9 million, $13.1 million and $6.6 million, in fiscal 1996, 1995 and 1994, respectively. PUF revenue, including software modification fees, amounted to $58.0 million, $44.9 million and $38.1 million, in fiscal 1996, 1995 and 1994, respectively.

Hardware Revenues. The Company has a written agreement with Tandem whereby Tandem pays commissions to the Company when the Company can demonstrate that a customer's purchase of its software resulted in that customer's purchase of hardware from Tandem. The commissions are determined as a percentage of Tandem's related hardware revenue. Generally, if a customer's transaction volume increases and the increase necessitates the purchase of additional hardware or an upgrade of its hardware platform, Tandem pays the Company additional commissions on the related hardware sale to the customer. The level of hardware commissions earned by the Company varies from year to year due to timing of customer purchases, introduction of new lines of hardware, and changing prices of hardware. Hardware prices continue to decline and could result in lower hardware commission revenues to the Company in future years. Commissions from Tandem amounted to $4.4 million, $4.6 million and $3.7 million in fiscal 1996, 1995 and 1994, respectively.

Public Offerings. The Company completed an initial public offering (IPO) in March 1995. The Company sold 4,825,000 shares of Class A Common Stock resulting in net proceeds to the Company, after deducting the underwriting discount and offering expenses, of approximately $32.3 million. The Company used $25.8 million of the IPO proceeds to repay all outstanding bank indebtedness (the "Indebtedness"). Upon repayment of the Indebtedness, the Company incurred an extraordinary loss of $2.7 million for the writeoff of debt issuance costs of $1.1 million and original issue discount of $1.6 million. In August 1995, the Company completed the issuance of an additional 2,000,000 shares of Class A Common Stock through a public offering, resulting in net proceeds, after deducting the underwriting discount and offering expenses, of approximately $22.4 million.

- # Management Discussion - Page 2

  - **Results of Operations**

    The following table sets forth certain financial data and the percentage of total revenues of the Company and its Predecessors for the periods indicated:

		Twelve Months Ended September 30,	

	1996		1995		1994	
(dollars in thousands)	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue
Revenues:						
Software license fees	$78,937	49.4%	$58,028	49.0%	$44,948	46.7%
Maintenance fees	35,614	22.3	29,167	24.6	24,018	25.0
Services	40,845	25.6	26,724	22.6	22,470	23.3
Hardware, net	4,388	2.7	4,554	3.8	4,831	5.0
Total revenues	159,784	100.0	118,473	100.0	96,267	100.0
Expenses:						
Cost of software license fees:						
Software costs	19,120	12.0	13,139	11.1	10,246	10.6
Amortization of purchased software	3,143	2.0	3,165	2.6	3,376	3.5
Purchased contracts in progress	--	--	2,956	2.5	12,398	12.9
Cost of maintenance and services	41,050	25.7	28,538	24.1	24,533	25.5
Research and development:						
Research and development costs	14,572	9.1	12,539	10.6	10,291	10.7
Charge for purchased research and development	--	--	--	--	22,712	23.6
Selling and marketing	34,414	21.5	30,074	25.4	23,036	23.9
General and administrative:						
General and administrative costs	26,151	16.4	18,651	15.7	17,604	18.3
Amortization of goodwill and purchased intangibles	656	0.4	344	0.3	1,650	1.7
Total expenses	139,106	87.1	109,406	92.3	125,846	130.7

Operating income (loss)	20,678	12.9	9,067	7.7	(29,579)	(30.7)
Other income (expense):						
Interest income	1,914	1.2	1,077	0.9	507	0.5
Interest expense	(235)	(0.1)	(1,751)	(1.5)	(3,092)	(3.2)
Other income	(626)	(0.4)	13	0.0	172	0.2
Total other	1,053	0.7	(661)	(0.6)	(2,413)	(2.5)
Income (loss) before income taxes	21,731	13.6	8,406	7.1	(31,992)	(33.2)
Provision for income taxes	(9,161)	(5.7)	(2,086)	(1.8)	(2,966)	(3.1)
Net income (loss) before extraordinary loss	12,570	7.9	6,320	5.3	(34,958)	(36.3)
Extraordinary loss related to early retirement of debt	--	--	(2,750)	(2.3)	--	--
Net income (loss)	$12,570	7.9%	$3,570	3.0%	$(34,958)	(36.3)

Revenues. Total revenues for fiscal 1996 increased 34.9% or $41.3 million over fiscal 1995. Of this increase, $20.9 million of the growth resulted from a 36.0% increase in software license fee revenue, $14.1 million from a 52.8% increase in services revenue and $6.4 million from a 22.1% increase in maintenance fee revenue.

Total revenues for fiscal 1995 increased 23.1% or $22.2 million over fiscal 1994. Of this increase, $13.1 million of the growth resulted from a 29.1% increase in software license fee revenue, $4.3 million from a 18.9% increase in services revenue and $5.1 million from a 21.4% increase in maintenance fee revenue.

The growth in software license fee revenue in both fiscal 1996 and 1995 is the result of increased demand for the Company's BASE24 products and a continued growth of the installed base of customers paying MLF revenue. Contributing to the strong demand for the Company's products is the continued world-wide growth of EFT transaction volume and the growing complexity of EFT payment systems. MLF revenue was $20.9 million, $13.1 million and $6.6 in fiscal 1996, 1995 and 1994, respectively.

The growth in service revenue in both fiscal 1996 and 1995 is the result of increased demand for technical and project management services which is a direct result of the increased installed base of the Company's BASE24 products.

The increase in maintenance fee revenue in both fiscal 1996 and 1995 is a result of the continued growth of the installed base of the Company¹s software products.

Expenses. Total operating expenses for fiscal 1996 increased 27.1% or $29.7 million over fiscal 1995. Total operating expenses for fiscal 1995 decreased 13.1% or $16.4 million over fiscal 1994. The primary reason for the overall increase in operating expenses during fiscal 1996 is the increase in staff required to support the increased demand for the Company's products and services. Total staff (including both employees and independent contractors) was 1,272, 1,040 and 837 at September 30, 1996, 1995 and 1994, respectively. The decrease in total operating expenses in fiscal 1995 as compared to fiscal 1994 is primarily due to a decrease in the Acquisition charges which were offset, in part, by higher labor costs associated with increases in staff.

The Company's operating margin (excluding the Acquisition charges of $3.3 million, $6.5 million and $40.1 million for fiscal 1996, 1995 and 1994, respectively) was 15.0%, 13.1% and 11.0% in fiscal 1996, 1995 and 1994, respectively. These improvements are primarily due to increased demand for the Company's products and the impact of the growth in the Company's recurring revenues (MLF's, maintenance and facilities management fees).

The Company's gross margin (total revenues minus cost of software and cost of maintenance and services) was 60.4%, 62.2% and 60.4% in fiscal 1996, 1995 and 1994, respectively. The decline in gross margin during fiscal 1996 is primarily due to the accelerated growth in services business which typically has a lower gross margin than software license fees which was offset, in part, by the impact of additional MLF revenue. The increase in gross margin during fiscal 1995 is due primarily to the impact of additional MLF revenue.

Research and development (R&D) costs as a percentage of total revenues were 9.1%, 10.6% and 34.3% in fiscal 1996, 1995 and 1994, respectively. R&D costs in fiscal 1994 include a one-time charge for purchased research and development associated with the Acquisitions. R&D costs, excluding the charge for purchased R&D, for fiscal 1994 were 10.7% of revenue. The majority of R&D costs have been charged to expense as incurred with the capitalization of software costs amounting to approximately $1.2 million per year. The Company expects R&D costs to remain relatively constant as a percentage of revenues.

Selling and marketing costs as a percentage of total revenues were 21.5%, 25.4% and 23.9% in fiscal 1996, 1995 and 1994, respectively. The decrease in 1996 is due primarily to higher levels of services revenue and backlog which typically has a lower level of sales commission expense associated with it. The increase in 1995 is due primarily to an investment in sales personnel to pursue business opportunities in the EFT market place.

General and administrative costs as a percentage of total revenues were 16.8%, 16.0% and 20.0% in fiscal 1996, 1995 and 1994. The 1996 increase is due primarily to the hiring of additional staff to support the Company's growth. The 1995 decrease is due to the Company's emphasis on cost controls and the decrease in Acquisition costs.

EBITDA. The Company's earnings before interest, income taxes, depreciation and amortization (EBITDA) was $30.6 million, $20.9 million and $16.5 million for fiscal 1996, 1995 and 1994, respectively. These increases are attributable to the continued growth in both recurring and non-recurring revenues more than offsetting the growth in operating expenses. EBITDA is not intended to represent cash flows for the periods.

Other Income and Expense. Other income and expense consists primarily of interest income derived from short-term investments and interest expense on indebtedness. The growth in interest income is due to the investment of a portion of the public offering proceeds received in March and August of 1995. The decrease in interest expense is due to the repayment of the Indebtedness out of the proceeds of the Company's March 1995 public offering.

Extraordinary Loss. Upon repayment of the Indebtedness, the Company incurred an extraordinary loss of $2.7 million for the write-off of debt issuance costs of $1.1 million and original issue discount of $1.6 million.

Income Taxes. The Company had an effective tax rate of 42.2% for fiscal 1996 as compared to 36.9% for fiscal 1995. The increase in the effective tax rate is principally the result of deferred tax assets which were recognized in fiscal 1995 which reduced the effective tax rate for that year with no corresponding recognition of deferred tax assets in fiscal 1996. During fiscal 1994, the Company had a pre-tax loss but still had a tax provision. This was the result of the Company expensing withholding taxes paid on remittances to the United States for software license fees. These foreign withholding taxes were expensed in fiscal 1994 because, at that time, realization of these taxes as a credit was not assured.

As of September 30, 1996, the Company has deferred tax assets of approximately $12.4 million and deferred tax liabilities of $0.7 million. Each year, the Company evaluates its historical operating results as well as its projections for the next 24 months to determine the realizability of the deferred tax assets. This analysis indicated that $4.4 million of the deferred tax assets were more likely than not to be realized. Accordingly, the Company has recorded a valuation allowance of $8.0 million as of September 30, 1996.

- # Management Discussion - Page 3

  - **Backlog**

    As of September 30, 1996 and 1995, the Company had non-recurring revenue backlog of $20.4 million and $17.1 million in software license fees and $13.6 million and $12.0 million in services, respectively. The Company includes in its non-recurring revenue backlog all fees specified in contracts which have been executed by the Company to the extent that the Company contemplates recognition of the related revenue within one year. There can be no assurance that the contracts included in non-recurring revenue backlog will actually generate the specified revenues or that the actual revenues will be generated within the one year period.

As of September 30, 1996 and 1995, the Company had recurring revenue backlog of $71.0 million and $53.1 million, respectively. The Company defines recurring revenue backlog to be all monthly license fees, maintenance fees and facilities management fees specified in contracts which have been executed by the Company and its customers to the extent that the Company contemplates recognition of the related revenue within one year. There can be no assurance, however, that contracts included in recurring revenue backlog will actually generate the specified revenues.

Selected Quarterly Information

The following table sets forth certain unaudited financial data for each of the quarters within fiscal years 1996, 1995 and 1994. This information has been derived from the Company's Consolidated Financial Statements and the financial statements of its Predecessors, and in management's opinion, reflects all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the information for the quarters presented. The operating results for any quarter are not necessarily indicative of results for any future period.

	Sep 30,	Jun 30,	Mar 31,	Dec. 31,	Sep 30,	Jun 30,	Mar 31,	Dec 31,	Sep 30,	Jun 30 ,	Mar 31,	Dec 31
(in thousands)	1996	1996	1996	1995	1995	1995	1995	1994	1994	1994	1994	1993
Revenues:												(Predeces
Software license fees	$22,733	$19,969	$19,018	$17,217	$18,084	$14,386	$13,108	$12,439	$13,766	$12,912	$10,311	$7,956
Maintenance fees	9,725	9,068	8,412	8,409	7,559	7,545	7,260	6,803	6,360	6,178	6,070	5,392
Services	11,991	11,067	9,169	8,618	7,286	7,012	6,250	6,187	6,421	5,787	5,301	4,353
Hardware, net	1,109	977	1,063	1,239	1,271	1,200	1,033	1,050	814	979	1,909	1,129
Total revenues	45,558	41,081	37,662	35,483	34,200	30,143	27,651	26,479	27,361	25,856	23,591	18,830
Expenses:												
Cost of software license fees:												
Software costs	5,171	5,173	4,871	3,905	4,059	2,829	2,892	3,359	2, 464	2,642	2,376	2,713
Amortization of purchased software	787	783	785	788	791	792	790	792	785	779	778	1,034

Purchased contracts in progress	--	--	--	--	--	--	631	2,325	3,550	3,222	5,626	--
Cost of maintenance and services	12,052	10,790	9,437	8,771	8,080	7,493	6,696	6,269	6,993	6,391	5,845	5,164
Research and development:												
Research and development costs	3,796	3,450	3,788	3,537	3,550	3,630	2,767	2,592	2,892	2,882	2,689	1,704
Charge for purchased research and development	--	--	--	--	--	--	--	--	--	--	22,712	--
Selling and marketing	9,832	8,314	7,864	8,404	9,074	7,559	7,002	6,439	6,779	6,063	5,637	4,359
General and administrative:												
General and administrative costs	7,284	7,094	6,079	5,695	4,786	4,502	4,685	4,678	4,596	4,552	4,359	3,946
Amortization of goodwill and purchased intangibles	204	157	145	150	50	50	103	141	140	555	139	816
Total expenses	39,126	35,761	32,969	31,250	30,390	26,855	25,566	26,595	28,199	27,086	50,161	19,736
Operating income (loss)	6,432	5,320	4,693	4,233	3,810	3,288	2,085	(116)	(838)	(1,230)	(26,570)	(906)
Other income (expense):												
Interest income	334	444	568	568	458	283	185	151	177	134	105	91
Other	(446)	(99)	(51)	(30)	(86)	58	149	(108)	(331)	349	154	--
Interest expense	(53)	(54)	(84)	(44)	(49)	(41)	(703)	(958)	(963)	(1,036)	(1,056)	(34)
Total other	(165)	291	433	494	323	300	(369)	(915)	(1,117)	(553)	(797)	57
Income (loss) before income taxes	6,267	5,611	5,126	4,727	4,133	3,588	1,716	(1,031)	(1,955)	(1,783)	(27,367)	(849)
Benefit	(2,876)	(2,392)	(2,095)	(1,798)	(1,394)	(730)	547	(509)	(982)	(664)	(533)	(802)

(provision) for income taxes												
Net income (loss) before extraordinary loss	3,391	3,219	3,031	2,929	2,739	2,858	2,263	(1,540)	(2,937)	(2,447)	(27,900)	(1,651)
Extraordinary loss related to early retirement of debt	--	--	--	--	--	--	(2,750)	--	--	--	--	--
Net income (loss)	$3,391	$3,219	$3,031	$2,929	$2,739	$2,858	$(487)	$(1,540)	$(2,937)	$(2,447)	$(27,900)	$(1,651)

Liquidity and Capital Resources

As of September 30, 1996, the Company had working capital of $41.0 million, cash and cash equivalents of $31.5 million and a $10 million bank line of credit of which there are no borrowings outstanding. The bank line of credit expires in June 1997.

For the year ended September 30, 1996, the Company's cash flow from operations amounted to $17.8 million and cash used in investing activities amounted to $22.8 million.

In the normal course of business, the Company evaluates potential acquisitions of complementary businesses, products or technologies. On October 2, 1995, the Company acquired the capital stock of a German software company for $3.4 million. The acquisition was accounted for under the purchase accounting method and was financed with existing cash and future payments to the sellers.

On January 24, 1996, the Company entered into a transaction with Insession, Inc. (Insession) whereby the term of the Company's ICE distribution rights was extended to September 2001. In addition, the Company has loaned Insession $4.0 million under promissory notes and acquired a 7.5% minority interest in Insession for $1.5 million.

On June 3, 1996, the Company acquired substantially all of the net assets of TXN Solution Integrators (TXN) for $3.6 million in cash and the assumption of certain liabilities of TXN. The acquisition was accounted for under the purchase accounting method and was financed with existing cash.

In August 1995, the Company entered into a transaction with a start-up transaction processing business whereby it agreed to extend to the start-up venture a $2.5 million credit facility and obtained the right to acquire the start-up venture. During fiscal 1996, the Company increased the credit facility to $3.6 million. During fiscal 1996 and 1995, the start-up venture borrowed $3.1 million and $500,000, respectively, under the credit facility.

On September 13, 1996, the Company acquired Grapevine in exchange for 380,441 shares of the Company¹s Class A Common Stock.

On October 8, 1996, the Company acquired OSSI in exchange for 210,000 shares of the Company's Class A Common Stock. Management believes that the Company's working capital, cash flow generated from operations and borrowing capacity are sufficient to meet the Company's working capital requirements for the foreseeable future.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

- To the Board of Directors of
  Transaction Systems Architects, Inc.:

  We have audited the accompanying consolidated balance sheets of Transaction Systems Architects, Inc. (a Delaware corporation) and Subsidiaries as of September 30, 1996 and 1995, and the related consolidated statements of operations, stockholders' equity and cash flows for the years ended September 30, 1996 and 1995 and for the period from inception (November 2, 1993) through September 30, 1994. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

  We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Transaction Systems Architects, Inc. and Subsidiaries as of September 30, 1996 and 1995, and the results of their operations and their cash flows for the years ended September 30, 1996 and 1995 and for the period from inception (November 2, 1993) through September 30, 1994, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Omaha, Nebraska,
October 31, 1996

CONSOLIDATED BALANCE SHEETS

CONSOLIDATED BALANCE SHEETS (in thousands except share data)		
September 30, 1996 1995		
	1996	1995
Assets		
Current assets:		
Cash and cash equivalents	**$31,546**	$35,511
Receivables, net	**49,135**	40,284
Deferred income taxes	**4,348**	2,732
Other	**1,010**	992
Total current assets	**86,039**	79,519
Property and equipment, net	**13,001**	9,717
Software, net	**5,424**	6,741
Intangible assets, net	**7,236**	2,027
Installment receivables	**1,593**	1,505
Investment and notes receivable	**8,105**	500
Other	**1,761**	1,896
Total assets	**$123,159**	$101,905
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	**$1,147**	$480
Current portion of capital lease obligations	**342**	456
Accounts payable	**8,322**	5,070
Accrued employee compensation	**5,210**	4,564

Accrued liabilities	**7,631**	7,526
Income taxes	**4,383**	3,562
Deferred revenue	**17,987**	19,534
Total current liabilities	**45,022**	41,192
Long-term debt	**1,431**	---
Capital lease obligations	**256**	357
Total liabilities	**46,709**	41,549
Commitments and contingencies (Note 8)		
Redeemable Convertible Preferred Stock, $.01 par value; 5,450,000 shares authorized; no shares issued and outstanding at September 30, 1996 and 1995		
Redeemable Convertible Class B Common Stock and Warrants, $.005 par value; 5,000,000 shares authorized; no shares issued and outstanding at September 30, 1996 and 1995		
Stockholders' equity (1995 shares are before the effect of the two-for-one stock split in June 1996):		
Class A Common Stock, $.005 par value; 50,000,000 shares authorized; 23,740,766 and 11,493,760 shares issued at September 30, 1996 and 1995, respectively	**119**	58
Class B Common Stock, $.005 par value; 5,000,000 shares authorized; 2,171,252 and 1,485,626 shares issued and outstanding at September 30, 1996 and 1995, respectively	**11**	7
Additional paid-in capital	**96,062**	92,721
Accumulated translation adjustments	**(236)**	(354)
Accumulated deficit	**(19,494)**	(32,064)
Treasury stock, at cost, 845 shares at September 30, 1996 and 1995	**(12)**	(12)
Total stockholders' equity	**76,450**	60,356
Total liabilities and stockholders' equity	**$123,159**	**$101,905**

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended September 30,	Year Ended September 30,	For the Period from Inception (November 2, 1993) Through September 30,
	1996	1995	1994
Revenues:			
Software license fees	**$78,937**	$58,028	$36,992
Maintenance fees	**35,614**	29,167	18,626
Services	**40,845**	26,724	18,117
Hardware, net	**4,388**	4,554	3,702
Total revenues	**159,784**	118,473	77,437
Expenses:			
Cost of software license fees:			
Software costs	**19,120**	13,139	7,533
Amortization of purchased software	**3,143**	3,165	2,342
Purchased contracts in progress	**---**	2,956	12,398
Cost of maintenance and services	**41.050**	28,538	19,369
Research and development:			
Research and development costs	**14,572**	12,539	8,587
Charge for purchased research and development	**---**	---	22,712
Selling and marketing	**34,414**	30,074	18,677
General and administrative:			
General and administrative costs	**26,151**	18,651	13,658
Amortization of goodwill and purchased intangibles	**656**	344	834
Total expenses	**139,106**	109,406	106,110
Operating income (loss)	**20,678**	9,067	(28,673)
Other income (expense):			
Interest income	**1,914**	1,077	416
Interest expense	**(235)**	(1,751)	(3,058)
Other	**(626)**	13	172
Total other	**1,053**	(661)	(2,470)

Income (loss) before income taxes	**21,731**	8,406	(31,143)
Provision for income taxes	**(9,161)**	(2,086)	(2,164)
Net income (loss) before extraordinary loss	**12,570**	6,320	(33,307)
Extraordinary loss related to early retirement of debt	**---**	(2,750)	---
Net income (loss)	**$12,570**	$3,570	$(33,307)
Net income (loss) per common and equivalent share:			
Before extraordinary loss	**$0.47**	$0.27	$(1.62)
Extraordinary loss	**---**	(0.12)	---
Net income (loss)	**$0.47**	$0.15	$(1.62)
Weighted average shares outstanding	**27,016**	23,251	20,588

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Class A Common Stock	Class B Common Stock	Additional Paid-in Capital	Accumulated Translation Adjustments	Accumulated Deficit	Treasury Stock	Total
Balance, at inception (November 2, 1993), as previously reported	$---	$---	$---	$---	$---	$---	$---
Adjustment for Grapevine Systems, Inc. pooling of interests	2	---	80	---	576	---	658
Balance, at inception, (November 2, 1993), as restated	2	---	80	---	576	---	658
Issuance of 1,250,000 shares of Class A Common Stock for cash	6	---	3,119	---	---	---	3,125
PIK dividends for Redeemable Convertible Preferred Stock	---	---	---	---	(1,175)	---	(1,175)
Accretion of Redeemable Convertible Preferred Stock	---	---	---	---	(243)	---	(243)
Accretion of Redeemable Convertible Class B Common	---	---	---	---	(459)	---	(459)

Stock and Warrants							
Net loss	---	---	---	---	(33,307)	---	(33,307)
Translation adjustments	---	---	---	(102)	---	---	(102)
Balance, September 30, 1994	8	---	3,199	(102)	(34,608)	---	(31,503)
PIK dividends for Redeemable Convertible Preferred Stock	---	---	---	---	(649)	---	(649)
Accretion of Redeemable Convertible Preferred Stock	---	---	---	---	(133)	---	(133)
Accretion of Redeemable Convertible Class B Common Stock and Warrants	---	---	---	---	(244)	---	(244)
Sale of Class A Common Stock pursuant to initial public offering, net of issuance costs	12	---	32,240	---	---	---	32,252
Conversion of Redeemable Convertible Preferred Stock to Common Stock pursuant to initial public offering	23	9	27,483	---	---	---	27,515
Termination of redemption rights of Convertible Class B Common Stock pursuant to initial public offering	8	---	5,468	---	---	---	5,476
Exercise of Class A Common Stock Warrants	---	---	1,754	---	---	---	1,754
Sale of Class A Common Stock pursuant to public offering, net of issuance costs	7	(2)	22,419	---	---	---	22,424
Purchase of 845 shares of Class A Common Stock	---	---	---	---	---	(12)	(12)
Exercise of stock options	---	---	158	---	---	---	158
Net income	---	---	---	---	3,570	---	3,570
Translation adjustments	---	---	---	(252)	---	---	(252)
Balance, September 30, 1995	58	7	92,721	(354)	(32,064)	(12)	60,356
Two-for-one stock split	56	8	(64)	---	---	---	---
Sale of Class A Common Stock pursuant to Employee Stock Purchase Plan	---	---	355	---	---	---	355
Conversion of Class B Common Stock to Class A Common Stock	4	(4)	---	---	---	---	---
Exercise of stock options	1	---	1,077	---	---	---	1,078
Tax benefit of stock options exercised	---	---	1,973	---	---	---	1,973
Net income	---	---	---	---	12,570	---	12,570
Translation adjustments	---	---	---	118	---	---	118

Balance, September 30, 1996	$119	$11	$96,062	$(236)	$(19,494)	$(12)	$76,450

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended September 30,	Year Ended September 30,	For the Period from Inception (November 2, 1993) Through September 30,
	1996	1995	1994
Cash flows from operating activities:			
Net income (loss)	**$12,570**	$3,570	$(33,307)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	**4,415**	3,895	3,711
Amortization	**5,929**	5,295	4,207
Purchased research and development	**---**	---	22,712
Extraordinary loss	**---**	2,750	---
Increase in receivables, net	**(6,729)**	(7,136)	(6,969)
Decrease in contracts in progress	**---**	2,955	12,398
Increase in other current assets	**(938)**	(1,926)	(718)
(Increase) decrease in installment receivables	**(88)**	(458)	435
(Increase) decrease in other assets	**(877)**	(1,850)	96
Increase (decrease) in accounts payable	**2,710**	(308)	2,591
Increase in accrued employee compensation	**425**	618	2,369
Increase (decrease) in accrued liabilities	**(399)**	(513)	414
Increase (decrease) in income tax liabilities	**2,801**	(113)	190
Increase (decrease) in deferred revenue	**(1,970)**	4,424	4,703
Net cash provided by operating activities	**17,849**	11,203	12,832
Cash flows from investing activities:			
Purchases of property and equipment	**(6,572)**	(4,700)	(3,721)
Additions to software	**(2,691)**	(1,562)	(1,591)
Acquisition of businesses, net of cash acquired	**(5,403)**	(206)	(56,594)

Additions to investment and notes receivable	**(8,106)**	(500)	---
Net cash used in investing activities	**(22,772)**	(6,968)	(61,906)
Cash flows from financing activities:			
Proceeds from issuance of Redeemable Convertible Preferred Stock	**---**	143	24,142
Proceeds from issuance of Redeemable Convertible Class B Common Stock and Warrants	**---**	1,754	1,863
Proceeds from issuance of Class A Common Stock	**355**	54,839	3,125
Payment of Preferred Stock Dividends	**---**	(1,825)	---
Purchase of Treasury Stock	**(2)**	(12)	(10)
Proceeds from exercise of stock options	**1,111**	---	---
Proceeds from long-term debt	**---**	3,045	36,824
Payments of long-term debt	**(100)**	(29,750)	(13,063)
Payments on capital lease obligations	**(225)**	(468)	(338)
Net cash provided by financing activities	**1,139**	27,726	52,543
Effect of exchange rate fluctuations on cash	**(181)**	(11)	92
Net increase (decrease) in cash and cash equivalents	**(3,965)**	31,950	3,561
Cash and cash equivalents, beginning of period	**35,511**	3,561	---
Cash and cash equivalents, end of period	**$31,546**	$35,511	$3,561
Supplemental cash flow information:			
Income taxes paid	**$7,476**	$2,140	$1,729
Interest paid	**$218**	$1,520	$2,639

Supplemental disclosure of noncash investing and financing activities:

In October 1995, the Company acquired the capital stock of M.R. GmbH, for $1,500 cash and $1,900 of debt. In connection with the acquisition, liabilities of $1,200 were assumed.

In June 1996, the Company acquired substantially all assets of TXN Solution Integrators for $3,600 in cash and assumed $1,320 in liabilities.

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. General

Transaction Systems Architects, Inc. (the Company or TSA) was formed on November 2, 1993, for the purpose of acquiring all of the outstanding capital stock of Applied Communications, Inc. (ACI) and Applied Communications Inc Limited (ACIL) (see Note 3). The Company did not have substantive operations prior to the acquisition of ACI and ACIL.

The Company develops, markets and supports a broad line of software products and services primarily focused on facilitating electronic payments and electronic commerce. In addition to its own products, the Company distributes software developed by third parties. The products are used principally in the financial services industry, both in domestic and international markets.

The Company derives a substantial portion of its revenue from licensing its BASE24 family of software products and providing services and maintenance related to those products. BASE24 products operate on Tandem computers. The Company's future results depend, in part, on market acceptance of Tandem computers and the financial success of Tandem Computers Incorporated.

The Company completed an initial public offering in March 1995. The Company sold 4,825,000 shares of Class A Common Stock resulting in net proceeds to the Company, after deducting the underwriting discount and offering expenses, of approximately $32,300,000. In connection with the initial public offering, all outstanding warrants for the purchase of Preferred and Common Stock were exercised and all of the Company's preferred stocks and Class B Common Stock converted to Class A Common Stock, except for 3,680,000 shares of nonvoting Class B Common Stock. The Class B Common Stock is convertible into Class A Common Stock but is no longer redeemable. (See notes 7, 9 and 10). During 1996, 800,000 shares of Class B Common Stock were converted to Class A Common Stock.

In August 1995, the Company completed the issuance of an additional 2,000,000 Class A Common shares through a public offering, resulting in net proceeds, after deducting the underwriting discount and offering expenses, of approximately $22,400,000.

2. Summary of Significant Accounting Policies

Consolidated Financial Statements

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated.

Revenue Recognition

Software license fees are comprised of one-time perpetual license fees, recurring monthly license fees and software modification fees. Perpetual license fees are recognized upon installation only if no significant vendor obligations remain. Software modification fees are recognized upon installation.Monthly license fees and maintenance fees are recognized ratably over the contract term. Services revenue is recognized as the related services are performed. Hardware revenue is comprised of commissions received on hardware sales associated with sales of the Company's software and net revenue received from hardware sales sold under original equipment manufacturer agreements. Hardware revenue is recognized when the related hardware is shipped to the customer.

Software

The Company capitalizes certain software development costs when the resulting products reach technological feasibility and begins amortization of such costs upon the general availability of the products for licensing.

Purchased software is stated at cost.

Amortization of all software development costs begins when the products are available for general release to customers and is computed separately for each product as the greater of (a) the ratio of current gross revenue for a product to the total of current and anticipated gross revenue for the product or (b) the straight-line method over the remaining estimated economic life of the product. Currently, estimated economic lives of three years are used in the calculation of amortization of these capitalized costs.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives ranging from three to seven years. Assets under capital leases are amortized over the shorter of the asset life or the lease term.

Intangible Assets

Intangible assets consists of goodwill arising from acquisitions (see Note 3) and are being amortized using the straight-line method over 10 years. As of September 30, 1996 and 1995, accumulated amortization of intangible assets was $1,013,000 and $353,000, respectively.

Translation of Foreign Currencies

The Company's non-U.S. subsidiaries use as their functional currency the local currency of the countries in which they operate. Their assets and liabilities are translated into U.S. dollars at the exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average rates of exchange prevailing during the period. Translation gains and losses are included as a component of equity. Transaction gains and losses related to intercompany accounts are not material and are included in the determination of net income (loss).

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of less than 90 days to be cash equivalents.

Financial Instruments with Market Risk and Concentrations of Credit Risk

The concentration of credit risk in the Company's receivables with respect to the financial services industry is mitigated by the Company's credit evaluation policy, reasonably short collection terms and geographical dispersion of sales transactions. The Company generally does not require collateral or other security to support accounts receivable.

Net Income (Loss) Per Common and Equivalent Share

Net income (loss) per common and equivalent share is based on the weighted average number of common equivalent shares outstanding during each period. Common equivalent shares include Redeemable Convertible Preferred Stock and Redeemable Convertible Class B Common Stock and Warrants. Pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 83, all shares and options issued since inception (November 2, 1993) have been treated as if they were outstanding for all periods prior to December 31, 1994, including periods in which the effect is antidilutive. For periods subsequent to December 31, 1994, net income (loss) per common and common equivalent share is determined by dividing net income (loss) by the weighted average number of shares of common stock and dilutive common equivalent shares outstanding during each period using the treasury stock method.

Long-Lived Assets

In March 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (FAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," which is effective for the Company's 1997 fiscal year. Pursuant to this Statement, companies are required to investigate potential impairments of long-lived assets, certain identifiable intangibles, and associated goodwill, when there is evidence that events or changes in circumstances have made recovery of an asset's carrying value unlikely.

An impairment loss would be recognized when the sum of the expected future cash flows is less than the carrying amount of the asset. The adoption of FAS 121 is not expected to have a significant impact on the Company's financial position or results of operations.

Stock-Based Compensation

In October 1995, the Financial Accounting Standards Board issued FAS No. 123, "Accounting for Stock-Based Compensation," which is effective for the Company's 1997 fiscal year. FAS No. 123 allows companies to either account for stock-based compensation under the new provisions of FAS No. 123 or under the provisions of APB 25, but requires pro forma disclosure in the footnotes to the financial statements as if the measurement provisions of FAS 123 had been adopted. The Company intends to continue accounting for its employee stock-based compensation in accordance with the provisions of APB 25. As such, the adoption of FAS No. 123 will not impact the financial position or the results of operations of the Company.

Stock Split

On June 7, 1996, the Company's Board of Directors authorized a two-for-one stock split effected in the form of a 100% stock dividend distributed on July 1, 1996 to shareholders of record on June 17, 1996. All references in the consolidated financial statements and notes to consolidated financial statements to number of shares, except authorized shares and treasury shares, and per share amounts have been restated to reflect this stock split. The par value of each class of Common Stock of $.005 did not change.

Reclassifications

Certain September 30, 1995 amounts have been reclassified to conform to the September 30, 1996 presentation.

Use of Estimates in Preparation of Consolidated Financial Statements

The preparation of the Consolidated Financial Statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Acquisitions

On December 31, 1993, the Company acquired all of the outstanding stock of ACI and ACIL for $55 million cash. In addition, on January 3, 1994, the Company acquired all of the outstanding stock of USSI, Inc. for $3.6

million cash, of which $475,000 was paid in January 1995, and issuance of 350,000 shares of Junior Convertible Preferred Stock, Series A valued at $3.5 million. The acquisitions were funded through the issuance of common and preferred stock (see Notes 9 and 10) and a credit facility (see Note 7). The acquisitions were recorded using the purchase method of accounting and, accordingly, the cost in excess of the fair value of the net tangible assets was allocated as follows (in thousands):

Purchased research and development	$22,712
Contracts in progress	15,303
Purchased software	5,908
Goodwill	2,007
	$45,930

Purchased research and development represents research and development of software technologies which had not reached technological feasibility as of the acquisition date. Purchased research and development was charged to operations as of the acquisition date.

Contracts in progress represents the value assigned to open contracts of the acquired companies at the acquisition date. Contracts in progress are charged to cost of software license fees as the related contracts are recognized as revenue. The value of contracts in progress has been reduced for estimated costs of delivery of software, completion of contracted services and third-party commissions. The gross margin earned in connection with completion and delivery of these contracts was approximately $400,000.

On October 2, 1995, the Company acquired the capital stock of M.R. GmbH, a German software company, for $3.4 million. The acquisition was accounted for under the purchase method and was financed with existing cash and future payments to the sellers. Results of operations prior to the acquisition were not significant.

On June 3, 1996, the Company acquired substantially all of the assets of TXN Solution Integrators (TXN), a Canadian partnership, for $3.6 million in cash and the assumption of certain liabilities of TXN. The acquisition was accounted for under the purchase method of accounting and, accordingly, the cost in excess of the fair value of the net tangible assets acquired was allocated to software ($350,000) and goodwill ($2,000,000).

The following represents pro forma results of operations as if the TXN acquisition had occurred October 1, 1994 (in thousands except per share amounts):

Year Ended September 30,	1996	1995
Revenues	$165,648	$127,336
Net income before extraordinary loss	12,901	6,952

Net income	12,901	4,202
Net income per share	.48	.18

The pro forma financial information is shown for illustrative purposes only and is not necessarily indicative of the future results of operations of the Company or results of operations of the Company that would have actually occurred had the transaction been in effect for the periods presented.

On September 13, 1996, the Company and Grapevine Systems, Inc. (Grapevine) completed a stock exchange transaction which resulted in Grapevine becoming a wholly owned subsidiary of the Company. The stock exchange was accounted for as a pooling of interests. Accordingly the Company's financial statements have been restated to include the results of Grapevine for all periods presented.

Combined and separate results of the Company and Grapevine during the periods preceding the merger were as follows (in thousands):

	Company	Grapevine	Adjustments	Combined
Year ended September 30, 1996:				
Net revenues	$154,931	5,482	(629)	159,784
Net income	12,506	64	---	12,570
Year ended September 30, 1995:				
Net revenues	114,888	3,637	(52)	118,473
Net income (loss)	3,800	(230)	---	3,570
Year ended September 30, 1994:				
Net revenues	74,063	3,532	(158)	77,437
Net income (loss)	(33,538)	231	---	(33,307)

The combined financial results presented above include adjustments made to eliminate intercompany transactions from the combined results.

In October 1996, the Company completed the acquisition of Open Systems Solutions, Inc. (OSSI). Stockholders of OSSI received 210,000 shares of TSA Class A Common Stock in exchange for 100% of OSSI's Common Stock. The stock exchange was accounted for as a pooling of interests. OSSI's results of operations prior to the acquisition were not material.

4. Receivables

Receivables consist of the following (in thousands):

September 30,	**1996**	1995

Billed	**$32,534**	$30,835
Accrued	**19,284**	11,866
	51,818	42,701
Less allowance for doubtful accounts	**(1,090)**	(912)
	50,728	41,789
Less amount not collectible within one year	**(1,593)**	(1,505)
Current receivables, net	**$49,135**	$40,284

Typically, the Company receives a substantial down payment upon execution of a contract, with the remaining balance due upon specified dates or events as set forth in the contract.

5. Property and Equipment

Property and equipment consists of the following (in thousands):

September 30,	**1996**	1995
Computer equipment	**$16,846**	$10,726
Office furniture and fixtures	**3,765**	3,242
Leasehold improvements	**1,841**	1,588
Vehicles	**1,427**	1,331
	23,879	16,887
Less accumulated depreciation and amortization	**(10,878)**	(7,170)
Property and equipment, net	**$13,001**	$9,717

6. Software

Software consists of the following (in thousands):

September 30,	**1996**	1995
Internally developed software	**$4,759**	$3,176
Purchased software	**12,318**	10,796
	17,077	13,972
Less accumulated amortization	**(11,653)**	(7,231)
Software, net	**$5,424**	$6,741

7. Debt

Long-term debt consists of the following (in thousands):

September 30,	**1996**	1995
Payments due to the sellers of M.R. GmbH (See Note 3), due December 1996 ($747), December 1997 ($745) and December 1998 ($367)	**$1,859**	$---
Other	**719**	480

	2,578	480
Less current portion	**1,147**	480
Long-term debt	**$1,431**	**$---**

The acquisitions of ACI, ACIL and USSI (described in Note 3) were partially funded with $36,000,000 in debt placed through a $38,500,000 Credit Agreement with two financial institutions. The Credit Agreement was comprised of term loans in the amount of $12,500,000 (Tranche A Loan) and $16,000,000 (Tranche B Loan) and a Revolving Credit Facility in the amount of $10,000,000. In connection with the Credit Agreement, the lenders received warrants to purchase shares of the Company's Class B Common Stock (see Note 10). The Credit Agreement was collateralized by substantially all of the Company's assets.

In March 1995, the Company used a portion of the initial public offering proceeds to repay all outstanding indebtedness under the Credit Agreement. Upon repayment of the indebtedness, the Company incurred an extraordinary loss of $2,750,000 for the writeoff of unamortized balances of debt issue costs of $1,100,000 and original issue discount of $1,650,000. The Credit Agreement was cancelled in June 1995 and replaced with a $10 million Revolving Line of Credit, collateralized by accounts receivable, which expires in June 1997.

Maximum borrowings under the Revolving Credit Facility during the year ended September 30, 1995 and the period from inception (November 2, 1993) through September 30, 1994 were $1,250,000 and $7,500,000, respectively. The average outstanding borrowings and the average interest rate during the year ended September 30, 1995 and the period from inception (November 2, 1993) through September 30, 1994 were $316,000 and 10.1% and $4,375,000 and 8.5%, respectively.

Interest expense for the year ended September 30, 1995 and the period from inception (November 2, 1993) through September 30, 1994, includes amortization of original issue discount of $213,000 and $398,000, respectively.

The Revolving Line of Credit requires the maintenance of a minimum working capital level of $6 million. As of September 30, 1996 and 1995, the Company was in compliance with this covenant. There were no borrowings under the Revolving Line of Credit during the years ended September 30, 1996 and 1995.

8. Commitments and Contingencies

Operating Leases

The Company leases office space and equipment under operating leases which run through February 2011. Aggregate minimum lease payments under these agreements for the years ending September 30 are as follows (in thousands):

1997	$5,052
1998	2,927
1999	2,192
2000	1,164
2001	1,088
Thereafter	7,961
Total	**$20,384**

Total rent expense for the years ended September 30, 1996 and 1995 and for the period from inception (November 2, 1993) through September 30, 1994 was $6,313,000, $4,566,000 and $3,038,000, respectively.

Capital Leases

The Company leases certain computer equipment, vehicles and office furniture under long-term capital leases. Capitalized costs and accumulated depreciation (included in property and equipment, net) consist of the following (in thousands):

September 30,	**1996**	1995
Vehicles	**$1,441**	$1,217
Computer equipment	**485**	280
Office furniture and fixtures	**165**	152
	2,091	1,649
Less accumulated depreciation	**(1,334)**	(766)
	$757	$883

A summary of future minimum lease payments under long-term capital leases together with the present value of the net minimum lease payments for the years ending September 30 are as follows (in thousands):

1997	$401
1998	202
1999	110
2000	35
Total minimum lease payments	748
Amount representing interest	(150)

Present value of future minimum lease payments	598
Amount due within one year	(342)
Amount due after one year	$256

9. Redeemable Convertible Preferred Stock

The following table represents Redeemable Convertible Preferred Stock activity (in thousands):

	Senior Series A	Senior Series B	Junior Series A	Junior Series B	Total
Balance, at inception (November 2, 1993)	$---	$---	$---	$---	$---
Shares issued	11,759	6,718	3,500	2,375	24,352
Shares subscribed	---	---	---	2,646	2,646
Accretion	155	88	---	---	243
PIK Dividends	748	427	---	---	1,175
Balance, September 30, 1994	12,662	7,233	3,500	5,021	28,416
Shares issued	---	---	---	143	143
Accretion	84	48	---	---	132
PIK dividends	413	236	---	---	649
Cash payment of PIK dividends	(1,161)	(664)	---	---	(1,825)
Conversion to common stock pursuant to initial public offering	(11,998)	(6,853)	(3,500)	(5,164)	(27,515)
Balance, September 30, 1995 and 1996	**$---**	**$---**	**$---**	**$---**	**$---**

All Redeemable Convertible Preferred Stock converted to 9,079,856 and 3,200,000 shares of Class A and Class B Common Stock, respectively, upon completion of the Company's initial public offering.

In December 1993, the Company sold for cash 1,400,000 shares of Senior Convertible Preferred Stock, Series A, and 800,000 shares of Senior Convertible Preferred Stock, Series B, (cumulatively, the Senior Preferred Stock). Total proceeds, net of issuance costs, from the sale of the Senior Preferred Stock was $18,477,000 ($8.40 per share).

In December 1993, the Company sold for cash 237,500 shares of Junior Convertible Preferred Stock, Series B for $2,375,000 ($10 per share). In January 1994, the Company issued 350,000 shares of Junior Convertible Preferred Stock, Series A valued at $3,500,000 ($10 per share) in connection with the acquisition of USSI as discussed in Note 3. The Junior Convertible Preferred Stock, Series A and Series B are herein referred to as the Junior Preferred Stock.

During 1994, the Board of Directors approved the Employees Stock Purchase Plan for substantially all TSA employees. Under this plan, employees subscribed to 268,163 shares of the Company's Junior Convertible Preferred Stock, Series B, at a price of $10 per share. In October 1994, employees subscribed to an additional 14,301 shares at a price of $10 per share. All subscribed shares were fully paid for and issued in December 1994.

Prior to the Company's initial public offering, the holders of the Senior Preferred Stock were entitled to quarterly cumulative dividends at an annual rate of $.70 per share. All such dividends were payable solely in kind by the issuance of a dividend of additional shares of Senior Convertible Preferred Stock, Series A or Series B (the PIK Dividends) at the rate of 7/100 of a share for each $.70 of accruing dividends. If the Senior Preferred Stock converted prior to January 1, 1997, accruing dividends would have been paid in cash or PIK Dividends. As of September 30, 1994, 74,794 shares of Senior Convertible Preferred Stock, Series A and 42,739 shares of Senior Convertible Preferred Stock, Series B had been accrued as PIK Dividends, respectively.

The holders of the shares of the Senior and Junior Preferred Stock were entitled, at their option, to convert at any time at a rate of one share of Senior and Junior Convertible Preferred Stock, Series A or Series B into two shares of Class A or Class B Common Stock, respectively.

The holders of Senior and Junior Preferred Stock also had the right at their option to redeem shares at any time on or after December 31, 2003, at an amount equal to $10 per share plus an amount equal to all accrued and unpaid dividends thereon, whether or not earned or declared, plus any other dividends unpaid. The excess of the redemption value over the carrying value was being accreted by periodic charges to accumulated deficit over the life of the issue. Holders of the Senior and Junior Preferred Stock, Series A and Class A Common Stock have the right to one vote per share on any matters subject to stockholder vote.

10. Redeemable Convertible Class B Common Stock and Warrants

The following table represents Redeemable Convertible Class B Common Stock and Warrants activity (in thousands):

	Warrants	Class B Common Stock	Total
Balance, at inception (November 2, 1993)	$---	$---	$---

Warrants issued	4,773	---	4,773
Warrants exercised	(1,860)	1,860	---
Accretion	229	230	459
Balance, September 30, 1994	3,142	2,090	5,232
Accretion	122	122	244
Warrants exercised	(3,264)	3,264	---
Termination of redemption rights and conversion to Class A and Class B Common Stock pursuant to initial public offering	---	(5,476)	(5,476)
Balance, September 30, 1995 and 1996	**$---**	**$---**	**$---**

All redemption rights terminated upon completion of the Company's initial public offering. In December 1993, warrants to purchase 1,320,000 shares of Class B Common Stock were issued as part of the Senior Convertible Preferred Stock and Warrant Purchase Agreement (see Note 9). The warrants were exercisable at a price of $.003 per share. The warrants were recorded at their fair value, net of issuance costs, on date of issuance of $1,800,000 ($1.36 per share). As of September 30, 1995, all warrants had been exercised and converted to Class A or Class B Common Stock.

In December 1993, warrants to purchase 1,528,780 shares of Class B Common Stock were issued as part of the credit agreement (see Note 7). The warrants were exercisable at any time at a price of $.003 per share. The warrants were recorded at their fair value on date of issuance of $2,262,000 ($1.48 per share). As of September 30, 1995, all warrants had been exercised and converted to Class A Common Stock.

In December 1993, warrants to purchase 700,000 shares of Class B Common Stock were issued in connection with the sale of Senior Preferred Stock. The warrants were exercisable at a price of $2.50 per share. The warrants were recorded at their fair value on date of issuance of $711,000 ($1.02 per share). As of September 30, 1995, all warrants had been exercised and converted to Class A Common Stock.

Prior to the Company's initial public offering, the Class B Common Stock and any shares issuable as such under the respective warrant agreements described above were redeemable at fair value by the holders upon the earlier of; 1) repayment of 50% of the Tranche B debt, 2) change in control of the Company or 3) December 31, 1998. The difference between the current fair value over the carrying value of the Class B Common

Stock and Warrants was being accreted by periodic charges to accumulated deficit over the life of the respective issues.

11. Stock Option Plans

The Company has a 1994 Stock Option Plan (1994 Plan) whereby 1,910,976 shares of the Company's Class B Common Stock have been reserved for issuance to eligible employees of the Company and its subsidiaries. Shares issuable upon exer-cise of these options will be Class A Common Stock. Options granted are considered incentive stock options. The stock options are granted at a price set by the Board of Directors provided that the minimum price shall be $2.50 per share for 955,488 shares and $5 per share for 955,488 shares. The term of the outstanding options is ten years. The stock options vest ratably over a period of four years.

During 1996, the Company adopted the 1996 Stock Option Plan (1996 Plan) whereby 1,008,000 shares of the Company's Class A Common Stock have been reserved for issuance to eligible employees of the Company and its subsidiaries and non-employee members of the Board of Directors. The stock options are granted at a price not less than fair market value at the time of the grant. The term of the outstanding options is ten years. The options vest annually over a period of four years.

Share activity under the option plans is set forth below:

	1996 Plan	1994 Plan	Total	Price Per Share
Outstanding, at inception (November 2, 1993)	---	---	---	---
Granted	---	941,300	941,300	$2.50
Cancelled	---	(21,600)	(21,600)	$2.50
Outstanding, September 30, 1994	---	919,700	919,700	
Granted	---	1,003,378	1,003,378	$2.50 - 12.50
Cancelled	---	(59,404)	(59,404)	$2.50 - 5.00
Exercised	---	(44,254)	(44,254)	$2.50 - 5.00
Outstanding, September 30, 1995	---	1,819,420	1,819,420	
Granted	236,000	39,000	275,000	$12.00 - 31.00
Cancelled	---	(35,308)	(35,308)	$2.50 - 20.25
Exercised	---	(327,673)	(327,673)	$2.50 - 20.25
Outstanding, September	236,000	1,495,439	1,731,439	

30, 1996				

At September 30, 1996 and 1995, 687,903 shares and 593,036 shares, respectively, were exercisable under the plans.

12. Employee Benefit Plans

Employee Stock Purchase Plan

During 1996, the Company adopted the 1996 Employee Stock Purchase Plan whereby 900,000 shares of the Company's Class A Common Stock have been reserved for sale to eligible employees of the Company and its subsidiaries. Employees may designate up to the lesser of $5,000 or 10% of their annual compensation for the purchase of stock under this plan. The price for shares purchased under the plan is 85% of market value on the last day of the purchase period. Purchases are made at the end of each fiscal quarter. As of September 30, 1996, 16,745 shares have been issued under this plan.

ACI 401(k) Retirement Plan

The 401(k) Retirement Plan is a defined contribution plan covering all domestic employees of ACI. Participants may contribute up to 15% of their annual wages. ACI matches 100% of participant contributions up to a maximum of 2.5% of compensation. ACI's contributions charged to expense during the years ended September 30, 1996 and 1995 and the period from the date of acquisition of ACI through September 30, 1994 were $507,000, $466,000 and $299,000, respectively.

ACI Profit Sharing Plan and Trust

The ACI Profit Sharing Plan and Trust is a non-contributory profit sharing plan covering all employees of ACI provided they are at least 21 years of age and have completed one year of service. The plan provides for ACI to contribute a discretionary amount as determined annually by the Company's President and Chief Financial Officer. ACI's contributions charged to expense during the years ended September 30, 1996 and 1995 and the period from the date of acquisition of ACI through September 30, 1994 were $399,000, $382,000 and $241,000, respectively.

ACIL Pension Plan

ACIL has a defined benefit pension plan covering substantially all of its employees. The benefits are based on years of service and the employees' compensation during employment. Contributions to the plan are determined by an independent actuary on the basis of periodic valuations using the projected unit cost method. Participants contribute 5% of their pensionable salaries and ACIL contributes at the rate of 10% of pensionable salaries. Net periodic pension expense includes the following components (in thousands):

	Year Ended September 30, **1996**	Year Ended September 30, 1995	For the period from inception (November 2, 1993 through September 30, 1994)
Service cost	**$1,018**	$786	$617
Interest cost on projected benefit obligation	**738**	542	384
Return on plan assets:			
Actual	**(1,187)**	(851)	254
Gain (loss) deferred	**382**	233	(689)
Amortization of unrecognized gain	**(13)**	(32)	---
Total periodic pension expense	**$938**	$678	$566

The following table summarizes the funded status of the plan and the related amounts recognized in the Company's consolidated balance sheet (in thousands):

September 30,	**1996**	1995
Actuarial present value of benefit obligations:		
Vested	**$8,932**	$7,680
Non-vested	**524**	444
Accumulated benefit obligation	**9,456**	8,124
Impact of future salary increases	**654**	564
Projected benefit obligation	**10,110**	8,688
Plan assets at fair value, primarily investments in marketable equity securities of United Kingdom companies	**10,762**	8,485
Plan assets greater (less) than projected benefit obligation	**652**	(203)
Unrecognized gain	**(2,113)**	(1,156)
Accrued pension cost	**$(1,461)**	$(1,359)

The accrued pension cost at September 30, 1996 and 1995, includes an unfunded accrued pension cost of approximately $1,200,000 recorded in connection with the acquisition of ACIL.

The most significant actuarial assumptions used in 1996 and 1995 in determining the pension expense and funded status of the plan are as follows:

-

Discount rate for valuing liabilities	8.0%
Expected long-term rate of return on assets	9.0%
Rate of increase in future compensation levels	6.0%

USSI Profit Sharing Plan and Trust

The USSI Profit Sharing Plan and Trust has both a profit sharing component and a 401(k) component. USSI contributions are discretionary. USSI's contributions charged to expense during the years ended September 30, 1996 and 1995 were $90,000 and $82,000, respectively. No contributions were made to this plan for the period from the date of acquisition of USSI through September 30, 1994.

Grapevine 401(k) Profit Sharing Plan

The Grapevine 401(k) Profit Sharing Plan is a defined contribution plan covering all employees of Grapevine. Grapevine contributions are discretionary. Employees may contribute up to 10% of their compensation. No contributions were made by Grapevine to this plan during the years ended September 30, 1996, 1995 and 1994.

13. Segment Information

The Company operates primarily in one industry segment, which includes the development, marketing and support of on-line computer software products and services for automated electronic payment systems.

The Company operates in three geographic regions: 1) North and South America, 2) Europe, Middle East and Africa and 3) Asia Pacific. The following table sets forth information about the Company's operations in these different geographic regions (in thousands):

	Year Ended September 30, **1996**	Year Ended September 30, 1995	For the period from inception (November 2, 1993) through

			September 30, 1994
Revenues:			
Americas	**$91,061**	**$75,624**	**$47,727**
Europe, Middle East and Africa	**47,267**	**31,264**	**21,707**
Asia/Pacific	**21,456**	**11,585**	**8,003**
	$159,784	$118,473	$77,437
Operating Income:			
Americas	**$27,981**	**$21,009**	**$4,037**
Europe, Middle East and Africa	**8,302**	**4,910**	**1,374**
Asia/Pacific	**6,740**	**1,235**	**457**
	43,023	27,154	5,868
Research and Development and Corporate General and Administrative Expenses	**(22,345)**	**(18,087)**	**(34,541)**
Operating Income (Loss)	**$20,678**	**$9,067**	**$(28,673)**
Identifiable Assets:			
Americas	**$77,496**	**$69,692**	**$40,406**
Europe, Middle East and Africa	**33,706**	**25,936**	**17,514**
Asia/Pacific	**11,957**	**6,277**	**2,515**
	$123,159	$101,905	$60,435

14. Income Taxes

The Company accounts for income taxes in accordance with FAS 109, "Accounting for Income Taxes". FAS 109 is an asset and liability approach which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events which have been recognized in the Company's financial statements or tax returns. In estimating future tax consequences, FAS 109 generally considers all expected future events other than enactments or changes in the tax law or rates. Although the Company incurred losses for the period from inception (November 2, 1993) through September 30, 1994, there was a provision for income taxes consisting of taxes related to foreign jurisdictions. The provision for income taxes consists of the following (in thousands):

	For the Year Ended September 30,	For the period from Inception (November 2, 1993) through September 30, 1994

		1996			1995				

	Current	**Deferred**	**Total**	Current	Deferred	Total	Current	Deferred	Total
Federal	**$6,074**	**$(2,066)**	**$4,008**	$1,086	$(1,327)	$(241)	$---	$165	$165
State	**1,933**	**(71)**	**1,862**	753	---	753	---	---	---
Foreign	**3,291**	**---**	**3,291**	1,793	(219)	1,574	1,999	---	1,999
Total	**$11,298**	**$(2,137)**	**$9,161**	$3,632	$(1,546)	$2,086	$1,999	$165	$2,164

The difference between the income tax provision computed at the statutory federal income tax rate and the financial statement provision for income taxes is summarized as follows:

	For the Year Ended September 30, 1996	For the Year Ended September 30, 1995	For the period from Inception (November 2, 1993) through September 30, 1994
Tax expense (benefit) at federal rate of 34%	$7,389	$1,923	$(10,589)
Losses with no current tax benefit	239	872	12,238
Effective state income tax	1,140	497	(1,516)
Foreign taxes	---	---	1,999
Recognition of deferred income tax assets previously reserved against	---	(1,844)	---
Amortization of intangibles	578	731	---
Other	(185)	(93)	32
	$9,161	**$2,086**	**$2,164**

The deferred tax assets and liabilities result from differences in the timing of the recognition of certain income and expense items for tax and financial accounting purposes. The sources of these differences are as follows (in thousands):

	September 30, **1996**	September 30, 1995
Deferred assets:		
Depreciation	**$ 431**	$ 484
Amortization	**5,850**	5,943
Foreign taxes	**3,754**	2,433
Acquired net operating loss carryforward of USSI	**1,200**	1,200
Net operating loss carryforward	**594**	1,430

Other	**539**	574
	12,368	12,064
Deferred tax asset valuation allowance	**(8,021)**	(9,332)
Deferred liabilities:		
Acquired software	**(171)**	(629)
Other	**(493)**	(557)
	(664)	(1,186)
	$3,683	$1,546

For income tax purposes, the Company had foreign tax credit carryforwards of approximately $2,105,000 at September 30, 1996, which expire in 1999. At September 30, 1996, management evaluated its 1996 and 1995 operating results as well as its projections for 1997 and 1998 and concluded that it was more likely than not that certain of the deferred tax assets would be realized. Accordingly, the Company has recognized a deferred tax asset of $4.4 million as of September 30, 1996.

15. Quarterly Financial Data (in thousands, except per share data, and unaudited)

Three Months Ended :	December 31	March 31	June 30	September 30
1996				
Total revenues	**$35,483**	**$37,662**	**$41,081**	**$45,558**
Operating income	**4,233**	**4,693**	**5,320**	**6,432**
Net income	**2,929**	**3,031**	**3,219**	**3,391**
Net income per share	**.11**	**.11**	**.12**	**.13**
1995				
Total revenues	26,479	27,651	30,143	34,200
Operating income (loss)	(116)	2,085	3,288	3,810
Net income (loss) before extraordinary loss	(1,540)	2,263	2,858	2,739
Net income (loss) per share before extraordinary loss	(.07)	.10	.12	.11
Net income (loss)	(1,540)	(487)	2,858	2,739
Net income (loss) per share	(.07)	(.02)	.12	.11

Corporate and Shareholder Information

Transaction Systems Architects, Inc.
330 South 108th Avenue
Omaha, Nebraska 68154

Investor Information

A copy of the Company's Annual Report on Form 10-K for the year ended September 30, 1996, as filed with the Securities and Exchange Commission, will be sent to stockholders free of charge upon written request to:

William J. Hoelting
Director of Investor Relations
Transaction Systems Architects, Inc.
330 South 108th Avenue
Omaha, Nebraska 68154

In Europe Contact:

Michael E. Carter
Director of Investor Relations -- Europe
Transaction Systems Architects, Inc.
59 Clarendon Road
Watford, Herts WD1 1LA
United Kingdom

Home Page: www.tsainc.com

Stock Information

Transaction Systems Architects' common stock is traded on the Nasdaq Stock Market under symbol TSAI. The high and low sale prices (adjusted for two-for-one stock split occurring July 1, 1996) for the Company's common stock during the fiscal quarters since its initial public offering on February 23, 1995 are as follows:

1996	High	Low
First Quarter	**16 7/8**	**12 1/2**
Second Quarter	**20 5/8**	**16 3/8**
Third Quarter	**34**	**19 7/8**
Fourth Quarter	**45 3/4**	**24 3/4**

1995

Transfer Agent

Communications regarding change of address, transfer of stock ownership or lost stock certificates should be directed to:

Norwest Bank Minnesota, N.A.
161 North Concord Exchange
Post Office Box 738
South St. Paul, Minnesota 55705

Annual Meeting

The Annual Meeting of Shareholders will be held at 10:00 a.m. on Tuesday, February 25, 1997 at the Company's Corporate Meeting center, 230 South 108th Avenue, in Omaha, Nebraska.

Independent Public Accountants

Arthur Andersen LLP 1700 Farnam Street
Omaha, Nebraska 68102

Second Quarter	11 3/4	8 7/8
Third Quarter	13 3/8	9 3/8
Fourth Quarter	14	11 3/4

DIRECTORS AND OFFICERS

Board of Directors

William E. Fisher
Chairman, President and Chief Executive Officer --
Transaction Systems Architects, Inc., and
Chairman and Chief Executive Officer --
Applied Communications, Inc.

David C. Russell
Senior Vice President --
Transaction Systems Architects, Inc., and
President and Chief Operating Officer --
Applied Communications, Inc.

Frederick L. Bryant
General Partner
ABS Partners, L.P.

Promod Haque
Vice President and General Partner
Norwest Venture Capital, Inc.

Charles E.Noell, III
Managing Partner
JMI Equity Fund, L.P.

Jim D. Kever
President and Co-Chief Executive Officer
ENVOY Corporation

Larry G. Fendley
Executive Vice President
CSG Systems, Inc.

Executive Officers

William E. Fisher
Chairman, President and Chief Executive Officer --
Transaction Systems Architects, Inc., and
Chairman and Chief Executive Officer --
Applied Communications, Inc.

David C. Russell
Senior Vice President --
Transaction Systems Architects, Inc., and
President and Chief Operating Officer --
Applied Communications, Inc.

David P. Stokes
General Counsel and Secretary

Gregory J. Duman
Chief Financial Officer and Treasurer

Jon L. Howe
Chief Technical Officer

Edward H. Mangold
Senior Vice President - Americas Region

Thomas H. Boje
Vice President - Europe, Middle East and Africa Region

Fred L. Grabher
Vice President - Asia/Pacific Region

Mark H. Vipond
Vice President - Transaction Systems Architects, Inc., and
President - USSI, Inc.

Stephen J. Royer
Vice President - Transaction Systems Architects. Inc.. and

President - Grapevine Systems, Inc.

Richard N. Launder
Senior Vice President - Corporate Development