TRANSACTION SYSTEMS ARCHITECTS INC

What do you call 16 billion transactions a year?

A start.

FINANCIAL HIGHLIGHTS [1]

In Thousands, Except Per Share Amounts	1998	1997	1996
Year Ended September 30			
Revenues	$289,761	$238,533	$183,236
Operating Income	50,988	38,619	23,268
Net Income [2]	31,126	24,405	14,286
Basic Net Income Per Share [2]	1.05	0.84	0.50
Diluted Net Income Per Share [2]	1.02	0.81	0.48
Earnings Before Interest, Taxes, Depreciation and Amortization	62,150	48,389	33,204
As of September 30			
Working Capital	$ 85,293	$ 62,914	$ 43,268
Total Assets	221,402	176,891	134,988
Long-term Obligations	1,915	2,379	1,687
Stockholders' Equity	143,546	109,346	80,298
Backlog	185,200	141,400	105,000

SUPPLEMENTAL INFORMATION [1,3]

In Thousands, Except Per Share Amounts	1998	1997	1996	% Change 1997 to 1998
Year Ended September 30				
Revenues	$289,761	$238,533	$183,236	21
Pro Forma Operating Income	50,988	39,470	26,611	29
Pro Forma Net Income	33,466	25,176	17,262	33
Pro Forma Basic Net Income Per Share	1.13	0.87	0.60	30
Pro Forma Diluted Net Income Per Share	1.10	0.84	0.58	31

[1] Adjusted for the acquisition of IntraNet, Inc. (IntraNet), accounted for as a pooling of interests.

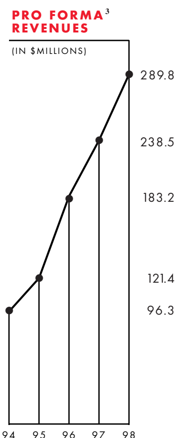
[2] Net income and basic and diluted net income per share reflects a *pro forma* tax provision for Regency Voice Systems, Inc. (RVS) and IntraNet for combined federal and state income taxes to report income taxes on the basis of which income taxes will be reported in future periods. Prior to the acquisitions, RVS and IntraNet were taxed primarily as a partnership and as a S corporation and, accordingly, taxable income was included in the personal tax of their owners who were responsible for the payment of tax thereof.

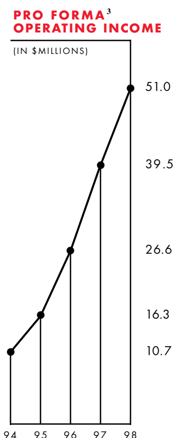
[3] *Pro forma* operating income, *pro forma* net income and *pro forma* basic and diluted net income per share exclude certain one-time or acquisition related expenses associated with the acquisition of ACI and ACIL in fiscal 1994. The total of these expenses were $43.1 million, $10.8 million, $3.3 million and $851,000 in 1994, 1995, 1996 and 1997, respectively. In addition, the 1998 *pro forma* results exclude $2.5 million of transaction related expenses associated with acquisitions accounted for as poolings of interest. All *pro forma* results of operations were computed using an effective tax rate of 38 percent.

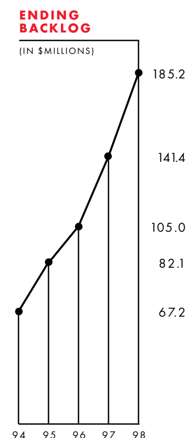
FELLOW SHAREHOLDERS

I can hear the reaction—

"How can 16 billion of anything represent a start? After all, tallying just one billion of something is a huge accomplishment." OK, I admit that's a valid point, but when your business is selling software that processes electronic transactions, you view 16 billion a little differently. Last year, TSA customers processed 16 billion transactions—the largest number yet, but just two percent of the estimated number



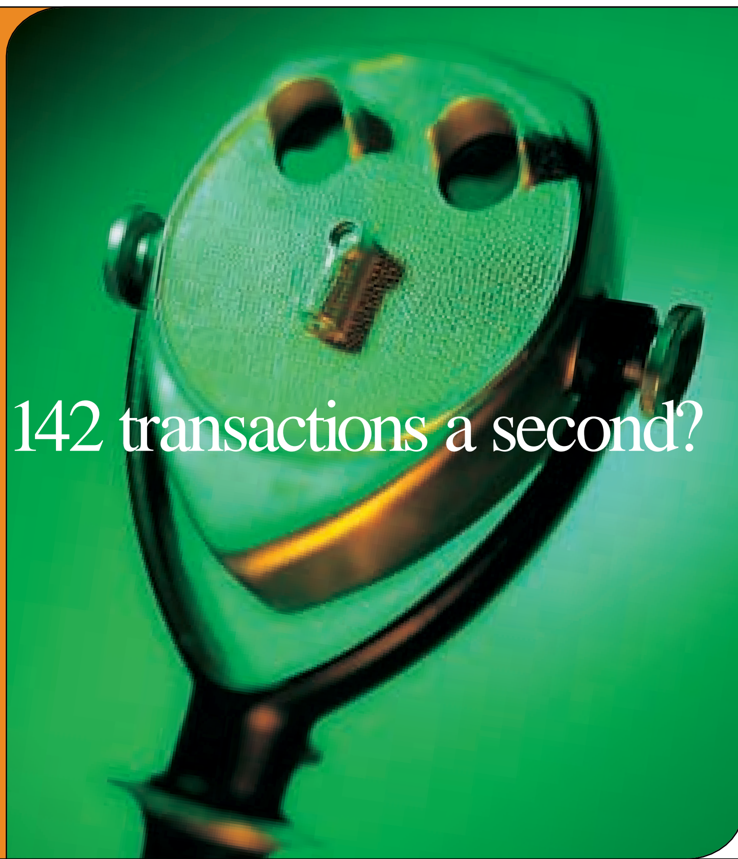




of transactions generated around the world. That's why at TSA, we think of 16 billion transactions as "a start." ▪ Granted, it's a good start. We've been in this business for more than 20 years and have a portfolio of applications that process smart card, debit card, credit card and loyalty card transactions from ATMs (Automated Teller Machines), POS (Point-of-Sale) devices, PCs (Personal Computers), the Internet, and a host of others. Our software is used in 70 countries by banks, retailers, stock exchanges and other enterprises needing high-volume, reliable processing seven days a week, 24 hours a day. ▪ TSA software is designed to help our more than 2,000 customers take advantage of the ongoing shift in

payments from paper to pulse. This movement, fueled by the younger generation's acceptance of electronic payments (for those of you scoring at home, my mom still won't use an ATM, while my sons understand all too well how they work), continues to drive the growth in transaction volumes and the need for around-the-clock services—making our products even more attractive. ■ During the past year we built on our solid history of strong financials by reaching a number of milestones. TSA achieved records in key financial metrics including record revenues of $289.8 million, record operating income of $51.0 million, and record backlog of $185.2 million. ■ Our geographic diversity enabled TSA to ride out the recent difficult economic situations in various areas of the world. In fiscal year 1998, 54 percent of our revenues came from outside the United States. Our Americas revenues grew 20 percent, while our revenues in the Europe/Middle East/Africa region and the Asia/Pacific region were up 35 and 1 percent, respectively. ■ In addition to our financial achievements, we completed several acquisitions to complement our product and service offerings. TSA acquired IntraNet to add to our corporate banking product expertise; SCIL and MINT to give us additional strength in the smart card product and integration arena; PRI to complement our information systems consulting offerings; and Edgeware to provide us with additional products for retailers. ■ At TSA we believe our business of supplying software for electronic payments is just starting—that it is a business with significant growth opportunities all around the world. We also believe we are strategically positioned to take advantage of those opportunities. ■ Thank you for your continued support and interest in TSA. WILLIAM E. FISHER, CHAIRMAN, PRESIDENT AND CEO, TRANSACTION SYSTEMS ARCHITECTS INC

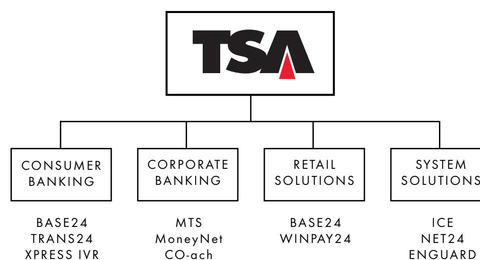
How do competitors view 142 transactions a second?



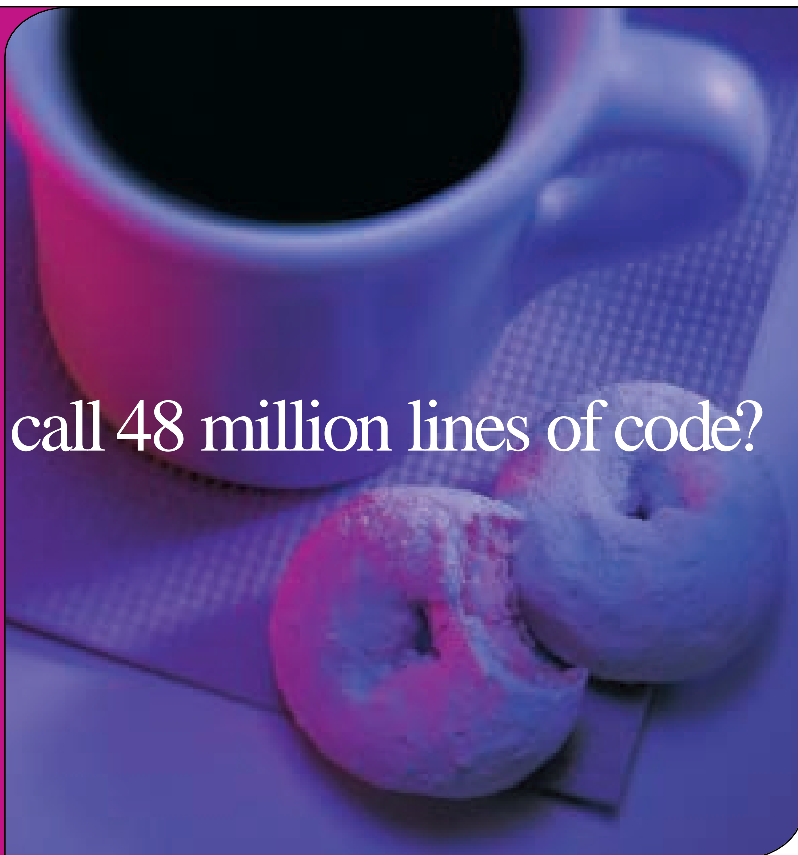
From a distance.

If you've ever used an ATM or credit card anywhere in the world, chances are TSA software helped complete your transaction—silently, seamlessly and instantaneously. That's what distances our applications from others. We've set the industry standard for software that quickly and efficiently processes large numbers of transactions around the clock. ▪ Our products are organized in four lines of business groups—Consumer Banking, Corporate Banking, Retail Solutions and System Solutions—to better respond to our customers' needs. **CONSUMER BANKING** Products in the TSA Consumer Banking group represent our most mature and well-established applications. Financial institutions use these products to route and process transactions for ATM networks; process transactions from retailers using traditional POS devices and the Internet; handle billpay and other telephone and PC banking requests; and control fraud. **CORPORATE BANKING** Our Corporate Banking products enable financial institutions to automatically deposit paychecks and complete other automated clearing house (ACH) transactions; and automate the process by which institutions transfer high-value (wire) payments. **RETAIL SOLUTIONS** Some of the world's largest retailers use products in the TSA Retail Solutions portfolio to route transactions from their ATM and POS networks, process Electronic Benefit Transfer (EBT) transactions, authorize checks, establish frequent shopper programs and control fraud. **SYSTEM SOLUTIONS** TSA System Solutions products are used by a cross-section of customers in many industries to monitor mission critical systems, establish communications links between high-volume systems, and handle intersystem messaging. ▪ TSA software operates on a variety of hardware platforms to meet specific processing needs.

TSA LINES OF BUSINESS



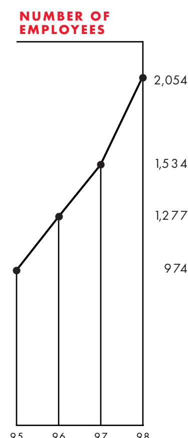
What do you call 48 million lines of code?

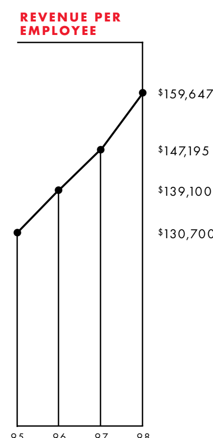


Each line of code contained in TSA products is backed by the most precious resource on the planet—people committed to excellence. We recruit, hire and retain the most talented people available, then turn them loose to do what they do best—design, deliver and support proven technology. Their hard work over the past 20 years has enabled us to build a product set comprised of more than 48 million lines of code—an obstacle to competitors trying to enter our market space. ▪ TSA employees also help us maintain an edge over our competition with a "work hard, play hard" attitude that permeates everything we do. Whether working around the clock to meet a customer need or gathering stones from travels around the world for a special corporate rock collection, TSA employees approach every task with the same high level of

Another day at the office.

energy and professionalism. ▪ All totaled, more than 2,000 people work for TSA in our headquarters on the "Silicon Prairie" of Omaha, Nebraska, and in offices located in Watford, England; Singapore and more than a dozen other cities around the world. No matter the location, TSA fosters a corporate culture that values growth, creativity, a solid work ethic and customer-centric thinking. ▪ As you might expect from an application software company, TSA employees are young, energetic and well-educated—just the kind of overachievers needed to meet the needs of customers that have grown accustomed to the around-the-clock performance of our products. The average TSA employee is 37.5 years old, 55.7 percent of TSA employees have achieved a bachelor's degree or above, and the average tenure is 3.8 years. Company tenure is even greater among TSA executives. Our executive officers average 10 years of service with the company.

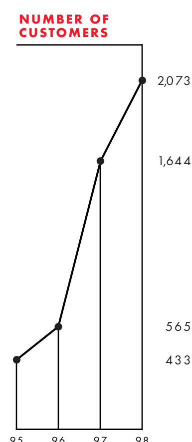


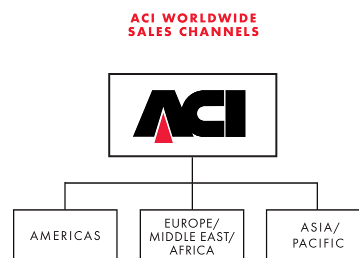


What do you call over 2,000 customers in 70 countries?

Through ACI Worldwide, our distribution and support operation, TSA products and services reach more than 2,000 customers around the globe. They come from all segments of the financial, retail and networking industries and include more than 100 of the world's top 500 banks and 19 of the top 100 retailers in the US. ▪ Opportunities exist to add to our customer list—especially among the world's largest banks. The majority of them continue to use in-house software developed in the 1970s or early 1980s. As transaction volumes increase and new types of services emerge, modifications to these in-house systems may overtax precious bank resources. TSA products offer banks the ability to replace their homegrown systems with a proven, feature-rich infrastructure that supports around-the-clock financial services and processes ever-growing transaction volumes. ▪ Retailers are just beginning to enjoy the benefits our products provide. TSA solutions enable them to efficiently manage their POS systems in-house instead of using outside providers. We also offer products that help them control fraud, and offer customer loyalty programs. ▪ Opportunities for our products expand beyond the world's largest institutions. Since TSA products operate on a variety of hardware platforms, we can also meet the processing needs of medium and smaller companies. ▪ To reach customers, ACI Worldwide maintains three distribution and support channels, an Americas channel headquartered in Omaha; a Europe/Middle East/Africa channel headquartered in Watford, England; and an Asia/Pacific channel headquartered in Singapore. Each maintains offices in principal cities throughout its region and supports TSA products with a full complement of services including installation, a 24-hour hotline, custom software development and on-site technical services.

A toehold.

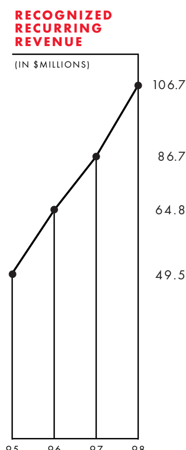


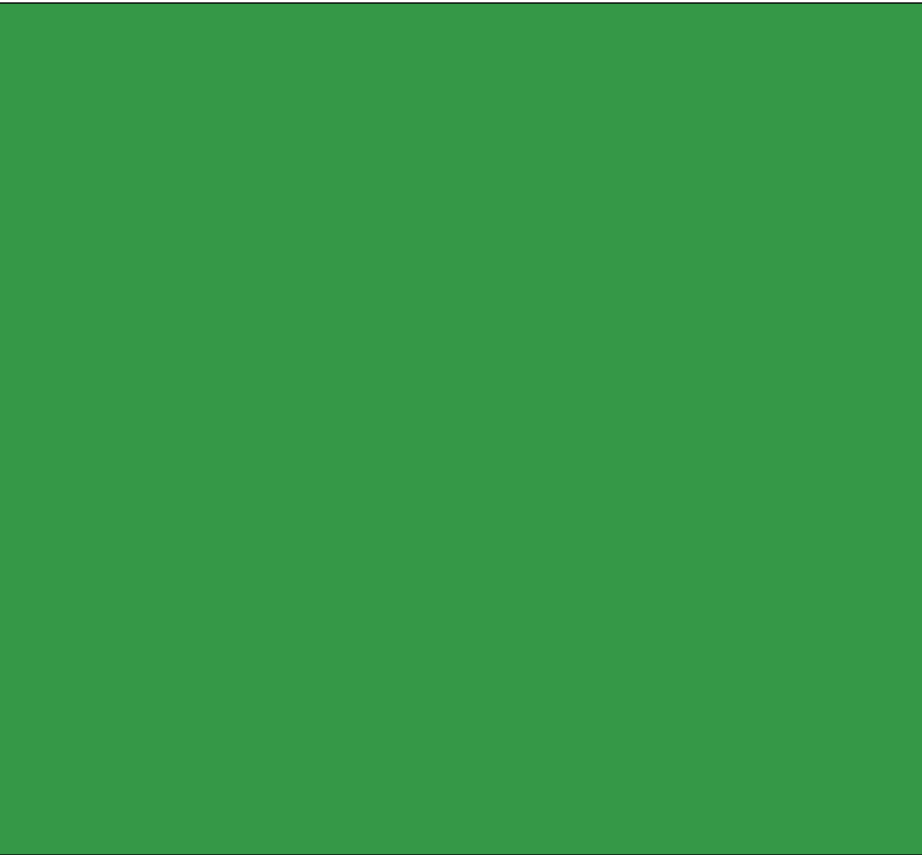


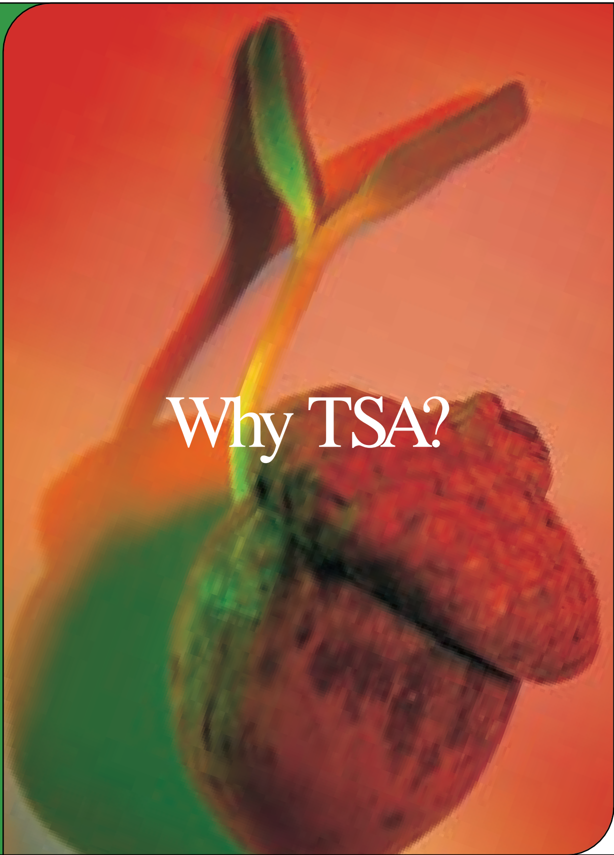
What do you call $106 million in recurring revenue?

Storing acorns.

From our home on the "Silicon Prairie" we take a conservative, Midwestern US approach to our financials, which means we like to keep things simple and consistent. We base TSA's financial model on volume-sensitive pricing, monthly license fees and maintaining a healthy backlog of contracted, but not yet recognized revenue—our way of storing acorns. This allows us to grow with the electronic payments marketplace. ▪ During our 1998 fiscal year, we recognized over $106 million in recurring revenue comprised of $43.7 million in monthly license fees, $57.1 million in maintenance fees and $5.9 million in transaction processing fees. This growth helped us achieve operating income of $51.0 million, up from $38.6 million in 1997. Our operating margin in the fourth quarter of the fiscal year reached 17.7 percent as compared with 17.0 percent for the fourth quarter of the previous year. ▪ Our financial model, based on volume-sensitive pricing and monthly license fees, helped us maintain a rolling 12-month backlog that grew 31 percent in fiscal 1998 reaching $185.2 million as of our September 30 fiscal year end. The recurring revenue portion of our backlog which will be recognized in fiscal year 1999 reached $119.4 million. ▪ Overall, our revenues reached a record $289.8 million in fiscal 1998, an increase of 21 percent over fiscal year 1997. Cash flow from operating activities for the year totaled $35.4 million, up from $34.0 million. The combined cash and cash-equivalent balance at the end of September 1998 was $62.6 million. ▪ The combination of volume-sensitive pricing and recurring revenue—our method of storing acorns—differentiates us from virtually every other company in our business niche.



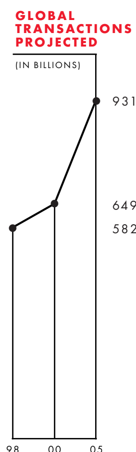




Why TSA?

At TSA we're a business just taking root—a business tied to the world's growing demand for anytime, anywhere access to money and information. ■ Customers using TSA products processed 16 billion electronic transactions in the past year—a mere two percent of the world's estimated transactions. In coming years electronic transactions are projected to grow at a faster pace than those made by cash and check, increasing the need for the proven, reliable products in the TSA portfolio. ■ The TSA product set extends from ATM processing solutions to products that address emerging technologies like the Internet and smart cards, while operating on a variety of hardware platforms and offering Year 2000 compatibility. ■ The employees of TSA stand behind their products with a simple philosophy—meet customers' needs on time, on budget, with no surprises. While simple, it provides a guiding set of principles that continue to earn TSA a high customer-retention rate, and additional business from existing customers. ■ ACI Worldwide, TSA's distribution and support division, delivers product and services to customers in 70 countries. Opportunities await as the acceptance of technology fuels the spread of electronic payments around the globe. ■ TSA "stores acorns" by basing our financial model on volume-sensitive pricing, monthly license fees and maintaining a healthy backlog of contracted, but not yet recognized revenue. ■ The result is an organization that's just getting started—an organization designed to take long-term advantage of the shift to electronic payments and tap the potential in a vital and growing industry.

Because we're just getting started.



Source: Corporate Information Center

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OVERVIEW

The Company was formed on November 2, 1993, for the purpose of acquiring all of the outstanding capital stock of ACI and 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, Inc., ("USSI"). The acquisitions of ACI, ACIL and USSI are here after referred to as the "Acquisitions." As a result of the Acquisitions, the Company incurred certain one-time or acquisition related expenses in fiscal 1997 and 1996. These acquisition-related charges included, among others, purchased software and goodwill amortization. These expenses are hereafter referred to as the "Acquisition Charges." The Company provides electronic payments software and related services. During fiscal 1998, 1997 and 1996, 54%, 53% and 48%, respectively, of total revenues resulted from international operations. The Company derived approximately 68%, 68% and 65%, 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 products over the next several years, the Company has acquired and developed and is currently developing other software products and related services. These products are in the areas of network connectivity, middleware, internet and remote banking, wire transfer, ACH and IVR.

The following table summarizes revenues by geographic region:

(in thousands)	Twelve Months Ended September 30, 1998	1997	1996
Americas	$ 174,069	$145,825	$114,513
EMEA	87,492	64,792	47,267
Asia/Pacific	28,200	27,916	21,456
Total revenues	$289,761	$238,533	$183,236

See Note 11 to the Company's Consolidated Financial Statements for additional information relating to geographic regions.

Acquisitions. The Company has completed several acquisitions during fiscal 1998, 1997 and 1996. The Company's acquisition strategy is focused primarily on two areas: (i) additional products to complement and enhance the Company's strategy of being the leading provider of electronic payments software for banks, retailers and other enterprises needing high-volume, reliable processing engines and (ii) geographic expansion into markets which have proven or have a high level of opportunity to embrace electronic payments. Significant acquisitions in fiscal 1998, 1997 and 1996 include the following:

Acquiree	Date Acquired
M.R. GmbH	October 1995
TXN Solution Integrators	June 1996
Grapevine Systems, Inc.	September 1996
Open Systems Solutions, Inc.	October 1996
Regency Voice Systems, Inc.	May 1997
IntraNet, Inc.	August 1998
Professional Resources, Inc.	August 1998
Smart Card Integrators Ltd	August 1998

All of the acquisitions on the previous page were acquired using the pooling of interests method of accounting except for M.R. GmbH and TXN Solution Integrators which were accounted for under the purchase method of accounting. The Company's financial statements have been restated for all periods presented to include the results of the material entities acquired using the pooling of interests method of accounting.

Product Pricing. The Company's primary pricing method is transaction sensitive whereby products are priced based upon the number of transactions processed by the customer. Under this method, customers pay an Initial License Fee (ILF) and a Monthly License Fee (MLF) which allows the customer to process a contractually predetermined maximum volume of transactions per month. Once transaction volume exceeds this maximum volume level, the customer is required to pay a Capacity License Fee (CLF) and a Capacity Monthly License Fee (CMLF). There is a separate CLF and CMLF for each incremental volume level.

In addition to the transaction-sensitive method, the Company also offers a hardware specific pricing method whereby the product is priced on a per-copy basis and tiered to recognize different performance levels of the processing hardware. Under this method, customers pay an ILF and MLF for each copy of the software they have licensed.

Substantially all ILF (including CLF) revenue is recognized when the software is delivered and MLF (including CMLF) revenue is recognized on a monthly basis. MLF revenue amounted to $43.7 million, $32.4 million and $22.0 million, in fiscal 1998, 1997 and 1996, respectively. ILF revenue, including software modification fees, amounted to $118.4 million, $95.9 million and $67.1 million, in fiscal 1998, 1997 and 1996, respectively.

Hardware Revenues. The Company had a software house agreement with Compaq whereby Compaq paid commissions to the Company when the Company demonstrated that a customer's purchase of its software resulted in that customer's purchase of hardware from Compaq. The commissions were determined as a percentage of Compaq's related hardware revenue. Commissions from Compaq amounted to $3.4 million, and $4.4 million in fiscal 1997 and 1996, respectively. This agreement expired on December 31, 1997. On January 1, 1998, the Company entered into a market development funding (MDF) agreement with Compaq whereby Compaq provides the Company with funds to be used for marketing efforts to promote the Company's BASE24 and Compaq's NonStop Himalaya product lines. The MDF agreement replaced the previous software house fee agreement. Revenue from the software house and MDF agreement in fiscal year 1998 amounted to $4.3 million.

RESULTS OF OPERATIONS

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

Year Ended September 30, *(dollars in thousands)*	1998 Amount	1998 % of Revenue	1997 Amount	1997 % of Revenue	1996 Amount	1996 % of Revenue
Revenues:						
Software license fees	$162,131	56.0%	$128,330	53.8%	$ 89,075	48.6%
Maintenance fees	57,077	19.7	48,714	20.4	41,500	22.6
Services	65,944	22.8	55,426	23.2	46,922	25.6
Hardware, net	4,609	1.6	6,063	2.5	5,739	3.1
Total revenues	289,761	100.0	238,533	100.0	183,236	100.0
Expenses:						
Cost of software license fees:						
Software costs	34,346	11.9	27,876	11.7	22,494	12.3
Amortization of purchased software	–	0.0	801	0.3	3,143	1.7
Cost of maintenance and services	65,607	22.6	56,404	23.6	46,179	25.2
Research and development	25,365	8.8	19,508	8.2	15,883	8.7
Selling and marketing	62,013	21.4	50,168	21.0	36,749	20.1
General and administrative:						
General and administrative costs	50,007	17.3	44,149	18.5	34,864	19.0
Amortization of goodwill and purchased intangibles	1,435	0.5	1,008	0.4	656	0.4
Total expenses	238,773	82.4	199,914	83.8	159,968	87.3
Operating income	50,988	17.6	38,619	16.2	23,268	12.7
Other income (expense):						
Interest income	3,204	1.1	2,291	1.0	2,024	1.1
Interest expense	(242)	(0.1)	(178)	(0.1)	(233)	(0.1)
Transaction related expenses	(2,512)	(0.9)	–	0.0	–	0.0
Other	(203)	(0.1)	(652)	(0.3)	(561)	(0.3)
Total other	247	0.1	1,461	0.6	1,230	0.7
Income before income taxes	51,235	17.7	40,080	16.8	24,498	13.4
Provision for income taxes	(19,476)	(6.7)	(14,325)	(6.0)	(9,296)	(5.1)
Net income	$ 31,759	11.0%	$ 25,755	10.8%	$ 15,202	8.3%
Unaudited pro forma net income [1]	$ 31,126	10.7%	$ 24,405	10.2%	$ 14,286	7.8%

[1] Pro forma net income reflects pro forma tax provisions for RVS and IntraNet for combined federal and state income taxes to report income taxes on the basis of which income taxes will be reported in future periods. Prior to the stock exchange transactions, RVS and IntraNet were taxed primarily as a partnership and as a S corporation and, accordingly, taxable income was included in the personal tax of their owners who were responsible for the payment of tax thereof.

Revenues. Total revenues for fiscal 1998 increased 21.5% or $51.2 million over fiscal 1997. Of this increase, $33.8 million of the growth resulted from a 26.3% increase in software license fee revenue, $10.5 million from a 19.0% increase in services revenue and $8.3 million from a 17.2% increase in maintenance fee revenue.

Total revenues for fiscal 1997 increased 30.2% or $55.3 million over fiscal 1996. Of this increase, $39.3 million of the growth resulted from a 44.1% increase in software license fee revenue, $8.5 million from a 18.1% increase in services revenue and $7.2 million from a 17.4% from increase in maintenance fee revenue.

The growth in software license fee revenue in both fiscal 1998 and 1997 is primarily the result of increased demand, from both existing and new customers, 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 worldwide growth of electronic payment transaction volume and the growing complexity of electronic payment systems. MLF revenue was $43.7 million, $32.4 million and $22.0 million in fiscal 1998, 1997 and 1996, respectively.

The growth in service revenue in both fiscal 1998 and 1997 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 1998 and 1997 is a result of the continued growth of the installed base of the Company's software products.

Expenses. Total operating expenses for fiscal 1998 increased 19.4% or $38.9 million over fiscal 1997. Total operating expenses for fiscal 1997 increased 25.0% or $39.9 million over fiscal 1996. The primary reason for the overall increase in operating expenses during fiscal 1998 and 1997 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 2,054, 1,684 and 1,230 at September 30, 1998, 1997 and 1996, respectively.

The Company's operating margin (excluding the Acquisition charges of $0.9 million and $3.3 million for fiscal 1997 and 1996, respectively) was 17.6%, 16.5% and 14.5% in fiscal 1998, 1997 and 1996, respectively. These improvements are primarily due to increased demand for the Company's products and the impact of the growth in the Company's MLF revenues.

The Company's gross margin (total revenues minus cost of software and cost of maintenance and services) was 65.5%, 64.7% and 62.5% in fiscal 1998, 1997 and 1996, respectively. The increase in gross margin is primarily due to the impact of additional MLF revenue.

Research and development (R&D) costs as a percentage of total revenues were 8.8%, 8.2% and 8.7% in fiscal 1998, 1997 and 1996, respectively. The majority of R&D costs have been charged to expense as incurred with the capitalization of software costs amounting to approximately $1.0 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 21.4%, 21.0% and 20.1% in fiscal 1998, 1997 and 1996, respectively. The slight increase in fiscal 1998 is the result of higher levels of new license fee orders received in fiscal 1998.

General and administrative (G&A) costs as a percentage of total revenues were 17.3%, 18.5% and 19.0% in fiscal 1998, 1997 and 1996. The decrease is due primarily to increased leverage from the larger revenue base in relation to the level of G&A expenses being incurred.

EBITDA. The Company's earnings before interest, income taxes, depreciation and amortization (EBITDA) was $62.1 million, $48.4 million and $33.2 million for fiscal 1998, 1997 and 1996, 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 increase in cash and cash equivalents.

Transaction Related Expenses. Transaction related expenses include legal, accounting, investment banking fees and other non-recurring expenses associated with the acquisitions accounted for as poolings of interest. During 1998, the Company incurred $2.5 million of these expenses to complete the acquisition of IntraNet, SCIL and PRI.

Income Taxes. The Company had a pro forma effective tax rate of 39.3% for fiscal 1998 as compared to 39.1% for fiscal 1997.

As of September 30, 1998, the Company has deferred tax assets of approximately $16.6 million and deferred tax liabilities of $0.3 million. Each year, the Company evaluates its historical operating results as well as its projections to determine the realizability of the deferred tax assets. This analysis indicated that $4.9 million of the deferred tax assets were more likely than not to be realized. Accordingly, the Company has recorded a valuation allowance of $11.7 million as of September 30, 1998.

The Company intends to analyze the realizability of the net deferred-tax assets at each future reporting period. Such analysis may indicate that the realization of various deferred tax benefits is more likely than not and, therefore, the valuation reserve may be reduced.

BACKLOG

As of September 30, 1998 and 1997, the Company had non-recurring revenue backlog of $30.2 million and $27.7 million in software license fees and $35.6 million and $19.2 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, 1998 and 1997, the Company had recurring revenue backlog of $119.4 million and $94.5 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.

Year 2000 problems may arise in computer equipment and software, as well as embedded electronic systems, because of the way these systems are programmed to interpret certain dates that will occur around the change in century. In the computer industry this is primarily the result of computer programs being designed and developed using or reserving only two digits in date fields (rather than four digits) to identify the century, without considering the ability of the program to properly distinguish the upcoming century change in the Year 2000. In addition, the Year 2000 is a special-case leap year. And some programs may drop February 29th from their internal calendars. Likewise, other dates may present problems because of the way the digits are interpreted. Because the Company's business is based on the licensing of applications software, the Company's business would be adversely impacted if its products or its internal systems experience problems associated with the century change. This issue also potentially affects the software programs and systems used by the Company in its operations.

Project Definition. In 1996 the Company initiated a company-wide program to analyze three specific categories of systems (1) software developed by the Company which is licensed to customers (2) IT systems utilized by the Company consisting of applications developed in-house and purchased from third party suppliers and (3) non-IT systems and embedded technology which are integral components of the infrastructure of the Company.

The Company adopted a methodology for its licensed software into four distinct categories (1) preparation (2) analysis and remediation (3) testing and (4) delivery. The Company developed tools during the preparation phase of the project which were utilized during the analysis and testing and subsequently made available to its customers at no charge. The Company believes that its remediation efforts with respect to its licensed products will prove to be successful. The Company's belief is based on testing by the company of its licensed software products by using testing tools simulating dates and testing by many of the customers of the Company who have in turn completed their own Year 2000 testing. The licensed products have been made available by the company to customers in a timely manner and the communication efforts have been proactive and ongoing. The Company continues to actively monitor the status and progress of customers and distributors and assess the risk associated in those cases where the customer has not taken delivery of the compliant version or may have not made satisfactory progress in their own Year 2000 testing.

With respect to IT and non-IT systems, the Company is utilizing a similar methodology adopted for its licensed software. Specifically, the Company is utilizing the following steps: (1) preparation, in which the Company conducts systematic inventory, analysis, and prioritization of the systems in accordance with mission critical impact (2) analysis, replacement and remediation (3) testing and (4) implementation.

Recognizing that communications and organization of Year 2000 tasks and responsibilities is key, the Company has embraced a management approach utilizing central coordination with distributed administration over geographic and business units. This approach mirrors the Company's organization and ensures that Year 2000 Communications Managers are deployed and managing tasks in close proximity to actual efforts. Those efforts are then reported centrally to upper management. The approach also ensures that customers are kept informed of product and Company activities relating to the Year 2000 and that the Company is able to measure progress and plan support for customers' Year 2000 projects.

Current Status. Following analysis, remediation and testing efforts, the Company began shipping Year 2000 compliant versions of its major licensed software applications in March of 1997. As efforts were completed on other applications, they too were shipped to customers so that they could upgrade as part of their own Year 2000 projects. As of December 1998, 96% of all of the Company's licensed software applications are compliant and available to customers. The remaining applications are expected to be completed during the first calendar quarter of 1999. The company continues to conduct analysis of products of other companies as they are acquired with appropriate measurement and documentation in accordance with the Year 2000 methodology in place.

With respect to the IT and non-IT systems, remediation and replacement is underway and has been substantially completed in the most critical areas. The internal accounting systems utilized by the Company and most of the subsidiaries have been replaced and are in production. Replacement or remediation of accounting systems for the other subsidiaries is currently underway and is expected to be implemented by June of 1999. The overall IT and non-IT project is approximately 65% complete. As new IT and non-IT purchases are made, each is scrutinized and inventoried for Year 2000 compliance. The Company currently anticipates it will complete its Year 2000 IT and non-IT compliance efforts by June of 1999.

The majority of the embedded systems on which the Company relies in its day to day operations around the world are owned and managed by the lessors of the buildings in which the Company's offices are located, or by agents of such lessors. The Company has sent letters to its lessors and, as applicable, their agents requesting certifications of the Year 2000 compliance of the embedded systems. The Company has received responses from more than half of its lessors indicating that the systems in the buildings either already are, or are expected to be before the end of 1999, Year 2000 compliant. Those systems not owned by and managed by lessors have undergone a similar inventory and certification gathering. The Company will prioritize systems and develop necessary test plans based on the further responses it continues to receive, or not to receive, to its letters.

The Company is developing contingency plans for support of its customers prior to, during, and following the "Year 2000 weekend." Such plans will incorporate, but not be limited to, distribution of support personnel in locations around the world, backup plans for telecommunications, decision and notification hierarchy, and other infrastructure support. Contingency plans are presently anticipated to be complete by July of 1999.

Costs. The Company expects to incur project costs of approximately $10 million over the life of the Year 2000 project. These costs consist of: (i) internal staff costs related to licensed product remediation and testing; (ii) internal staff costs related to IT and non-IT compliance; (iii) hardware and software cost for replacement of IT systems; and (iv) costs related to non-IT compliance involving embedded systems and consulting services. Cost incurred from the beginning of the project in 1996 through September 1998 have totaled approximately $7.5 million. The Company expects to incur an additional $2.5 million over the remaining life of the Year 2000 project. All costs related to the Year 2000 project are being expensed as incurred. The estimated remaining costs are based on currently known circumstances and various assumptions regarding future events. There can be no assurance that this estimate will be achieved and actual results could differ materially from those anticipated.

Risks. The Company believes that the most likely Year 2000 risks relate to third parties with which it has material relationships. Those parties include computer hardware system providers on which the Company and its customers rely as well as service providers such as those providing telecommunications and electricity. Failure or disruption of such services or systems could adversely affect operations and the Company's ability to support its customers. The second most likely Year 2000 risk relates to the Company's products that are used in conjunction with software products developed by other vendors or by customers who have developed their own applications for use with the Company's products, which may not be Year 2000 compliant. Since the majority of the Company's customers utilize its products for authorization, routing, or processing of financial transactions, the failure of such customers' systems, which may be particularly susceptible to Year 2000 compliance issues, could impact the transaction volume processed by the customers thereby reducing transaction fees paid by customers with usage-based fee structures. Failures of such systems could also increase the efforts required by the Company to assist customers with resolving problems unrelated to the Company's licensed products. The third most likely Year 2000 risk relates to certain foreign countries in which the Company operates and the Company's customers in such countries which are not acting to sufficiently remediate Year 2000 issues. Some customers outside of the United States have chosen to concentrate on issues other than the Year 2000. Without concentrating on the Year 2000 upgrade and testing efforts, such customers will not be prepared and may require additional support to assist them. Commercial risks are associated with operating in countries which are not prepared for the Year 2000.

In each case cited previously, the Company is developing contingency plans to address each identified risk. In addition, the Company continues to use its methodology of centralized and distributed management to keep in contact and monitor progress with customer projects and to communicate at an upper management level to those customers categorized as "at risk" due to their lack of progress. The contingency plan being developed by the Company acknowledges the risk associated with suppliers of material services, hardware vendors closely related to the operation of the Company's licensed products, the Company's own licensed products and the ability of the Company to support its customers. In addition to distributed support methods, the Company is investigating alternative services, such as telecommunications, as part of the contingency plan. The (i) inability to timely implement contingency plans, if deemed necessary and (ii) the cost to implement such plans, may have a material adverse effect on the Company's results of operations.

Except for statements of existing or historical facts, the foregoing discussion consists of forward-looking statements and assumptions relating to forward-looking statements, including without limitation the statements relating to the timetable for completion of Year 2000 compliance efforts, future costs, potential problems relating to Year 2000, the Company's state of readiness, third party representations, and the Company's plans and objectives for addressing Year 2000 problems. Certain factors could cause actual results to differ materially from the Company's expectations, including without limitation (i) the failure of existing or future customers to achieve Year 2000 compliance, (ii) the failure of computer hardware system providers on which the Company and its customers rely or other vendors or service providers of the Company or its customers to timely achieve Year 2000 compliance, (iii) the Company's products and systems not containing all necessary date code changes, (iv) the failure of the Company's analysis and testing to detect operational problems in IT and non-IT systems utilized by the Company or in the Company's products or services, whether such failure results from the technical inadequacy of the Company's validation and testing efforts, the technological infeasibility of testing certain non-IT systems, and the unavailability of customers or other third parties to participate in testing, (v) potential litigation arising out of Year 2000 issues, with respect to providers of software and related technical and consulting services such as the Company generally, and particularly in light of the numerous interfaces between the Company's products and products and systems of third parties which are required to successfully utilize the Company's products which could involve the Company in expensive, multiple party litigation even though the Company may have no responsibility for the alleged problem, and (vi) the failure to timely implement a contingency plan to the extent Year 2000 compliance is not achieved.

SELECTED QUARTERLY INFORMATION

The following table sets forth certain unaudited financial data for each of the quarters within fiscal 1998, 1997 and 1996. This information has been derived from the Company's Consolidated Financial Statements 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.

Quarter Ended *(in thousands, except per share data)*	Sep. 30 1998	June 30 1998	March 31 1998	Dec. 31 1997	Sep. 30 1997	June 30 1997	March 31 1997	Dec. 31 1996	Sep. 30 1996	June 30 1996	March 31 1996	Dec. 31 1995
Revenues:												
Software license fees	$44,242	$41,753	$38,872	$37,264	$33,772	$33,655	$32,529	$28,374	$25,009	$22,808	$21,798	$19,460
Maintenance fees	15,078	14,664	14,162	13,173	12,628	12,470	11,861	11,755	11,362	10,651	9,831	9,656
Services	19,091	17,018	15,195	14,640	14,431	14,526	12,912	13,557	13,599	12,650	11,064	9,609
Hardware, net	883	1,232	1,105	1,389	1,175	1,083	3,213	592	1,159	1,174	1,940	1,466
Total revenues	79,294	74,667	69,334	66,466	62,006	61,734	60,515	54,278	51,129	47,283	44,633	40,191
Expenses:												
Cost of software license fees:												
Software costs	9,388	8,896	8,047	8,015	7,246	7,214	7,114	6,302	6,066	6,026	5,681	4,721
Amortization of purchased software	–	–	–	–	–	–	–	801	787	783	785	788
Cost of maintenance and services	18,226	17,069	15,696	14,616	14,476	14,483	13,589	13,856	13,331	12,023	10,751	10,074
Research and development	6,807	6,566	6,093	5,899	5,071	5,004	4,982	4,451	4,202	3,812	4,116	3,753
Selling and marketing	16,917	15,682	15,010	14,404	13,713	13,062	12,441	10,952	10,496	9,011	8,415	8,827
General and administrative:												
General and administrative costs	13,586	13,227	11,811	11,383	10,588	11,104	12,590	9,867	9,115	9,421	8,119	8,209
Amortization of goodwill and purchased intangibles	359	347	414	315	344	210	237	217	204	157	145	150
Total expenses	65,283	61,787	57,071	54,632	51,438	51,077	50,953	46,446	44,201	41,233	38,012	36,522
Operating income	14,011	12,880	12,263	11,834	10,568	10,657	9,562	7,832	6,928	6,050	6,621	3,669
Other income (expense):												
Interest income	894	863	800	647	642	621	547	481	374	465	596	589
Interest expense	(98)	(46)	(78)	(20)	(42)	(55)	(24)	(57)	(54)	(54)	(84)	(41)
Transaction related expenses	(2,512)	–	–	–	–	–	–	–	–	–	–	–
Other	63	(226)	40	(80)	(76)	(40)	(223)	(313)	(425)	(83)	(29)	(24)
Total other	(1,653)	591	762	547	524	526	300	111	(105)	328	483	524
Income before income taxes	12,358	13,471	13,025	12,381	11,092	11,183	9,862	7,943	6,823	6,378	7,104	4,193
Provision for income taxes	(5,289)	(5,040)	(4,700)	(4,447)	(3,786)	(3,793)	(3,667)	(3,079)	(2,915)	(2,393)	(2,124)	(1,864)
Net income	$ 7,069	$ 8,431	$ 8,325	$ 7,934	$ 7,306	$ 7,390	$ 6,195	$ 4,864	$ 3,908	$ 3,985	$ 4,980	$ 2,329
Unaudited pro forma net income [1]	$ 6,875	$ 8,433	$ 8,149	$ 7,669	$ 7,170	$ 6,996	$ 5,819	$ 4,420	$ 3,736	$ 3,694	$ 4,258	$ 2,598
Unaudited basic earnings per share	$0.23	$0.28	$0.28	$0.26	$0.25	$0.24	$0.20	$0.15	$0.13	$0.13	$0.15	$0.09
Unaudited diluted earnings per share	$0.22	$0.28	$0.27	$0.25	$0.24	$0.23	$0.20	$0.14	$0.13	$0.12	$0.14	$0.09

[1] Pro forma net income reflects pro forma tax provisions for RVS and IntraNet for combined federal and state income taxes to report income taxes on the basis of which income taxes will be reported in future periods. Prior to the stock exchange transaction, RVS and IntraNet were taxed primarily as a partnership and as a S corporation and, accordingly, taxable income was included in the personal tax of their owners who were responsible for the payment of tax thereof.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 1998, the Company's principal sources of liquidity consisted of $62.6 million of cash and cash equivalents, as compared to $52.2 million at September 30, 1997 and a $10 million line of credit of which there are no borrowings outstanding. The bank line of credit expires in June 1999.

The Company's net cash flow from operating activities for fiscal 1998, 1997 and 1996 were $35.4 million, $34.0 million and $21.8 million, respectively. The increase of $1.4 million in fiscal 1998 is principally due to higher net income and increases in accounts payable, accrued liabilities and deferred revenue, partly offset by increases in receivables. The increase of $12.2 million in fiscal 1997 is principally due to higher net income and increases in accrued liabilities and deferred revenue partly offset by increases in receivables.

The Company's net cash flows used in investing activities totaled $24.7 million, $18.4 million and $22.8 million in fiscal 1998, 1997 and 1996, respectively. The increase of $6.3 million in fiscal 1998 is principally due to higher capital expenditures to support the Company's growth, the purchase of 2.5 million shares of Nestor, Inc. (Nestor) Common Stock for $5.0 million and an increase in advances to US Processing, Inc. (USPI). The decrease of $4.4 million in fiscal 1997 is due principally to notes receivable repayments from Insession, Inc. (Insession) partly offset by higher capital expenditures to support the Company's growth and the purchase of software rights.

In the normal course of business, the Company evaluates potential acquisitions of complementary businesses, product or technologies. In fiscal year 1996, the Company acquired Grapevine in exchange for 380,441 shares of the Company's Class A Common Stock. In fiscal year 1997, the Company acquired 100% of RVS and OSSI in exchange for 1,615,383 and 210,000 shares, respectively, of the Company's Class A Common Stock. In February 1998 the Company acquired 100% of Coyote in exchange for 26,400 shares of the Company's Class A Common Stock. In April 1998, the Company acquired 2.5 million shares of Nestor Common Stock for $5.0 million. The Company also received warrants to purchase an additional 2.5 million shares of Nestor Common Stock for exercise price of $3 per share. In May 1998 the Company acquired 100% of Edgeware in exchange for 143,436 shares of the Company's Class A Common Stock. In August 1998, the Company acquired 100% of IntraNet in exchange for 1,220,300 shares of the Company's Class A Common Stock. Also in August 1998 the Company acquired 100% of SCIL and PRI in exchange for 380,000 and 180,000, respectively, of the Company's Class A Common Stock.

In January 1996, the Company entered into a transaction with Insession whereby the Company acquired a 6% minority interest in Insession for $1.5 million. In addition, the Company has extended Insession $6.6 million in promissory notes as of September 30, 1998. The promissory notes bear an interest rate of prime plus 0.25%, and are payable in January 1999 ($1.0 million), January 2000 ($1.0 million) and January 2001 ($1.5 million). The remaining $3.1 million of promissory notes are payable upon demand. The promissory notes are secured by future royalties owed by the Company to Insession.

The Company has extended a line of credit facility to USPI, a transaction processing business in which the Company has a 19.9% ownership interest. As of September 30, 1998, borrowings under the line of credit totaled $5.6 million. On December 10, 1998, the Company acquired substantially all of the net assets of USPI for $3.6 million cash and the assumption of certain liabilities of USPI.

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.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks associated primarily to changes in foreign currency exchange rates. The Company conducts business in all parts of the world. As a general rule, the Company's revenue contracts are denominated in U.S. dollars. Thus, any decline in the value of local foreign currencies against the U.S. dollar will result in the Company's products and services being more expensive to a potential foreign buyer, and in those instances where the Company's goods and services have already been sold, will result in the receivables being more difficult to collect. The Company does at times enter into revenue contracts that are denominated in the currency of the country in which it has substantive operations, principally the United Kingdom, Australia, Canada and Singapore. This practice serves as a natural hedge to finance the expenses incurred in those locations. The Company has not entered into, nor does it currently anticipate entering into, any foreign currency hedging transactions.

The Company does not purchase or hold any derivative financial instruments for the purpose of speculation or arbitrage.

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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, 1998 and 1997, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended September 30, 1998. 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, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1998, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Omaha, Nebraska,
October 29, 1998

September 30, *(in thousands except share data)*	1998	1997
Assets		
Current assets:		
Cash and cash equivalents	$ 62,603	$ 52,170
Marketable securities	2,188	–
Billed receivables, net of allowances of $4,728 and $2,298, respectively	54,937	42,898
Accrued receivables	33,000	26,269
Deferred income taxes	4,921	3,495
Other	3,585	3,248
Total current assets	161,234	128,080
Property and equipment, net	20,510	17,837
Software, net	7,050	6,105
Intangible assets, net	9,385	9,539
Installment receivables	2,056	2,394
Investments and notes receivable	16,754	7,969
Other	4,413	4,967
Total assets	$221,402	$176,891
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 1,078	$ 1,292
Accounts payable	13,583	7,972
Accrued employee compensation	6,076	6,591
Accrued liabilities	14,826	11,070
Income taxes	4,784	6,085
Deferred revenue	35,594	32,156
Total current liabilities	75,941	65,166
Long-term debt	1,915	2,379
Total liabilities	77,856	67,545
Commitments and contingencies		
Stockholders' equity:		
Redeemable Convertible Preferred Stock, $.01 par value; 5,450,000 shares authorized; no shares issued and outstanding at September 30, 1998 and 1997		
Redeemable Convertible Class B Common Stock and Warrants, $.005 par value; 5,000,000 shares authorized; no shares issued and outstanding at September 30, 1998 and 1997		
Class A Common Stock, $.005 par value; 50,000,000 shares authorized; 29,133,947 and 28,097,767 shares issued at September 30, 1998 and 1997, respectively	146	140
Class B Common Stock, $.005 par value; 5,000,000 shares authorized; 1,171,252 shares issued and outstanding at September 30, 1998 and 1997, respectively	6	6
Additional paid-in capital	112,052	104,753
Accumulated translation adjustments	(2,075)	(260)
Retained earnings	36,241	4,719
Unrealized investment holding loss	(2,812)	–
Treasury stock, at cost, 845 shares at September 30, 1998 and 1997	(12)	(12)
Total stockholders' equity	143,546	109,346
Total liabilities and stockholders' equity	$221,402	$176,891

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

Year Ended September 30, *(in thousands, except per share amounts)*	1998	1997	1996
Revenues:			
Software license fees	$162,131	$128,330	$ 89,075
Maintenance fees	57,077	48,714	41,500
Services	65,944	55,426	46,922
Hardware, net	4,609	6,063	5,739
Total revenues	289,761	238,533	183,236
Expenses:			
Cost of software license fees:			
Software costs	34,346	27,876	22,494
Amortization of purchased software	–	801	3,143
Cost of maintenance and services	65,607	56,404	46,179
Research and development	25,365	19,508	15,883
Selling and marketing	62,013	50,168	36,749
General and administrative:			
General and administrative costs	50,007	44,149	34,864
Amortization of goodwill and purchased intangibles	1,435	1,008	656
Total expenses	238,773	199,914	159,968
Operating income	50,988	38,619	23,268
Other income (expense):			
Interest income	3,204	2,291	2,024
Interest expense	(242)	(178)	(233)
Transaction related expenses	(2,512)	–	–
Other	(203)	(652)	(561)
Total other	247	1,461	1,230
Income before income taxes	51,235	40,080	24,498
Provision for income taxes	(19,476)	(14,325)	(9,296)
Net income	$ 31,759	$ 25,755	$ 15,202
Average shares outstanding:			
Basic	29,558	29,089	28,526
Diluted	30,453	29,967	29,852
Unaudited pro forma information (Note 3):			
Pro forma net income	$ 31,126	$ 24,405	$ 14,286
Pro forma earnings per share data:			
Basic	$1.05	$0.84	$0.50
Diluted	1.02	0.81	0.48

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

(in thousands except share amounts)	Class A Common Stock	Class B Common Stock	Additional Paid-in Capital	Accumulated Translation Adjustments	Retained Earnings	Unrealized Investment Holding Loss	Treasury Stock	Total
Balance, September 30, 1995, as previously reported	$ 66	$ 7	$ 92,568	$ (354)	$(31,873)	$ –	$ (12)	$ 60,402
Adjustment for IntraNet, Inc. pooling of interests	6	–	1,075	–	2,918	–	–	3,999
Balance, September 30, 1995, as restated	72	7	93,643	(354)	(28,955)	–	(12)	64,401
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
Distribution to RVS owners	–	–	–	–	(2,787)	–	–	(2,787)
Tax benefit of stock options exercised	–	–	1,973	–	–	–	–	1,973
Net income	–	–	–	–	15,202	–	–	15,202
Translation adjustments	–	–	–	118	–	–	–	118
Balance, September 30, 1996	133	11	96,984	(236)	(16,540)	–	(12)	80,340
Adjustment for Open Systems Solutions, Inc. pooling of interests	1	–	5	–	(176)	–	–	(170)
Sale of Class A Common Stock pursuant to Employee Stock Purchase Plan	–	–	778	–	–	–	–	778
Conversion of Class B Common Stock to Class A Common Stock	5	(5)	–	–	–	–	–	–
Exercise of stock options	1	–	1,268	–	–	–	–	1,269
Distribution to RVS and IntraNet, Inc. owners	–	–	–	–	(4,320)	–	–	(4,320)
Tax benefit of stock options exercised	–	–	2,586	–	–	–	–	2,586
Sale of stock options	–	–	3,132	–	–	–	–	3,132
Net income	–	–	–	–	25,755	–	–	25,755
Translation adjustments	–	–	–	(24)	–	–	–	(24)
Balance, September 30, 1997	140	6	104,753	(260)	4,719	–	(12)	109,346
Adjustment for immaterial pooled businesses	4	–	17	–	663	–	–	684
Issuance of Class A Common Stock for purchase of Coyote Systems, Inc.	1	–	1,086	–	–	–	–	1,087
Sale of Class A Common Stock pursuant to Employee Stock Purchase Plan	–	–	971	–	–	–	–	971
Exercise of stock options	1	–	2,099	–	–	–	–	2,100
Distribution to IntraNet, Inc. owners	–	–	–	–	(900)	–	–	(900)
Tax benefit of stock options exercised	–	–	3,126	–	–	–	–	3,126
Unrealized investment holding loss	–	–	–	–	–	(2,812)	–	(2,812)
Net income	–	–	–	–	31,759	–	–	31,759
Translation adjustments	–	–	–	(1,815)	–	–	–	(1,815)
Balance, September 30, 1998	$146	$ 6	$112,052	$ (2,075)	$ 36,241	$ (2,812)	$ (12)	$143,546

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

Year Ended September 30, *(in thousands)*	1998	1997	1996
Cash flows from operating activities:			
Net income	$ 31,759	$25,755	$15,202
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	6,449	5,475	4,484
Amortization	5,022	4,404	5,933
Increase in receivables, net	(17,325)	(15,949)	(7,361)
(Increase) decrease in other current assets	(345)	1,068	(1,182)
(Increase) decrease in installment receivables	338	(801)	(74)
Increase in other assets	(1,672)	(736)	(988)
Increase (decrease) in accounts payable	2,628	(947)	2,763
Increase (decrease) in accrued employee compensation	(390)	325	1,007
Increase (decrease) in accrued liabilities	5,405	3,521	(626)
Decrease in income tax liabilities	839	3,432	2,937
Increase (decrease) in deferred revenue	2,644	8,459	(289)
Net cash provided by operating activities	35,352	34,006	21,806
Cash flows from investing activities:			
Purchases of property and equipment	(8,812)	(7,618)	(6,604)
Purchases of software and distribution rights	(3,651)	(7,314)	(2,691)
Purchase of marketable securities	(5,000)	–	–
Acquisiton of businesses, net of cash acquired	417	(2,612)	(5,403)
Additions to investment and notes receivable	(7,840)	(5,036)	(8,106)
Proceeds from notes receivable repayments	149	4,180	–
Net cash used in investing activities	(24,737)	(18,400)	(22,804)
Cash flows from financing activities:			
Proceeds from issuance of Class A Common Stock	971	778	353
Proceeds from sale and exercise of stock options	2,062	5,234	1,111
Distribution to RVS and Intranet owners	(900)	(4,320)	(2,787)
Payments of long-term debt	(1,672)	(1,549)	(367)
Net cash provided by (used in) financing activities	461	143	(1,690)
Effect of exchange rate fluctuations on cash	(643)	(442)	(181)
Net increase (decrease) in cash and cash equivalents	10,433	15,307	(2,869)
Cash and cash equivalents, beginning of period	52,170	36,863	39,732
Cash and cash equivalents, end of period	$62,603	$52,170	$36,863
Supplemental cash flow information:			
Income taxes paid	$19,653	$ 8,848	$ 7,612
Interest paid	$ 304	$ 175	$ 218

The accompanying notes are an integral part of the 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). 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 by financial institutions, retailers and third-party processors, 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 Compaq's NonStop Himalaya servers. The Company's future results depend, in part, on market acceptance of Compaq's NonStop Himalaya servers and the financial success of Compaq, Inc.

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.

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.

Revenue Recognition. Software license fees are comprised of initial license fees (ILF), monthly license fees (MLF), and software modification fees. Software license fees are recognized when all significant vendor obligations are performed and certain software revenue recognition criteria are met (i.e., evidence of a contract, delivery of the software, fixed and determinable fees and collectibility of fees). ILF revenues, where the Company collects a significant portion of the total software license fees at the beginning of the software license term, are recognized upon delivery of the software. MLF revenues are recognized ratably over the contract term because the "fixed and determinable fees" and/or the "collectibility" revenue recognition criteria have not been met. Software modification fees are recognized upon delivery.

Maintenance fees are recognized ratably over the term of the software license. Services revenue are recognized as the services are performed. Hardware revenues, representing commissions on hardware sales associated with the sales of the Company's software (through December 31, 1997), or market development funding (after December 31, 1997), are recognized as the fees become collectible from Compaq.

In fiscal 1998, the Company initiated a program to sell the rights to future payment streams under selected MLF contracts to financing institutions on a non-recourse basis. Upon determination that 1) the Company has surrendered control over the future payment stream to the financing institutions in accordance with the provisions of SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," and 2) the MLF arrangements have satisfied all of the software revenue recognition criteria, the Company has recognized software license fees equal to the net proceeds from these arrangements. The software license fee revenues recognized as the result of this program in fiscal 1998 totaled approximately $9.2 million.

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. Amortization of capitalized 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 on the calculation of amortization of these capitalized costs.

Purchased software is stated at cost and amortized using the straight-line method over three years.

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 consist of goodwill arising from acquisitions and are being amortized using the straight-line method over 10 years. As of September 30, 1998 and 1997, accumulated amortization of the intangible assets was $3,600,000 and $1,700,000 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.

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.

Earnings Per Share. Effective October 1, 1997, the Company adopted Statement of Financial Accounting Standards No. 128 "Earnings Per Share." Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the periods. Diluted earnings per share is computed by dividing net income by the sum of the weighted average number of shares of common stock outstanding and the potential dilutive effect of the outstanding stock options associated with the Company's stock incentive plans.

Long-Lived Assets. The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recovered.

Stock-Based Compensation. The Company accounts for its stock-based compensation plans under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, and follows the disclosure provisions of Statement of Financial Accounting Standards No. 123, (SFAS No. 123) "Accounting for Stock-Based Compensation." See Note 9 for the required disclosures under SFAS No. 123.

Other Recent Pronouncements. The Company intends to adopt Statement of Financial Standards No. 130 (SFAS No. 130), "Reporting Comprehensive Income" and Statement of Financial Standards No. 131 (SFAS No. 131), "Disclosures About Segments of an Enterprise and Related Information" in fiscal 1999. Both will require additional disclosures but will not have a material effect on the Company's consolidated financial position or results of operations. SFAS No. 130 will be reflected in the Company's first quarter 1999 interim financial statements and establishes standards for the reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. SFAS No. 131 requires segments to be determined based upon how management measures performance and makes decisions about allocating resources. SFAS No. 131 will first be reflected in the Company's 1999 Form 10-K.

Reclassifications. Certain September 30, 1997 amounts have been reclassified to conform to the September 30, 1998 presentation.

3. ACQUISITIONS

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 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, 1995 *(in thousands except per share amounts)*:

	Year Ended September 30, 1996
Revenues	$189,100
Unaudited pro forma net income	14,617
Basic net income per share	0.51
Diluted net income per share	0.49

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.

In September 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. Stockholders of Grapevine received 380,441 shares of TSA Class A Common Stock in exchange for 100% of Grapevine's common stock. The stock exchange was accounted for as a pooling of interests. Accordingly, the Company's financial statements were restated to include the results of Grapevine for the periods presented prior to the date of acquisition.

In October 1996, the Company and Open Systems Solutions, Inc. (OSSI) completed a share exchange transaction which resulted in OSSI becoming a wholly-owned subsidiary of the Company. 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.

In May 1997, the Company and Regency Voice Systems, Inc. and related entities (RVS) completed a stock exchange transaction which resulted in RVS becoming a wholly owned subsidiary of the Company. Shareholders of RVS received 1,615,383 shares of TSA Class A Common Stock in exchange for 100% of RVS's shares. 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 RVS for all periods presented. Prior to the stock exchange, RVS was taxed primarily as a partnership. The unaudited pro forma net income and earnings per share in the accompanying consolidated statements of income reflects a pro forma tax provision for combined federal and state taxes for RVS's results of operations.

During fiscal 1998, the Company acquired all of the outstanding securities of IntraNet, Inc., Edgeware, Inc., Coyote Systems, Inc., Professional Resources, Inc. and Smart Card Integrators Ltd. in separate transactions. These companies were principally engaged in the development and sale of electronic payments software products and services. The aggregate number of shares issued for all transactions was 1,950,136 shares of Class A Common Stock. All transactions, except for Coyote Systems, Inc. which was accounted for under the purchase method of accounting, were accounted for as pooling of interests. The excess purchase price over the estimated fair value of the net tangible assets acquired from Coyote Systems, Inc. amounted to $1.1 million and was allocated to goodwill which is being amortized over 10 years. The Company's financial statements have been restated for IntraNet, Inc. (IntraNet) for all periods presented. The results of operations prior to the acquisitions of the remaining companies were not material.

Prior to the share exchange, IntraNet was taxed primarily as a Subchapter S Corporation. The unaudited pro forma net income and earnings per share in the accompanying consolidated statements of income reflects a pro forma tax provision for combined federal and state taxes for IntraNet's results of operations for each of the years presented.

Combined and separate results of the Company and IntraNet during the periods preceding the merger are listed below *(in thousands)*.

	Interim period 1998	Year ended September 30, 1997	1996
Total revenues:	(unaudited)		
Company	$194,357	$215,466	$166,367
IntraNet	18,051	23,067	16,869
	$212,408	$238,533	$183,236
Net income:			
Company	$ 23,516	$ 23,566	$ 15,038
IntraNet	1,612	2,189	164
	$ 25,128	$ 25,755	$ 15,202
Unaudited pro forma information:			
Net income – historical	$ 25,128	$ 25,755	$ 15,202
RVS tax adjustment – pro forma	–	(507)	(854)
IntraNet tax adjustment pro forma	(633)	(843)	(62)
Net income – pro forma	$ 24,495	$ 24,405	$ 14,286

4. MARKETABLE SECURITIES

In April 1998, the Company entered into a transaction with Nestor, Inc. (Nestor), whereby the Company acquired 2.5 million shares of Nestor's Common Stock for $5.0 million. In addition, the Company received warrants to purchase an additional 2.5 million shares at an exercise price of $3 per share. Nestor is a provider of neural-network solutions for financial, Internet and transportation industries. The Company distributes Nestor's PRISM intelligent fraud detection product. The Company has accounted for the investment in Nestor's Common Stock and warrants in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities."

The investment in marketable securities has been classified as available-for-sale and recorded at fair market value, which is estimated based on quoted market prices. Net unrealized holding gains and losses, net of the related tax effect, are reported as a separate component of stockholders' equity. Unrealized gains and losses are determined by specific identification.

5. PROPERTY AND EQUIPMENT

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

September 30,	1998	1997
Computer equipment	$ 32,111	$26,270
Office furniture and fixtures	7,110	5,487
Leasehold improvements	4,032	3,427
Vehicles	777	1,080
	44,030	36,264
Less accumulated depreciation and amortization	(23,520)	(18,427)
Property and equipment, net	$ 20,510	$ 17,837

6. SOFTWARE

Software consists of the following *(in thousands)*:

September 30,	1998	1997
Internally developed software	$ 7,206	$ 6,334
Purchased software	16,960	13,613
	24,166	19,947
Less accumulated amortization	(17,116)	(13,842)
Software, net	$ 7,050	$ 6,105

7. DEBT

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

September 30,	1998	1997
Payments due to the sellers of M.R. GmbH (See Note 3), due December 1998	$ 367	$ 1,112
Other	2,626	2,559
	2,993	3,671
Less current portion	1,078	1,292
Long-term debt	$ 1,915	$ 2,379

The Company has a $10 million revolving line of credit, which expires in June 1999. The revolving line of credit requires the maintenance of a minimum working capital level of $50 million. There were no borrowings under the revolving line of credit during the years ended September 30, 1998 and 1997.

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)*:

1999	$ 8,540
2000	7,341
2001	5,338
2002	4,869
2003	4,145
Thereafter	16,749
Total	$46,982

Total rent expense for the years ended September 30, 1998, 1997 and 1996 was, $9,738,000, $8,739,000 and $7,599,000.

Legal Proceedings. From time to time, the Company is involved in litigation relating to claims arising out of its operations in the normal course of business. The Company is not currently a party to any legal proceedings, the adverse outcome of which, individually or in the aggregate, would have a material adverse effect on the Company's financial condition or results of operations.

9. STOCK-BASED COMPENSATION PLANS

Stock Incentive Plans. The Company has a 1994 Stock Option 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 exercise of these options will be Class A Common Stock. 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.

The Company has a 1996 Stock Option 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 of the Company's Class A Common Stock 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.

The Company has a 1997 Management Stock Option Plan whereby 1,050,000 shares of the Company's Class A Common Stock have been reserved for issuance to eligible management employees of the Company and its subsidiaries. The stock options are granted at a price not less than fair market value of the Company's Class A Common Stock at the time of the grant and require the participant to pay $3 for each share granted. The term of the outstanding options is ten years. The options vest annually over a period of four years.

A summary of the stock options issued under the Stock Incentive Plans previously described and changes during the years ending September 30 are as follows:

	1998		1997		1996	
	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price
Outstanding on October 1,	2,794,437	$16.82	1,731,439	$ 7.18	1,819,420	$ 3.81
Granted	387,650	$34.30	1,387,567	$26.27	275,000	$24.69
Exercised	325,371	$ 6.35	283,862	$4.57	327,673	$ 3.47
Cancellations	45,209	$25.20	40,707	$ 13.83	35,308	$ 4.94
Outstanding on September 30	2,811,507	$20.30	2,794,437	$ 16.82	1,731,439	$ 7.18
Options exercisable at end of year	1,275,778	$ 11.19	909,429	$ 5.04	687,903	$ 3.73
Shares available on September 30 for options that may be granted	174,287		516,728		816,622	
Weighted-average grant date fair value of options granted during the year – exercise price equals stock market price at grant		$ 17.74		$ 13.01		$ 14.02

The following table summarizes information about stock options outstanding at September 30, 1998.

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$2.50	359,268	5.38	$ 2.50	358,823	$ 2.50
$5.00	505,645	6.09	5.00	486,420	5.00
$7.50 to $9.75	11,197	6.43	7.80	9,636	7.91
$12.00 to $16.50	21,817	7.23	14.37	13,674	14.27
$20.25 to $25.875	1,189,367	8.32	24.42	319,641	24.50
$26.50 to $31.625	80,813	8.41	29.43	23,366	29.62
$32.25 to $35.75	562,000	9.31	33.27	62,018	33.30
$36.00 to $42.125	81,400	9.32	38.40	2,200	37.33
	2,811,507	7.75	$20.30	1,275,778	$ 11.19

Employee Stock Purchase Plan. The Company has a 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 the lower of the first or last day of the purchase period. Purchases are made at the end of each fiscal quarter. Shares issued under this plan for the years ended September 30, 1998, 1997 and 1996 totaled 30,881, 27,748 and 16,745, respectively.

Stock-Based Compensation Plans. The Company adopted the disclosure provisions of SFAS No. 123. Accordingly, no compensation cost has been recognized for the stock incentive plans.

Had compensation expense for the Company's stock-based compensation plans been based on the fair value of the stock options at the grant dates for awards under those plans consistent with the fair value based method of SFAS No. 123, the Company's net income and net income per common and equivalent share for fiscal 1998, 1997 and 1996 would approximate the pro forma amounts as follows *(in thousands, except per share amounts)*:

Year ended September 30,	1998	1997	1996
Net income – historical:			
As reported	$31,759	$25,755	$15,202
Pro forma	29,733	24,442	15,047
Unaudited net income – pro forma:			
As reported	31,126	24,405	14,286
Pro forma	29,100	23,092	14,131
Pro forma net income per share – basic	$0.98	$0.79	$0.50
Pro forma net income per share – diluted	$0.96	$0.77	$0.47

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

Year ended September 30,	1998	1997	1996
Expected life	5.8	5.8	5.8
Interest rate	5.5%	6.3%	6.3%
Volatility	39%	38%	38%
Dividend yield	–	–	–

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. SFAS No. 123 applies only to options granted during fiscal 1998, 1997 and 1996, and additional awards in future years are anticipated.

10. EMPLOYEE BENEFIT PLANS

TSA 401(k) Retirement Plan. The 401(k) Retirement Plan is a defined contribution plan covering all domestic employees of TSA. Participants may contribute up to 15% of their annual wages. Beginning January 1, 1998, TSA began matching 160% of participant contributions up to a maximum of 2.5% of compensation, not to exceed $2,500. Prior to January 1, 1998, TSA matched 100% of participants contributions up to a maximum of 2.5%. TSA's contributions charged to expense during the years ended September 30, 1998, 1997 and 1996 were $1,197,000, $489,000 and $507,000 respectively.

ACI Profit Sharing Plan and Trust. The Company had a Profit Sharing Plan and Trust which was a non-contributory profit sharing plan covering all employees of ACI provided they were at least 21 years of age and had completed one year of service. Effective October 1, 1997 the ACI Profit Sharing Plan and Trust was merged into the 401(k) Retirement Plan. The plan provided 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, 1997 and 1996 were $480,000 and $399,000 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,	1998	1997	1996
Service cost	$1,666	$1,307	$ 1,018
Interest cost on projected benefit obligation	1,192	830	738
Return on plan assets:			
Actual and gain deferred	(1,501)	(1,055)	(805)
Amortization of unrecognized gain	(85)	3	(13)
Total periodic pension expense	$1,272	$1,085	$ 938

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

Year ended September 30,	1998	1997
Projected benefit obligation	$18,439	$14,035
Plan assets at fair value, primarily investments in marketable equity securities of United Kingdom companies	17,467	14,955
Plan assets greater (less) than projected benefit obligation	(972)	920
Unrecognized gain	(826)	(2,530)
Accrued pension cost	$ (1,798)	$ (1,610)

TRANSACTION SYSTEMS ARCHITECTS INC

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

Year ended September 30,	1998	1997	1996
Discount rate for valuing liabilities	6.0%	8.0%	8.0%
Expected long-term rate of return on assets	7.0%	9.0%	9.0%
Rate of increase in future compensation levels	3.5%	6.0%	6.0%

11. SEGMENT INFORMATION

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

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,	1998	1997	1996
Revenues from Unaffiliated Customers:			
Americas	$174,069	$145,825	$114,513
Europe, Middle East and Africa	87,492	64,792	47,267
Asia/Pacific	28,200	27,916	21,456
	$289,761	$238,533	$183,236
Intercompany revenues:			
Americas	$ 32,612	$ 26,183	$ 13,065
Operating Income:			
Americas	$ 53,816	$ 42,148	$ 32,996
Europe, Middle East and Africa	25,321	16,783	8,302
Asia/Pacific	6,723	8,625	6,740
	85,860	67,556	48,038
Research and Development and Corporate General and Administrative Expenses	(34,872)	(28,937)	(24,770)
Operating Income	$ 50,988	$ 38,619	$ 23,268
Identifiable Assets:			
Americas	$139,766	$115,625	$ 89,325
Europe, Middle East and Africa	60,446	44,497	33,706
Asia/Pacific	21,190	16,769	11,957
	$221,402	$176,891	$134,988

12. INCOME TAXES

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." SFAS No. 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, SFAS No. 109 generally considers all expected future events other than enactments or changes in the tax law or rates.

The provision for income taxes consists of the following *(in thousands)*:

For the Year Ended September 30,	1998			1997			1996		
	Current	Deferred	Total	Current	Deferred	Total	Current	Deferred	Total
Federal	$13,433	$(1,212)	$12,221	$ 7,022	$1,355	$ 8,377	$ 6,209	$(2,066)	$4,143
State	2,252	(257)	1,995	1,905	240	2,145	1,933	(71)	1,862
Foreign	5,260	–	5,260	3,803	–	3,803	3,291	–	3,291
Total	$20,945	$(1,469)	$19,476	$12,730	$1,595	$14,325	$11,433	$ (2,137)	$9,296

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,	1998	1997	1996
Tax expense at federal rate of 35% for 1998 and 1997 and 34% for 1996	$17,932	$14,028	$ 8,329
Losses with no current tax benefit	22	1,503	239
Effective state income tax	1,508	1,394	1,140
Foreign tax rate differential	385	1,160	–
RVS nontaxable income	–	(663)	(750)
IntraNet nontaxable income	(564)	(766)	(55)
Recognition of deferred income tax assets previously reserved against	(830)	(2,979)	–
Amortization of intangibles	–	–	578
Transaction related expenses	461	–	–
Other	562	648	(185)
	$19,476	$14,325	$ 9,296

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,	1998	1997
Deferred assets:		
Depreciation	$ 167	$ 226
Amortization	4,822	4,959
Foreign taxes	1,122	1,210
Acquired net operating loss carryforward of USSI	1,167	1,157
Net operating loss carryforward	1,058	1,715
Acquired basis in partnership assets	6,016	6,613
Unrealized investment holding loss	1,094	–
Other	1,140	717
	16,586	16,597
Deferred tax asset valuation allowance	(11,665)	(13,080)
Deferred liabilities:		
Other	(288)	(438)
	(288)	(438)
	$ 4,633	$ 3,079

For income tax purposes, the Company had foreign tax credit carryforwards of approximately $680,000 at September 30, 1998, which expire in 2002.

At September 30, 1998 management evaluated its 1998 and 1997 operating results as well as its future tax projections 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 $4.9 million as of September 30, 1998.

13. SUBSEQUENT EVENTS (UNAUDITED)

In November 1998, the Company and Media Integration BV (MINT) completed a stock exchange transaction which resulted in MINT becoming a wholly owned subsidiary of the Company. Shareholders of MINT received 740,000 shares of TSA Class A Common Stock in exchange for 100% of MINT shares. The stock exchange will be accounted for as a pooling of interests. MINT's results of operations prior to the acquisition were not material.

Also on December 10, 1998, the Company acquired the remaining interests in the net assets of US Processing, Inc. (USPI) by paying $3.6 million in cash and the forgiveness of $5.6 million of debt owed to TSA. Prior to that date, the Company had owned 19.9% of USPI. The transaction will result in the recording of goodwill of approximately $11.0 million to be amortized over 10 years.

FIVE-YEAR SELECTED FINANCIAL DATA

(in thousands, except per share data)	Company [2] Year Ended Sept. 30, 1998	Year Ended Sept. 30, 1997	Year Ended Sept. 30, 1996	Year Ended Sept. 30, 1995	Nine Months Sept. 30, 1994[3]	Predecessors [1] Three Months Dec. 31, 1993
Income Statement Data						
Revenues	$289,761	$238,533	$183,236	$121,403	$ 77,437	$ 18,830
Operating Income (Loss)	50,988	38,619	23,268	9,853	(28,673)	(906)
Net Income (Loss)[4]	31,126	24,405	14,286	4,060	(33,307)	(1,651)
Basic Net Income (Loss) Per Share[4]	1.05	0.84	0.50	0.16	(1.50)	
Diluted Net Income (Loss) Per Share[4]	1.02	0.81	0.48	0.16	(1.50)	
Balance Sheet data						
Working Capital	$ 85,293	$ 62,914	$ 43,268	$ 38,153	$ 2,037	$ 6,861
Total Assets	221,402	176,891	134,988	103,586	61,382	47,861
Long-term Obligations	1,915	2,379	1,687	357	22,801	601
Stockholders' Equity (Deficit)	143,546	109,346	80,298	60,402	(31,406)	28,940

1 The Company was formed on November 2, 1993 for the purpose of acquiring all of the outstanding capital stock of ACI and 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. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Overview."

2 The statement of income data after January 1, 1994 are not comparable to data for prior periods due to the effects of the acquisition of the Predecessors. The acquisition was accounted for as a purchase and the financial statements since the date of the acquisition are presented on the new basis of accounting established for the purchased assets and liabilities.

3 The financial data for the nine months ended September 30, 1994 represents the results of operations of the Company for the periods from inception (November 2, 1993) through September 30, 1994. The Company did not have substantive operations prior to the December 31, 1993 acquisition of ACI and ACIL.

4 *Pro forma* operating income, *pro forma* net income and *pro forma* basic and diluted net income per share exclude certain one-time or acquisition related expenses associated with the acquisition of ACI and ACIL in fiscal 1994. The total of these expenses were $43.1 million, $10.8 million, $3.3 million and $851,000 in 1994, 1995, 1996 and 1997, respectively. In addition, the 1998 pro forma results exclude $2.5 million of transaction related expenses associated with acquisitions accounted for as poolings of interest. All pro forma results of operations were computed using an effective tax rate of 38 percent.

REVENUES BY PRODUCTS

Twelve Months Ended September 30, *(in thousands)*	1998	1997	1996
BASE24	$194,109	$159,906	$119,898
System Solutions Products	35,336	24,259	25,585
Wholesale Products	30,592	32,533	25,243
TRANS24	14,573	9,699	5,926
IVR Products	11,535	9,851	6,584
WINPAY24	3,616	2,285	–
	$289,761	$238,533	$183,236

The amounts in the above table include products and related services, including maintenance fees.

TRANSACTION SYSTEMS ARCHITECTS, INC.

224 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, 1998, as filed with the Securities and Exchange Commission, will be sent to stockholders free of charge upon written request to:

William J. Hoelting, Vice President - Investor Relations
Transaction Systems Architects, Inc.
224 South 108th Avenue
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In Europe Contact:

Michael E. Carter, Vice President - Marketing and Communications
Transaction Systems Architects, Inc.
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HOME PAGE: WWW.TSAINC.COM

STOCK INFORMATION

Transaction Systems Architects' common stock is traded on the NASDAQ stock market under the symbol TSAI. There were 380 holders of record of the Company's common stock as of December 31, 1998. The high and low sale prices for the Company's common stock for each quarterly period during the fiscal year 1998 and fiscal year 1997, are as follows:

1998	High	Low
First Quarter	44 1/2	36 5/8
Second Quarter	43 1/2	34 5/8
Third Quarter	43	37 1/8
Fourth Quarter	39 7/8	32 3/4

1997	High	Low
First Quarter	45 1/4	32 1/2
Second Quarter	34 1/2	24 3/8
Third Quarter	43	23 1/4
Fourth Quarter	40 5/8	32 1/2

DIVIDENDS

The Company has not declared or paid cash dividends on its common stock since its incorporation.

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
South St. Paul, Minnesota 55075

ANNUAL MEETING

The Annual Meeting of Shareholders will be held at 10:00 a.m. on Tuesday, February 23, 1999, at the Company's Corporate Meeting Center, 230 South 108th Avenue, in Omaha, Nebraska.

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The acceptance of technology and growth of electronic payments is opening a world of opportunity into which TSA is just starting to tap. With a legacy in the first ATM networks and a hand in today's developing technologies, TSA is strategically positioned to meet the world's demand for anytime anywhere access to money and information.

We're just getting started.

TSA