AMDOCS LTD
Form 6-K
May 17, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 6-K

REPORT OF FOREIGN PRIVATE ISSUER

PURSUANT TO RULE 13a-16 OR 15d-16 OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended March 31, 2016

Commission File Number 1-14840

AMDOCS LIMITED

Hirzel House, Smith Street,

St. Peter Port, Island of Guernsey, GY1 2NG

Amdocs, Inc.

1390 Timberlake Manor Parkway, Chesterfield, Missouri 63017

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

FORM 20-F x FORM 40-F ¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ¨

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

YES ¨ NO x

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-

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AMDOCS LIMITED

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER

FOR THE QUARTER ENDED MARCH 31, 2016

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This report on Form 6-K shall be incorporated by reference into any Registration Statement filed by the Registrant that by its terms automatically incorporates the Registrant s filings and submissions with the SEC under Sections 13(a), 13(c) or 15(d) of the Securities Exchange Act of 1934.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

AMDOCS LIMITED

CONSOLIDATED BALANCE SHEETS

(dollar and share amounts in thousands, except per share data)

	As of	
	March 31, 2016 (Unaudited)	**September 30, 2015**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 823,456	$ 1,035,573
Short-term interest-bearing investments	326,629	318,439
Accounts receivable, net	755,381	714,784
Deferred income taxes		150,733
Prepaid expenses and other current assets	202,144	158,633
Total current assets	2,107,610	2,378,162
Equipment and leasehold improvements, net	311,723	309,320
Deferred income taxes	123,660	80,130
Goodwill	2,047,782	2,049,093
Intangible assets, net	221,490	252,517
Other noncurrent assets	279,262	255,430
Total assets	$ 5,091,527	$ 5,324,652
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 158,000	$ 111,974
Accrued expenses and other current liabilities	579,281	608,827
Accrued personnel costs	199,136	224,232
Short-term financing arrangements		220,000
Deferred revenue	205,786	198,470
Total current liabilities	1,142,203	1,363,503
Deferred income taxes and taxes payable	217,071	305,985
Other noncurrent liabilities	257,270	248,322
Total liabilities	1,616,544	1,917,810
Shareholders equity:		

Preferred Shares Authorized 25,000 shares; £0.01 par value; 0 shares issued and outstanding		
Ordinary Shares Authorized 700,000 shares; £0.01 par value; 269,962 and 267,777 issued and 149,765 and 151,150 outstanding, respectively	4,363	4,331
Additional paid-in capital	3,271,971	3,182,573
Treasury stock, at cost 120,197 and 116,627 ordinary shares, respectively	(3,811,713)	(3,611,105)
Accumulated other comprehensive income (loss)	8,775	(16,753)
Retained earnings	4,001,587	3,847,796
Total shareholders equity	3,474,983	3,406,842
Total liabilities and shareholders equity	$ 5,091,527	$ 5,324,652

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

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AMDOCS LIMITED

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(dollar and share amounts in thousands, except per share data)

	Three months ended March 31,		Six months ended March 31,	
	2016	**2015**	**2016**	**2015**
Revenue	$ 925,935	$ 902,578	$ 1,847,440	$ 1,808,865
Operating expenses:				
Cost of revenue	600,116	580,571	1,195,684	1,154,017
Research and development	63,711	62,805	126,198	126,446
Selling, general and administrative	114,474	107,186	234,022	220,766
Amortization of purchased intangible assets and other	27,487	14,016	51,854	28,115
	805,788	764,578	1,607,758	1,529,344
Operating income	120,147	138,000	239,682	279,521
Interest and other income (expense), net	1,460	(1,669)	(205)	(125)
Income before income taxes	121,607	136,331	239,477	279,396
Income taxes	13,887	20,070	30,915	32,145
Net income	$ 107,720	$ 116,261	$ 208,562	$ 247,251
Basic earnings per share	$ 0.72	$ 0.75	$ 1.39	$ 1.59
Diluted earnings per share	$ 0.71	$ 0.74	$ 1.37	$ 1.57
Cash dividends declared per ordinary share	$ 0.195	$ 0.170	$ 0.365	$ 0.325

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

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AMDOCS LIMITED

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(dollar amounts in thousands)

	Three months ended March 31,		Six months ended March 31,	
	2016	**2015**	**2016**	**2015**
Net income	$ 107,720	$ 116,261	$ 208,562	$ 247,251
Other comprehensive income (loss), net of tax:				
Net change in fair value of cash flow hedges(1)	20,082	1,826	25,229	(13,064)
Net change in fair value of available-for-sale securities(2)	1,314	633	299	436
Other comprehensive income (loss), net of tax	21,396	2,459	25,528	(12,628)
Comprehensive income	$ 129,116	$ 118,720	$ 234,090	$ 234,623

(1) Net of tax (expense) benefit of $(5,737) and $28 for the three months ended March 31, 2016 and 2015, respectively, and of $(6,720) and $3,288 for the six months ended March 31, 2016 and 2015, respectively.

(2) Net of tax (expense) benefit of $(6) and $(2) for the three months ended March 31, 2016 and 2015, respectively, and of $4 and $6 for the six months ended March 31, 2016 and 2015, respectively.

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

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AMDOCS LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(dollar amounts in thousands)

	Six months ended March 31, 2016	Six months ended March 31, 2015
Cash Flow from Operating Activities:		
Net income	$ 208,562	$ 247,251
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	104,225	83,303
Equity-based compensation expense	23,286	23,723
Deferred income taxes	(7,614)	(27,260)
Excess tax benefit from equity-based compensation	(5,248)	(3,628)
Loss from short-term interest-bearing investments	445	283
Net changes in operating assets and liabilities, net of amounts acquired:		
Accounts receivable, net	(23,061)	(14,623)
Prepaid expenses and other current assets	(28,684)	3,522
Other noncurrent assets	3,352	14,898
Accounts payable, accrued expenses and accrued personnel	27,784	8,428
Deferred revenue	(3,023)	18,762
Income taxes payable, net	2,416	18,363
Other noncurrent liabilities	14,233	(29,388)
Net cash provided by operating activities	316,673	343,634
Cash Flow from Investing Activities:		
Payments for purchase of equipment and leasehold improvements, net	(67,289)	(59,334)
Proceeds from sale of short-term interest-bearing investments	191,648	123,073
Purchase of short-term interest-bearing investments	(199,988)	(121,585)
Net cash paid for acquisitions	(24,993)	(8,099)
Other	(20,602)	509
Net cash used in investing activities	(121,224)	(65,436)
Cash Flow from Financing Activities:		
Payments under financing arrangements	(220,000)	(210,000)
Repurchase of shares	(200,608)	(212,195)
Proceeds from employee stock option exercises	59,060	58,116
Payments of dividends	(51,262)	(48,377)
Excess tax benefit from equity-based compensation	5,248	3,628
Other	(4)	(5)
Net cash used in financing activities	(407,566)	(408,833)

Net decrease in cash and cash equivalents	(212,117)	(130,635)
Cash and cash equivalents at beginning of period	1,035,573	1,103,269
Cash and cash equivalents at end of period	$ 823,456	$ 972,634
Supplementary Cash Flow Information		
Cash paid for:		
Income taxes, net of refunds	$ 29,252	$ 38,208
Interest	445	406

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

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AMDOCS LIMITED

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(dollar and share amounts in thousands, except per share data)

1. Nature of Entity and Basis of Presentation

Amdocs Limited (the Company) is a leading provider of software and services for communications, entertainment and media industry service providers. The Company and its subsidiaries operate in one segment, providing integrated products and services. The Company designs, develops, markets, supports, implements and operates customer experience solutions primarily for leading wireless, wireline, cable and satellite service providers throughout the world. Amdocs also offers a full range of advertising and media solutions for local marketing service providers and search and directory publishers.

The Company is a Guernsey corporation, which directly or indirectly holds numerous wholly-owned subsidiaries around the world. The majority of the Company s customers are in North America, Europe, Latin America and the Asia-Pacific region. The Company s main development facilities are located in Brazil, Canada, Cyprus, India, Ireland, Israel, Mexico, the Philippines, the United Kingdom and the United States.

The unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. In the opinion of the Company s management, all adjustments considered necessary for a fair presentation of the unaudited interim consolidated financial statements have been included herein and are of a normal recurring nature.

The preparation of financial statements during interim periods requires management to make numerous estimates and assumptions that impact the reported amounts of assets, liabilities, revenue and expenses. Estimates and assumptions are reviewed periodically and the effect of revisions is reflected in the results of operations for the interim periods in which changes are determined to be necessary.

The results of operations for the interim periods presented herein are not necessarily indicative of the results to be expected for the full fiscal year. These statements do not include all information and footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with GAAP. These statements should be read in conjunction with the Company s consolidated financial statements for the fiscal year ended September 30, 2015, set forth in the Company s Annual Report on Form 20-F filed on December 10, 2015 with the U.S. Securities and Exchange Commission, or the SEC.

Reclassification

From time to time, certain immaterial amounts in prior year financial statements may be reclassified to conform to the current year presentation. The Company s prior year consolidated balance sheet as of September 30, 2015 reflects the reclassification of taxes receivable to prepaid expenses and other current assets, as well as current taxes payable to accrued expenses and other current liabilities to conform with the current period presentation.

2. Recent Accounting Standards

In March 2016, the Financial Accounting Standards Board, or FASB, issued an Accounting Standard Update, or ASU, on employee share-based payments. The ASU simplifies several aspects related to how share-based payments are

accounted for and presented in the financial statements, including income taxes, accounting for forfeitures and classification in the statements of cash flows. This ASU will be effective for the Company on October 1, 2017, and early adoption is permitted. The Company is currently evaluating the effect that adoption of this ASU will have on its consolidated financial statements.

In February 2016, the FASB issued an ASU on accounting for leases to increase transparency and comparability by providing additional information to users of financial statements regarding an entity s leasing activities. The ASU requires reporting entities to recognize lease assets and lease liabilities on the balance sheet for most leases, including operating leases, with a term greater than twelve months. This ASU, which will be effective for the Company beginning in the first quarter of fiscal year 2020, must be adopted using a modified retrospective method and its early adoption is permitted. The Company is currently evaluating the impact of adoption of this ASU on its consolidated financial statements.

In January 2016, the FASB issued an ASU on recognition and measurement of financial assets and financial liabilities. The ASU affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. This ASU will be effective for the Company on October 1, 2018, and early adoption is permitted. The Company expects adoption of this ASU may result in changes in its financial statements presentation but will not affect the substantive content of its consolidated financial statements.

In September 2015, the FASB issued an ASU on simplifying the accounting for measurement-period adjustments in connection with business combinations. The ASU eliminates the requirement to restate prior period financial statements for measurement-period adjustments and requires that the cumulative impact of a measurement-period adjustment be recognized in the reporting period in which the adjustment is identified. This ASU will be effective for the Company with respect to measurement-period adjustments that occur after October 1, 2017.

In May 2014, the FASB issued an ASU on revenue from contracts with customers, or the new revenue standard, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. In August 2015, the FASB deferred the effective date of this ASU by one year, to fiscal years beginning after December 15, 2017; however, early adoption for fiscal years beginning after December 15, 2016, will be permitted. In March 2016, the FASB issued ASU 2016-08 that clarifies the implementation guidance for principal versus agent considerations in the new revenue standard. In April 2016, the FASB issued ASU 2016-10 that amends the guidance in the new revenue standard related to identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued ASU 2016-12, which amends guidance in the new revenue standard on collectibility, noncash consideration, presentation of sales tax and transition. ASU 2016-08, ASU 2016-10 and ASU 2016-12 must be adopted together with the new revenue standard. The Company is evaluating the methods and timing of its adoption, as well as the effect that adoption of the new revenue standard will have on its consolidated financial statements.

3. Adoption of New Accounting Standard

In November 2015, the FASB issued an ASU that requires entities to present deferred tax assets and liabilities as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. The ASU, which may be applied either prospectively or retrospectively, will be effective for public business entities in fiscal years beginning after December 15, 2016, including interim periods within those years, and early adoption is permitted. The Company prospectively adopted this ASU effective October 1, 2015 and, as such, the Company s consolidated balance sheet as of September 30, 2015 does not reflect the reclassification of current deferred tax assets and liabilities as noncurrent amounts.

4. Fair Value Measurement

The Company accounts for certain assets and liabilities at fair value. Fair value is the price that would be received from selling an asset or that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of its fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety.

The three levels of inputs that may be used to measure fair value are as follows:

Level 1: Quoted prices in active markets for identical assets or liabilities;

Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets), or other inputs that are observable (model-derived valuations

in which significant inputs are observable) or can be derived principally from, or corroborated by, observable market data; and

Level 3: Unobservable inputs that are supported by little or no market activity that is significant to the fair value of the assets or liabilities.

The following tables present the Company s assets and liabilities measured at fair value on a recurring basis as of March 31, 2016 and September 30, 2015:

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	As of March 31, 2016		
	Level 1	Level 2	Total
Available-for-sale securities:			
Money market funds	$ 468,583	$	$ 468,583
U.S. government treasuries	120,426		120,426
Corporate bonds		108,822	108,822
U.S. agency securities		37,654	37,654
Asset backed obligations		29,174	29,174
Commercial paper and certificates of deposit		24,955	24,955
Supranational and sovereign debt		7,870	7,870
Total available-for-sale securities	589,009	208,475	797,484
Derivative financial instruments, net		11,352	11,352
Total	$ 589,009	$ 219,827	$ 808,836

	As of September 30, 2015		
	Level 1	Level 2	Total
Available-for-sale securities:			
Money market funds	$ 470,286	$	$ 470,286
U.S. government treasuries	117,452		117,452
Corporate bonds		101,603	101,603
U.S. agency securities		45,181	45,181
Asset backed obligations		29,215	29,215
Commercial paper and certificates of deposit	2,015	25,487	27,502
Supranational and sovereign debt		10,443	10,443
Total available-for-sale securities	589,753	211,929	801,682
Derivative financial instruments, net		(13,097)	(13,097)
Total	$ 589,753	$ 198,832	$ 788,585

Available-for-sale securities that are classified as Level 2 assets are priced using observable data that may include quoted market prices for similar instruments, market dealer quotes, market spreads, non-binding market prices that are corroborated by observable market data and other observable market information. The Company s derivative instruments are classified as Level 2 as they represent foreign currency forward and option contracts valued primarily based on observable inputs including forward rates and yield curves. The Company did not have any transfers between Level 1 and Level 2 fair value measurements during the three and six months ended March 31, 2016.

Fair Value of Financial Instruments

The carrying amounts of the Company s cash and cash equivalents, accounts receivable, accounts payable, accrued personnel costs, short-term financing arrangements and other current liabilities approximate their fair value because of the relatively short maturity of these items.

5. Available-For-Sale Securities

Available-for-sale securities consist of the following interest-bearing investments:

	As of March 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$ 468,583	$	$	$ 468,583
U.S. government treasuries	120,246	180		120,426
Corporate bonds	108,515	359	52	108,822
U.S. agency securities	37,557	97		37,654
Asset backed obligations	29,148	26		29,174
Commercial paper and certificates of deposit	24,955			24,955
Supranational and sovereign debt	7,862	8		7,870
Total(1)	$ 796,866	$ 670	$ 52	$ 797,484

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(1) Available-for-sale securities with maturities longer than 90 days from the date of acquisition were classified as short-term interest-bearing investments and available-for-sale securities with maturities of 90 days or less from the date of acquisition were included in cash and cash equivalents on the Company s balance sheet. As of March 31, 2016, $326,629 of securities were classified as short-term interest-bearing investments and $470,855 of securities were classified as cash and cash equivalents.

	As of September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$ 470,286	$	$	$ 470,286
U.S. government treasuries	117,235	217		117,452
Corporate bonds	101,613	123	133	101,603
U.S. agency securities	45,105	76		45,181
Asset backed obligations	29,195	20		29,215
Commercial paper and certificates of deposit	27,502			27,502
Supranational and sovereign debt	10,423	20		10,443
Total(2)	$ 801,359	$ 456	$ 133	$ 801,682

(2) As of September 30, 2015, $318,439 of securities were classified as short-term interest-bearing investments and $483,243 of securities were classified as cash and cash equivalents.

As of March 31, 2016, the unrealized losses attributable to the Company s available-for-sale securities were primarily due to credit spreads and interest rate movements. The Company assessed whether such unrealized losses for the investments in its portfolio were other-than-temporary. Based on this assessment, the Company did not recognize any credit losses in the six months ended March 31, 2016 and 2015. Realized gains and losses on available-for-sale securities are included in earnings and are derived using the first-in-first-out (FIFO) method for determining the cost of securities.

As of March 31, 2016, the Company s available-for-sale securities had the following maturity dates:

	Market Value
Due within one year	$ 595,836
1 to 2 years	109,871
2 to 3 years	80,439
3 to 4 years	7,512
Thereafter	3,826
	$ 797,484

6. Derivative Financial Instruments

The Company s risk management strategy includes the use of derivative financial instruments to reduce the volatility of earnings and cash flows associated with changes in foreign currency exchange rates. The Company does not enter into derivative transactions for trading purposes.

The Company s derivatives expose it to credit risks from possible non-performance by counterparties. The Company utilizes standard counterparty master netting agreements that net certain foreign currency transactions in the event of the insolvency of one of the parties to the transaction. These master netting arrangements permit the Company to net amounts due from the Company to a counterparty with amounts due to the Company from the same counterparty. Although all of the Company s recognized derivative assets and liabilities are subject to enforceable master netting arrangements, the Company has elected to present these assets and liabilities on a gross basis. Taking into account the Company s right to net certain gains with losses, the maximum amount of loss due to credit risk that the Company would incur if all counterparties to the derivative financial instruments failed completely to perform, according to the terms of the contracts, based on the gross fair value of the Company s derivative contracts that are favorable to the Company, was approximately $19,472 as of March 31, 2016. The Company has limited its credit risk by entering into derivative transactions exclusively with investment-grade rated financial institutions and monitors the creditworthiness of these financial institutions on an ongoing basis.

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The Company classifies cash flows from its derivative transactions as cash flows from operating activities in the consolidated statements of cash flow.

The table below presents the total volume or notional amounts of the Company s derivative instruments as of March 31, 2016. Notional values are in U.S. dollars and are translated and calculated based on forward rates as of March 31, 2016 for forward contracts, and based on spot rates as of March 31, 2016 for options.

	Notional Value*
Foreign exchange contracts	$ 1,346,529

* Gross notional amounts do not quantify risk or represent assets or liabilities of the Company, but are used in the calculation of settlements under the contracts.

The Company records all derivative instruments on the balance sheet at fair value. For further information, please see Note 4 to the consolidated financial statements. The fair value of the open foreign exchange contracts recorded as an asset or a liability by the Company on its consolidated balance sheets as of March 31, 2016 and September 30, 2015, is as follows:

	As of	
	March 31, 2016	September 30, 2015
Derivatives designated as hedging instruments		
Prepaid expenses and other current assets	$ 11,485	$ 3,631
Other noncurrent assets	8,102	533
Accrued expenses and other current liabilities	(2,780)	(14,640)
Other noncurrent liabilities	(126)	(3,990)
	16,681	(14,466)
Derivatives not designated as hedging instruments		
Prepaid expenses and other current assets	5,383	4,508
Accrued expenses and other current liabilities	(10,712)	(3,139)
	(5,329)	1,369
Net fair value	$ 11,352	$ (13,097)

Cash Flow Hedges

In order to reduce the impact of changes in foreign currency exchange rates on its results, the Company enters into foreign currency exchange forward and option contracts to purchase and sell foreign currencies to hedge a significant portion of its foreign currency net exposure resulting from revenue and expense transactions denominated in currencies other than the U.S. dollar. The Company designates these contracts for accounting purposes as cash flow hedges. The Company currently hedges its exposure to the variability in future cash flows for a maximum period of

approximately two years. A significant portion of the forward and option contracts outstanding as of March 31, 2016 is scheduled to mature within the next 12 months.

The effective portion of the gain or loss on the derivative instruments is initially recorded as a component of other comprehensive income (loss), a separate component of shareholders equity, and subsequently reclassified into earnings in the same line item as the related forecasted transaction and in the same period or periods during which the hedged exposure affects earnings. The cash flow hedges are evaluated for effectiveness at least quarterly. As the critical terms of the forward contract or option and the hedged transaction are matched at inception, the hedge effectiveness is assessed generally based on changes in the fair value for cash flow hedges, as compared to the changes in the fair value of the cash flows associated with the underlying hedged transactions. Hedge ineffectiveness, if any, and hedge components, such as time value, excluded from assessment of effectiveness testing for hedges of estimated revenue from customers, are recognized immediately in interest and other income (expense), net.

The effect of the Company s cash flow hedging instruments in the consolidated statements of income for the three and six months ended March 31, 2016 and 2015, respectively, which partially offsets the foreign currency impact from the underlying exposures, is summarized as follows:

	Gains (Losses) Reclassified from Other Comprehensive Income (Loss) (Effective Portion)			
	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Line item in consolidated statements of income:				
Revenue	$ 221	$ 188	$ 574	$ 539
Cost of revenue	(1,759)	(5,225)	(2,703)	(9,414)
Research and development	(409)	(1,401)	(692)	(2,333)
Selling, general and administrative	(624)	(1,544)	(1,114)	(2,584)
Total	$ (2,571)	$ (7,982)	$ (3,935)	$ (13,792)

The activity related to the changes in net unrealized losses on cash flow hedges recorded in accumulated other comprehensive income (loss), net of tax, is as follows:

	Six months ended March 31,	
	2016	2015
Net unrealized losses on cash flow hedges, net of tax, beginning of period	$ (12,152)	$ (5,522)
Changes in fair value of cash flow hedges, net of tax	21,907	(24,644)
Reclassification of net losses into earnings, net of tax	3,322	11,580
Net unrealized gains (losses) on cash flow hedges, net of tax, end of period	$ 13,077	$ (18,586)

Net gains (losses) from cash flow hedges recognized in other comprehensive income (loss) were $28,014 and $(30,144), or $21,907 and $(24,644) net of taxes, during the six months ended March 31, 2016 and 2015, respectively.

Of the net gains related to derivatives designated as cash flow hedges and recorded in accumulated other comprehensive income (loss) as of March 31, 2016, a net gain of $6,698 will be reclassified into earnings within the next 12 months and will partially offset the foreign currency impact from the underlying exposures. The amount ultimately realized in earnings will likely differ due to future changes in foreign exchange rates.

The ineffective portion of the change in fair value of a cash flow hedge, including the time value portion excluded from effectiveness testing for the three and six months ended March 31, 2016 and 2015, was not material.

Cash flow hedges are required to be discontinued in the event it becomes probable that the underlying forecasted hedged transaction will not occur. The Company did not discontinue any cash flow hedges during any of the periods presented nor does the Company anticipate any such discontinuance in the normal course of business.

Other Risk Management Derivatives

The Company also enters into foreign currency exchange forward and option contracts that are not designated as hedging instruments under hedge accounting and are used to reduce the impact of foreign currency on certain balance

sheet exposures and certain revenue and expense transactions.

These instruments are generally short-term in nature, with typical maturities of less than 12 months, and are subject to fluctuations in foreign exchange rates.

The effect of the Company s derivative instruments not designated as hedging instruments in the consolidated statements of income for the three and six months ended March 31, 2016 and 2015, respectively, which partially offsets the foreign currency impact from the underlying exposure, is summarized as follows:

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	Gains (Losses) Recognized in Income			
	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Line item in consolidated statements of income:				
Revenue	$ (34)	$	$ (109)	$
Cost of revenue	2,777	(3,523)	2,185	(8,118)
Research and development	300	(265)	313	(963)
Selling, general and administrative	629	(739)	570	(1,790)
Interest and other income (expense), net	(9,640)	19,451	(7,286)	25,266
Income taxes	(950)	676	(1,007)	1,746
Total	$ (6,918)	$ 15,600	$ (5,334)	$ 16,141

7. Accounts Receivable, Net

Accounts receivable, net consists of the following:

	As of	
	March 31, 2016	September 30, 2015
Accounts receivable billed	$ 709,703	$ 668,424
Accounts receivable unbilled	92,812	80,197
Less-allowances	(47,134)	(33,837)
Accounts receivable, net	$ 755,381	$ 714,784

8. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

	As of	
	March 31, 2016	September 30, 2015
Project-related provisions	$ 198,390	$ 201,719
Taxes payable	52,018	68,448
Dividends payable	29,206	25,697
Derivative instruments	13,492	17,779
Other	286,175	295,184
Accrued expenses and other current liabilities	$ 579,281	$ 608,827

9. Income Taxes

The provision (benefit) for income taxes for the following periods consisted of:

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Current	$ 10,904	$ 23,569	$ 38,529	$ 59,405
Deferred	2,983	(3,499)	(7,614)	(27,260)
Income taxes	$ 13,887	$ 20,070	$ 30,915	$ 32,145

The Company s effective income tax rate varied from the statutory Guernsey tax rate as follows for the following periods:

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Statutory Guernsey tax rate	0%	0%	0%	0%
Foreign taxes	11	15	13	12
Effective income tax rate	11%	15%	13%	12%

As a Guernsey company subject to a corporate tax rate of zero percent, the Company s overall effective tax rate is attributable to foreign taxes.

Foreign taxes in the six months ended March 31, 2016 included a net benefit of $15,264 due to settlements and conclusions of tax audits in certain jurisdictions during the three months ended March 31, 2016, that resulted in a reduction to the Company s provision for gross unrecognized tax benefits, partially offset by a decrease to the Company s taxes receivable. Foreign taxes in the six months ended March 31, 2016 also included a provision for new uncertain tax positions of $22,309 recognized during the three months ended March 31, 2016. In addition, foreign taxes in the six months ended March 31, 2016 included a benefit of $19,963 as a result of a release of tax provision in light of a non-taxable internal capital gain recognized during the three months ended March 31, 2016.

Foreign taxes in the six months ended March 31, 2015 included a net benefit of $7,594 due to settlements of tax audits in certain jurisdictions during the three months ended December 31, 2014, that resulted in a reduction to the Company s provision for gross unrecognized tax benefits, partially offset by an increase to the Company s taxes payable. Foreign taxes in the six months ended March 31, 2015 also included a net benefit of $22,895 resulting from the release of valuation allowances on deferred tax assets at several of the Company s subsidiaries, which will, more likely than not, be realized due to the Company s projections of future taxable income.

As of March 31, 2016, deferred tax assets of $145,138, derived primarily from tax credits, net capital and operating loss carry forwards related to some of the Company s subsidiaries, were offset by valuation allowances due to the uncertainty of realizing tax benefit for such credits and losses.

The total amount of gross unrecognized tax benefits, which includes interest and penalties, was $143,977 as of March 31, 2016, all of which would affect the effective tax rate if realized.

As of March 31, 2016, the Company had accrued $29,195 in income taxes payable for interest and penalties relating to unrecognized tax benefits.

The Company is currently under audit in several jurisdictions for the tax years 2007 and onwards. Timing of the resolution of audits is highly uncertain and therefore the Company generally cannot estimate the change in unrecognized tax benefits resulting from these audits within the next 12 months.

10. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended March 31,		Six months ended March 31,	
	2016	**2015**	**2016**	**2015**
Numerator:				
Net income	$ 107,720	$ 116,261	$ 208,562	$ 247,251
Less-net income and dividends attributable to participating restricted shares	(965)	(1,164)	(1,957)	(2,687)
Numerator for basic earnings per common share	$ 106,755	$ 115,097	$ 206,605	$ 244,564
	703	900	1,442	2,138

Add-undistributed income allocated to participating restricted shares				
Less-undistributed income reallocated to participating restricted shares	(694)	(887)	(1,421)	(2,108)
Numerator for diluted earnings per common share	$ 106,764	$ 115,110	$ 206,626	$ 244,594
Denominator:				
Weighted average number of shares outstanding - basic	149,924	155,106	150,279	155,506
Less- weighted average number of participating restricted shares	(1,343)	(1,553)	(1,410)	(1,690)
Weighted average number of common shares - basic	148,581	153,553	148,869	153,816
Effect of assumed conversion of 0.5% convertible notes	5	15	7	15
Effect of dilutive stock options granted	2,019	2,237	2,216	2,217
Weighted average number of common shares - diluted	150,605	155,805	151,092	156,048
Basic earnings per common share	$ 0.72	$ 0.75	$ 1.39	$ 1.59
Diluted earnings per common share	$ 0.71	$ 0.74	$ 1.37	$ 1.57

For the three and six months ended March 31, 2016, 2,009 and 1,459 shares, respectively, on a weighted average basis, were attributable to antidilutive outstanding stock options. For the three and six months ended March 31, 2015, 1,778 and 1,295 shares, respectively, on a weighted average basis, were attributable to antidilutive outstanding stock options. Shares attributable to antidilutive outstanding stock options were not included in the calculation of diluted earnings per share.

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11. Repurchase of Shares

From time to time, the Company s Board of Directors has adopted share repurchase plans authorizing the repurchase of the Company s outstanding ordinary shares. The Company s Board of Directors adopted a share repurchase plan on April 30, 2014, for the repurchase of up to $750,000 of the Company s outstanding ordinary shares with no expiration date. In the six months ended March 31, 2016, the Company repurchased approximately 3,570 ordinary shares at an average price of $56.18 per share (excluding broker and transaction fees), and as of March 31, 2016, the Company had remaining authority to repurchase up to $59,533 of its outstanding ordinary shares. On February 2, 2016, the Company s Board of Directors adopted another share repurchase plan for the repurchase of up to an additional $750,000 of its outstanding ordinary shares with no expiration date. Each of the share repurchase plans permits the Company to purchase its ordinary shares in open market or privately negotiated transactions at times and prices that it considers appropriate.

12. Financing Arrangements

In September 2015, the Company borrowed an aggregate of $220,000 under its unsecured $500,000 five-year revolving credit facility with a syndicate of banks and repaid it in October 2015. As of March 31, 2016, the Company was in compliance with the financial covenants under the revolving credit facility and had no outstanding borrowings under this facility.

As of March 31, 2016, the Company had additional uncommitted lines of credit available for general corporate and other specific purposes and had outstanding letters of credit and bank guarantees from various banks totaling $74,881. These were supported by a combination of the uncommitted lines of credit that the Company maintains with various banks.

13. Stock Option and Incentive Plan

In January 1998, the Company adopted the 1998 Stock Option and Incentive Plan, or Equity Incentive Plan, which provides for the grant of restricted stock awards, stock options and other equity-based awards to employees, officers, directors, and consultants. Awards granted under the Equity Incentive Plan generally vest over a period of four years and stock options have a term of ten years.

During the six months ended March 31, 2016, the Company granted 485 restricted shares and options to purchase 1,880 ordinary shares. The weighted average fair values associated with these grants were $55.34 per restricted share and $7.97 per option.

Equity-based payments to employees, including grants of employee stock options, are recognized in the statements of income based on their fair values.

Employee equity-based compensation pre-tax expense for the three and six months ended March 31, 2016 and 2015 was as follows:

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Cost of revenue	$ 4,917	$ 3,737	$ 9,041	$ 7,981
Research and development	1,018	817	1,860	1,754

Selling, general and administrative	4,381	5,271	12,385	13,988
Total	$ 10,316	$ 9,825	$ 23,286	$ 23,723

As of March 31, 2016, there was $56,468 of unrecognized compensation expense related to unvested stock options and unvested restricted shares. The Company recognizes compensation costs using the graded vesting attribution method which results in a weighted average period of approximately one year over which the unrecognized compensation expense is expected to be recognized.

14. Dividends

The Company s Board of Directors declared the following dividends during the six months ended March 31, 2016 and 2015:

Declaration Date	Dividends Per Ordinary Share	Record Date	Total Amount	Payment Date
February 2, 2016	$ 0.195	March 31, 2016	$ 29,206	April 15, 2016
November 10, 2015	$ 0.170	December 31, 2015	$ 25,565	January 15, 2016
January 27, 2015	$ 0.170	March 31, 2015	$ 26,286	April 16, 2015
November 4, 2014	$ 0.155	December 31, 2014	$ 24,086	January 16, 2015

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The amounts payable as a result of the February 2, 2016 and January 27, 2015 declarations were included in accrued expenses and other current liabilities as of March 31, 2016 and 2015, respectively.

On May 4, 2016, the Company s Board of Directors approved the next quarterly dividend payment, at the rate of $0.195 per share, and set June 30, 2016 as the record date for determining the shareholders entitled to receive the dividend, which is payable on July 15, 2016.

15. Contingencies

Legal Proceedings

The Company is involved in various legal claims and proceedings arising in the normal course of its business. The Company accrues for a loss contingency when it determines that it is probable, after consultation with counsel, that a liability has been incurred and the amount of such loss can be reasonably estimated. At this time, the Company believes that the results of any such contingencies, either individually or in the aggregate, will not have a material adverse effect on the Company s financial position, results of operations or cash flows.

The Company generally offers its products with a limited warranty for a period of 90 days or more. The Company s policy is to accrue for warranty costs, if needed, based on historical trends in product failure. Based on the Company s experience, only minimal warranty charges have been required after revenue was fully recognized and, as a result, the Company did not accrue any amounts for product warranty liability during the six months ended March 31, 2016 and 2015.

The Company generally indemnifies its customers against claims of intellectual property infringement made by third parties arising from the use of the Company s software. To date, the Company has incurred and recorded immaterial costs as a result of such obligations in its consolidated financial statements.

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Item 2. Operating and Financial Review and Prospects

Forward Looking Statements

This section contains forward-looking statements (within the meaning of the United States federal securities laws) that involve substantial risks and uncertainties. You can identify these forward-looking statements by words such as expect , anticipate , believe , seek , estimate , project , forecast , continue , potential , should , would other words that convey uncertainty of future events or outcome. Statements that we make in this document that are not statements of historical fact also may be forward-looking statements. Forward-looking statements are not guarantees of future performance, and involve risks, uncertainties and assumptions that may cause our actual results to differ materially from the expectations that we describe in our forward-looking statements. There may be events in the future that we are not accurately able to predict, or over which we have no control. You should not place undue reliance on forward-looking statements. Although we may elect to update forward-looking statements in the future, we disclaim any obligation to do so, even if our assumptions and projections change, except where applicable law may otherwise require us to do so. Readers should not rely on those forward-looking statements as representing our views as of any date subsequent to the date of this report.

Important factors that may affect these projections or expectations include, but are not limited to: changes in the overall economy; changes in competition in markets in which we operate; changes in the demand for our products and services; consolidation within the industries in which our customers operate; the loss of a significant customer; changes in the telecommunications regulatory environment; changes in technology that impact both the markets we serve and the types of products and services we offer; financial difficulties of our customers; losses of key personnel; difficulties in completing or integrating acquisitions; litigation and regulatory proceedings; and acts of war or terrorism. For a discussion of these important factors and other risks, please read the information set forth under the caption Risk Factors in our Annual Report on Form 20-F for fiscal year 2015, filed on December 10, 2015 with the U.S. Securities and Exchange Commission.

Overview of Business and Trend Information

Amdocs is a leading provider of software and services for communications, entertainment and media industry service providers in developed countries and emerging markets. We develop, implement and manage software and services associated with business support systems (BSS), operational support systems (OSS) and network operations to enable service providers to efficiently and cost-effectively introduce new products and services, such as mobile financial services, process orders more efficiently, monetize data, support new business models and generally enhance their understanding of their customers. We refer to these products, systems and services collectively as customer experience solutions because of the crucial impact they have on the service providers end-user experience.

We believe the demand for our customer experience solutions is driven by the desire of service providers to help their consumer and business customers navigate the increasing number of devices, services and plans available in today s digital communications world and the need of service providers to cope with the rapidly growing demand for data that these devices and services have created. Regardless of whether service providers are bringing their first offerings to market, scaling for growth, consolidating systems or transforming the way they do business, we believe that they seek to differentiate themselves by delivering a customer experience that is simple, personal and valuable at every point of interaction.

Amdocs CES (customer experience solutions) enables service providers to respond to the multidimensional digital interaction demands of customers, as a result of which service providers are expected to offer innovative and personalized services that are delivered consistently across channels and with a seamless network experience. In the

second quarter of fiscal year 2016, we released Amdocs CES 10, an advanced product portfolio, which spans BSS, OSS, network operations including network functions virtualization, and big data analytics to enable service providers to drive digital transformation, diversify their business, become a data-empowered business, and achieve service agility. During this quarter, we also released an enhanced digital services portfolio to support and accelerate service providers transition from traditional to digital business models. In the first quarter of fiscal year 2016, we released Amdocs Kenan AX3.1 and C1 3.7.8, based on the BSS assets we acquired from Comverse. Amdocs Kenan AX3.1 provides ad-hoc or subscription-based enterprise-grade billing and is available for deployment on public or private cloud environments. Amdocs C1 3.7.8 supports complete BSS convergence and online charging into existing postpaid environments.

We also offer advertising and media products and services for media publishers, advertising agencies, advertising service providers and directory publishers. These offerings enable the management of media selling, fulfillment, operations, consumer experiences and financial processes across digital and print media.

We conduct our business globally, and as a result we are subject to the effects of global economic conditions and, in particular, market conditions in the communications, entertainment and media industry. In the six months ended March 31, 2016, customers in North America accounted for 63.0% of our revenue, while customers in Europe and the rest of the world accounted for 14.5% and 22.5%, respectively. We maintain development facilities in Brazil, Canada, Cyprus, India, Ireland, Israel, Mexico, the Philippines, the United Kingdom and the United States.

We derive our revenue principally from:

- the initial sales of licenses to use our products and related services, including modification, implementation, integration and customization services,
- providing managed services in our domain expertise and other related services, and
- recurring revenue from ongoing support, maintenance and enhancements provided to our customers, and from incremental license fees resulting from increases in a customer s business volume.

Revenue is recognized only when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed or determinable; and (iv) collectibility of the fee is reasonably assured. We usually sell our software licenses as part of an overall solution offered to a customer that combines the sale of software licenses with a broad range of services, which normally include significant customization, modification, implementation and integration. Those services are deemed essential to the software. As a result, we generally recognize initial license fee and related service revenue over the course of these long-term projects, using the percentage of completion method of accounting. Contingent subsequent license fee revenue is recognized upon completion of specified conditions in each contract, based on a customer s subscriber or transaction volume or other measurements when greater than the level specified in the contract for the initial license fee. Revenue from sales of hardware that functions together with the software licenses to provide the essential functionality of the product and that includes significant customization, modification, implementation and integration, is recognized as work is performed, under the percentage of completion method of accounting. Revenue from software solutions that do not require significant customization, implementation and modification is recognized upon delivery. Revenue from services that do not involve significant ongoing obligations is recognized as services are rendered. In managed services contracts, we typically recognize revenue from the operation of a customer s system as services are performed based on time elapsed, output produced, volume of data processed or subscriber count, depending on the specific contract terms of the managed services arrangement. Typically, managed services contracts are long-term in duration and are not subject to seasonality. Revenue from ongoing support services is recognized as work is performed.

Revenue from third-party hardware sales is recognized upon delivery and installation and revenue from third-party software sales is recognized upon delivery. Maintenance revenue is recognized ratably over the term of the maintenance agreement.

A significant portion of our revenue is recognized over the course of long-term implementation and integration projects under the percentage of completion method of accounting, usually based on a percentage that incurred labor effort to date bears to total projected labor effort. When total cost estimates exceed revenue in a fixed-price arrangement, the estimated losses are recognized immediately based upon the cost applicable to the project. The percentage of completion method requires the exercise of judgment on a quarterly basis, such as with respect to estimates of progress-to-completion, contract revenue, loss contracts and contract costs. Progress in completing such projects may significantly affect our annual and quarterly operating results.

Revenue generated in connection with managed services arrangements is a significant part of our business, generating substantial, long-term recurring revenue streams and cash flow. Revenue from managed services arrangements accounted for approximately $501.1 million and $448.8 million in the three months ended March 31, 2016 and 2015, respectively, and $988.7 million and $915.9 million in the six months ended March 31, 2016 and 2015, respectively.

In the initial period of our managed services projects, we often invest in modernization and consolidation of the customer s systems. Managed services engagements can be less profitable in their early stages; however, margins tend to improve over time, more rapidly in the initial period of an engagement, as we derive benefit from the operational efficiencies and from changes in the geographical mix of our resources.

Recent Accounting Standards

In March 2016, the Financial Accounting Standards Board, or FASB, issued an Accounting Standard Update, or ASU, on employee share-based payments. The ASU simplifies several aspects related to how share-based payments are accounted for and presented in the financial statements, including income taxes, accounting for forfeitures and classification in the statements of cash flows. This ASU will be effective for us on October 1, 2017, and early adoption is permitted. We are currently evaluating the effect that adoption of this ASU will have on our consolidated financial statements.

In February 2016, the FASB issued an ASU on accounting for leases to increase transparency and comparability by providing additional information to users of financial statements regarding an entity s leasing activities. The ASU requires reporting entities to recognize lease assets and lease liabilities on the balance sheet for most leases, including operating leases, with a term greater than twelve months.

This ASU, which will be effective for us beginning in the first quarter of fiscal year 2020, must be adopted using a modified retrospective method and its early adoption is permitted. We are currently evaluating the impact of adoption of this ASU on our consolidated financial statements.

In January 2016, the FASB issued an ASU on recognition and measurement of financial assets and financial liabilities. The ASU affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. This ASU will be effective for us on October 1, 2018, and early adoption is permitted. We expect adoption of this ASU may result in changes in our financial statements presentation but will not affect the substantive content of our consolidated financial statements.

In September 2015, the FASB issued an ASU on simplifying the accounting for measurement-period adjustments in connection with business combinations. The ASU eliminates the requirement to restate prior period financial statements for measurement-period adjustments and requires that the cumulative impact of a measurement-period adjustment be recognized in the reporting period in which the adjustment is identified. This ASU will be effective for us with respect to measurement-period adjustments that occur after October 1, 2017.

In May 2014, the FASB issued an ASU on revenue from contracts with customers, or the new revenue standard, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. In August 2015, the FASB deferred the effective date of this ASU by one year, to fiscal years beginning after December 15, 2017; however, early adoption for fiscal years beginning after December 15, 2016, will be permitted. In March 2016, the FASB issued ASU 2016-08 that clarifies the implementation guidance for principal versus agent considerations in the new revenue standard. In April 2016, the FASB issued ASU 2016-10 that amends the guidance in the new revenue standard related to identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued ASU 2016-12, which amends guidance in the new revenue standard on collectibility, noncash consideration, presentation of sales tax and transition. ASU 2016-08, ASU 2016-10 and ASU 2016-12 must be adopted together with the new revenue standard. We are evaluating the methods and timing of our adoption, as well as the effect that adoption of the new revenue standard will have on our consolidated financial statements.

Adoption of New Accounting Standard

In November 2015, the FASB issued an ASU that requires entities to present deferred tax assets and liabilities as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. The ASU, which may be applied either prospectively or retrospectively, will be effective for public business entities in fiscal years beginning after December 15, 2016, including interim periods within those years and early adoption is permitted. We prospectively adopted this ASU effective October 1, 2015 and, as such, our consolidated balance sheet as of September 30, 2015 does not reflect the reclassification of current deferred tax assets and liabilities as noncurrent amounts.

Results of Operations

The following table sets forth for the three and six months ended March 31, 2016 and 2015, certain items in our consolidated statements of income reflected as a percentage of revenue:

	Three months ended	Six months ended

	March 31,		March 31,	
	2016	2015	2016	2015
Revenue	100%	100%	100%	100%
Operating expenses:				
Cost of revenue	64.8	64.3	64.7	63.8
Research and development	6.9	7.0	6.8	7.0
Selling, general and administrative	12.3	11.9	12.7	12.2
Amortization of purchased intangible assets and other	3.0	1.5	2.8	1.5
	87.0	84.7	87.0	84.5
Operating income	13.0	15.3	13.0	15.5
Interest and other income (expense), net	0.1	(0.2)	0.0	0.0
Income before income taxes	13.1	15.1	13.0	15.5
Income taxes	1.5	2.2	1.7	1.8
Net income	11.6%	12.9%	11.3%	13.7%

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Six Months Ended March 31, 2016 and 2015

The following is a tabular presentation of our results of operations for the six months ended March 31, 2016 compared to the six months ended March 31, 2015. Following the table is a discussion and analysis of our business and results of operations for such periods.

	Six months ended March 31,		Increase (Decrease)	
	2016	2015	Amount	%
	(in thousands)			
Revenue	$ 1,847,440	$ 1,808,865	$ 38,575	2.1%
Operating expenses:				
Cost of revenue	1,195,684	1,154,017	41,667	3.6
Research and development	126,198	126,446	(248)	(0.2)
Selling, general and administrative	234,022	220,766	13,256	6.0
Amortization of purchased intangible assets and other	51,854	28,115	23,739	84.4
	1,607,758	1,529,344	78,414	5.1
Operating income	239,682	279,521	(39,839)	(14.3)
Interest and other income (expense), net	(205)	(125)	(80)	64.0
Income before income taxes	239,477	279,396	(39,919)	(14.3)
Income taxes	30,915	32,145	(1,230)	(3.8)
Net income	$ 208,562	$ 247,251	$ (38,689)	(15.6%)

Revenue. Revenue increased by $38.6 million, or 2.1%, to $1,847.4 million in the six months ended March 31, 2016, from $1,808.9 million in the six months ended March 31, 2015. The increase in revenue was attributable to increased activity in the rest of the world and, to a lesser extent, in Europe, partially offset by lower revenue from North America. The 2.1% increase in revenue, which was net of a decrease of approximately 2.5% from foreign exchange fluctuations, was also positively affected by revenue related to the BSS assets we acquired from Comverse.

Revenue attributable to the sale of customer experience solutions increased by $37.2 million, or 2.1%, to $1,796.7 million in the six months ended March 31, 2016, from $1,759.5 million in the six months ended March 31, 2015. The increase in revenue was attributable to increased activity in the rest of the world and, to a lesser extent, in Europe, partially offset by lower revenue from North America. Revenue resulting from the sale of customer experience solutions represented 97.3% of our total revenue in both the six months ended March 31, 2016 and 2015.

Revenue attributable to the sale of directory systems increased by $1.3 million, or 2.6%, to $50.7 million in the six months ended March 31, 2016, from $49.4 million in the six months ended March 31, 2015. Nevertheless, due to the continued slowness in the directory systems market, we expect that directory revenue will continue to decline in fiscal year 2016 compared to fiscal year 2015. Revenue from the sale of directory systems represented 2.7% of our total revenue in both the six months ended March 31, 2016 and 2015.

In the six months ended March 31, 2016, revenue from customers in North America, Europe and the rest of the world accounted for 63.0%, 14.5% and 22.5%, respectively, of total revenue, compared to 72.2%, 11.3% and 16.5%, respectively, in the six months ended March 31, 2015. The decrease in the percentage of revenue from customers in North America was primarily driven by AT&T s slower pace of discretionary spending. The increase in the percentage of revenue from customers in Europe was attributable to expanding our business relations with new and existing customers, including Vodafone. Revenue from customers in the rest of the world increased as a percentage of total revenue as a result of our progress in implementing complex modernization projects in both Latin America and Asia-Pacific, while capitalizing on the sustained business momentum with former Comverse customers.

Cost of Revenue. Cost of revenue consists primarily of costs associated with providing services to customers, including compensation expense and costs of third-party products, as well as fee and royalty payments to software suppliers. Cost of revenue increased by $41.7 million, or 3.6%, to $1,195.7 million in the six months ended March 31, 2016, from $1,154.0 million in the six months ended March 31, 2015. As a percentage of revenue, cost of revenue increased to 64.7% in the six months ended March 31, 2016, from 63.8% in the six months ended March 31, 2015. The reduction in the gross margin in the six months ended March 31, 2016 was primarily attributable to: a. our increased activity outside of our established markets, which are primarily North America, where we continued our penetration efforts in order to expand our business into those markets, and also to; b. a gain resulting from changes in fair value of certain acquisition-related liabilities recognized in the six months ended March 31, 2015.

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Research and Development. Research and development expense is primarily comprised of compensation expense. Research and development expense decreased by $0.2 million, or 0.2%, to $126.2 million in the six months ended March 31, 2016, from $126.4 million in the six months ended March 31, 2015. Research and development expense decreased as a percentage of revenue from 7.0% in the six months ended March 31, 2015, to 6.8% in the six months ended March 31, 2016. Our research and development efforts are a key element of our strategy and are essential to our success, and we intend to maintain our commitment to research and development. An increase or a decrease in our revenue would not necessarily result in a proportional increase or decrease in the levels of our research and development expenditures, which could affect our operating margin.

Selling, General and Administrative. Selling, general and administrative expense, which is primarily comprised of compensation expense, increased by $13.3 million, or 6.0%, to $234.0 million in the six months ended March 31, 2016, from $220.8 million in the six months ended March 31, 2015. The increase in selling, general and administrative expense was primarily attributable to the acquisition of the BSS assets of Comverse, as well as to an increase in the allowance for doubtful accounts. Selling, general and administrative expense may fluctuate from time to time, depending upon such factors as changes in our workforce and sales efforts and the results of any operational efficiency programs that we may undertake.

Amortization of Purchased Intangible Assets and Other. Amortization of purchased intangible assets and other in the six months ended March 31, 2016, increased by $23.7 million to $51.8 million from $28.1 million in the six months ended March 31, 2015. The increase in amortization of purchased intangible assets and other was primarily attributable to an increase in amortization of intangible assets due to the acquisition of the BSS assets of Comverse.

Operating Income. Operating income decreased by $39.8 million, or 14.3%, in the six months ended March 31, 2016, to $239.7 million, or 13.0% of revenue, from $279.5 million, or 15.5% of revenue, in the six months ended March 31, 2015. The decrease in operating income as a percentage of revenue was attributable to operating expenses, particularly amortization of purchased intangible assets and other, as well as cost of revenue, increasing at a higher rate than revenue. Positive foreign exchange impacts on our operating expenses were partially offset by the negative foreign exchange impacts on our revenue, resulting in a minor positive impact on our operating income.

Income Taxes. Income taxes for the six months ended March 31, 2016 were $30.9 million on pre-tax income of $239.5 million, resulting in an effective tax rate of 12.9%, compared to 11.5% in the six months ended March 31, 2015. Our effective tax rate may fluctuate between periods as a result of discrete items that may affect a particular period. Please see Note 9 to our consolidated financial statements.

Net Income. Net income decreased by $38.7 million, or 15.6%, to $208.6 million in the six months ended March 31, 2016, from $247.3 million in the six months ended March 31, 2015. The decrease in net income was primarily attributable to the decrease in operating income.

Diluted Earnings Per Share. Diluted earnings per share decreased by $0.20, or 12.7%, to $1.37 in the six months ended March 31, 2016, from $1.57 in the six months ended March 31, 2015. The decrease in diluted earnings per share was mainly attributable to the decrease in net income, which was partially offset by the decrease in the diluted weighted average number of shares outstanding.

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Three Months Ended March 31, 2016 and 2015

The following is a tabular presentation of our results of operations for the three months ended March 31, 2016 compared to the three months ended March 31, 2015. Following the table is a discussion and analysis of our business and results of operations for such periods.

	Three months ended March 31,		Increase (Decrease)	
	2016	2015	Amount	%
	(in thousands)			
Revenue	$ 925,935	$ 902,578	$ 23,357	2.6%
Operating expenses:				
Cost of revenue	600,116	580,571	19,545	3.4
Research and development	63,711	62,805	906	1.4
Selling, general and administrative	114,474	107,186	7,288	6.8
Amortization of purchased intangible assets and other	27,487	14,016	13,471	96.1
	805,788	764,578	41,210	5.4
Operating income	120,147	138,000	(17,853)	(12.9)
Interest and other income (expense), net	1,460	(1,669)	(3,129)	(187.5)
Income before income taxes	121,607	136,331	(14,724)	(10.8)
Income taxes	13,887	20,070	(6,183)	(30.8)
Net income	$ 107,720	$ 116,261	$ (8,541)	(7.3%)

Revenue. Revenue increased by $23.4 million, or 2.6%, to $925.9 million in the three months ended March 31, 2016, from $902.6 million in the three months ended March 31, 2015. The increase in revenue was attributable to increased activity in Europe and the rest of the world, partially offset by lower revenue from North America. The 2.6% increase in revenue, which was net of a decrease of approximately 1.5% from foreign exchange fluctuations, was also positively affected by revenue related to the BSS assets we acquired from Comverse.

Revenue attributable to the sale of customer experience solutions increased by $25.2 million, or 2.9%, to $902.3 million in the three months ended March 31, 2016, from $877.1 million in the three months ended March 31, 2015. The increase in revenue was attributable to increased activity in Europe and the rest of the world, partially offset by lower revenue from North America. Revenue resulting from the sale of customer experience solutions represented 97.5% and 97.2% of our total revenue in the three months ended-size:10pt;">(1

)

1,272

Asset-backed securities
354

—

—

354

Other [1]
110

2

(1
)

111

Total
$
2,552

$
4

$
(2
)

$
2,554

December 31, 2013

Amortized
Cost

		Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(in millions)			
Municipal securities	$ 267	$ —	$ —	$ 267
U.S. Government and Agency securities	560	—	—	560
Corporate securities	1,425	2	(1)	

1,426

Asset-backed securities
364

—

—

364

Other [1]
91

—

(1
)

90

Total
$
2,707

$
2

$
(2
)

$
2,707

[1] Other includes ARS, which are included in other assets on the consolidated balance sheet. The unrealized losses related to ARS have been in an unrealized loss position longer than 12 months, but have not been deemed other-than-temporarily impaired.
The municipal securities are primarily comprised of tax-exempt bonds and are diversified across states and sectors. The U.S. government and agency securities are primarily invested in U.S. government treasury bills and bonds and U.S. government sponsored agency bonds and discount notes. Corporate securities are comprised of commercial paper and corporate bonds. The asset-backed securities are investments in bonds which are collateralized primarily by automobile loan receivables.
Investment Maturities

The maturity distribution based on the contractual terms of the Company's investment securities at March 31, 2014 was as follows:

	Available-For-Sale	
	Amortized Cost	Fair Value
	(in millions)	
Due within 1 year	$1,476	$1,476
Due after 1 year through 5 years	1,025	1,027
Due after 5 years through 10 years	14	14
Due after 10 years	12	11
No contractual maturity	25	26
Total	$2,552	$2,554

All the securities due after ten years are ARS. Equity securities have been included in the no contractual maturity category, as these securities do not have stated maturity dates.

Investment Income

Investment income was $7 million and $8 million for the three months ended March 31, 2014 and 2013, respectively. Investment income primarily consisted of interest income generated from cash, cash equivalents, and investment securities available-for-sale. Dividend income and gross realized gains and losses were not significant.

Note 5. Prepaid Expenses and Other Assets

Prepaid expenses and other current assets consisted of the following:

	March 31, 2014	December 31, 2013
	(in millions)	
Customer and merchant incentives	$325	$239
Prepaid income taxes	20	36
Other	207	196
Total prepaid expenses and other current assets	$552	$471

Other assets consisted of the following:

	March 31, 2014	December 31, 2013
	(in millions)	
Customer and merchant incentives	$530	$531
Nonmarketable equity investments	173	229
Income taxes receivable	81	78
Other	74	64
Total other assets	$858	$902

Certain customer and merchant business agreements provide incentives upon entering into the agreement. Customer and merchant incentives represent payments made or amounts to be paid to customers and merchants under business agreements. Amounts to be paid for these incentives and the related liability were included in accrued expenses and other liabilities. Once the payment is made, the liability is relieved. Costs directly related to entering into such an agreement are deferred and amortized over the life of the agreement.

Investments for which the equity method or historical cost method of accounting is used are recorded in other assets on the consolidated balance sheet. MasterCard's share of net earnings or losses of entities accounted for under the equity method of accounting is included in other income (expense) on the consolidated statement of operations. The Company accounts for nonmarketable equity investments under the historical cost method of accounting when those investments do not qualify for the equity method of accounting. During the three months ended March 31, 2014, the Company acquired a controlling interest in an investment previously included within nonmarketable equity investments.

Note 6. Accrued Expenses and Accrued Litigation

Accrued expenses consisted of the following:

	March 31, 2014	December 31, 2013
	(in millions)	
Customer and merchant incentives	$1,293	$1,286
Personnel costs	206	413
Advertising	76	149
Income and other taxes	383	95
Other	170	158
Total accrued expenses	$2,128	$2,101

As of March 31, 2014 and December 31, 2013, the Company's provision related to U.S. merchant litigations was $859 million and $886 million, respectively. These amounts are not included in the accrued expenses table above and are separately reported as accrued litigation on the consolidated balance sheet. The accrued litigation item also includes $60 million as of March 31, 2014 and $68 million as of December 31, 2013 related to the timing of MasterCard's administration of the short-term reduction in default

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credit interchange from U.S. issuers. There is a corresponding equal amount presented in settlement due from customers. See Note 12 (Legal and Regulatory Proceedings) for further discussion of the U.S. merchant class litigation.

Note 7. Debt

Long-term debt at March 31, 2014 and December 31, 2013 was as follows:

	March 31, 2014	December 31, 2013
	(in millions)	
2.000% Notes due 2019	$500	$—
3.375% Notes due 2024	1,000	—
	1,500	—
Less: Unamortized discount	(6)	—
Long-term debt	$1,494	$—

In March 2014, MasterCard Incorporated issued $500 million aggregate principal amount of 2.000% Notes due April 1, 2019 (the “2019 Notes”) and $1 billion aggregate principal amount of 3.375% Notes due April 1, 2024 (the “2024 Notes”) (collectively the “Notes”). The effective interest rates were 2.081% and 3.426% on the 2019 Notes and 2024 Notes, respectively. The net proceeds from the issuance of the Notes, after deducting the underwriting discount and offering expenses, were $1,484 million. The Company is not subject to any financial covenants under the Notes. Interest on the Notes is payable semi-annually on April 1 and October 1, commencing on October 1, 2014. The Notes may be redeemed in whole, or in part, at the Company’s option at any time for a specified make-whole amount. The Notes are senior unsecured obligations and would rank equally with any future unsecured and unsubordinated indebtedness.

The Company has a $3 billion committed unsecured revolving credit facility (the “Credit Facility”) which expires on November 15, 2018. The Credit Facility decreases to $2.95 billion during the final year of the Credit Facility agreement. MasterCard had no borrowings under the Credit Facility at March 31, 2014 or December 31, 2013.

Note 8. Stockholders’ Equity

In June 2012, the Company’s Board of Directors approved a share repurchase program authorizing the Company to repurchase up to $1.5 billion of its Class A common stock (the “June 2012 Share Repurchase Program”). This program became effective in June 2012 at the completion of the Company’s previously announced $2 billion Class A share repurchase program.

In February 2013, the Company’s Board of Directors approved a share repurchase program authorizing the Company to repurchase up to $2 billion of its Class A common stock (the “February 2013 Share Repurchase Program”). This program became effective at the completion of the Company’s June 2012 Share Repurchase Program, which occurred in March 2013.

In December 2013, the Company’s Board of Directors approved a new share repurchase program authorizing the Company to repurchase up to $3.5 billion of its Class A common stock (the “December 2013 Share Repurchase Program”). During January 2014, the Company exhausted its purchases under the February 2013 Share Repurchase Program and began purchasing shares under the December 2013 Share Repurchase Program.

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MASTERCARD INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

The following table summarizes the Company's share repurchase authorizations of its Class A common stock through March 31, 2014, as well as historical purchases:

	Authorization Dates			
	December 2013	February 2013	June 2012	Total
	(in millions, except average price data)			
Board authorization	$3,500	$2,000	$1,500	$7,000
Dollar value of shares repurchased during the three months ended March 31, 2013	**	$162	604	$766
Remaining authorization at December 31, 2013	$3,500	$161	$—	$3,661
Dollar value of shares repurchased during the three months ended March 31, 2014	1,508	161	—	$1,669
Remaining authorization at March 31, 2014	$1,992	$—	$—	$1,992
Shares repurchased during the three months ended March 31, 2013	**	3.1	11.7	14.8
Average price paid per share during the three months ended March 31, 2013	**	$52.29	$51.72	$51.84
Shares repurchased during the three months ended March 31, 2014	19.4	1.9	—	21.3
Average price paid per share during the three months ended March 31, 2014	$77.70	$83.22	$—	$78.20
Cumulative shares repurchased through March 31, 2014	19.4	31.1	31.1	81.6
Cumulative average price paid per share	$77.70	$64.26	$48.16	$61.31

** Not applicable

As of April 24, 2014, the cumulative repurchases by the Company under the December 2013 Share Repurchase Program in 2014 totaled approximately 25.6 million shares of Class A common stock for an aggregate cost of approximately $2.0 billion at an average price of $76.52 per share of Class A common stock. As of April 24, 2014, the Company had approximately $1.5 billion remaining under the December 2013 Share Repurchase Program.

Note 9. Accumulated Other Comprehensive Income

The changes in the balances of each component of accumulated other comprehensive income, net of tax, for the three months ended March 31, 2014 and 2013 were as follows:

	Foreign Currency Translation Adjustments	Defined Benefit Pension and Other Postretirement Plans	Investment Securities Available-for-Sale	Accumulated Other Comprehensive Income (Loss)
	(in millions)			
Balance at December 31, 2012	$93	$ (37)	$ 5	$ 61
Current period other comprehensive income (loss) [1]	(112)	1	—	(111)
Balance at March 31, 2013	$(19)	$ (36)	$ 5	$ (50)
Balance at December 31, 2013	$206	$ (29)	$ 1	$ 178
Current period other comprehensive income (loss) [1]	(1)	1	2	2
Balance at March 31, 2014	$205	$ (28)	$ 3	$ 180

[1] During the three months ended March 31, 2014 and 2013, $2 million and $1 million of deferred costs related to the Company's Pension Plans and Postretirement Plans were reclassified from accumulated other comprehensive income to general and administrative expense. In addition, $1 million of net gains on available-for-sale investment securities were recognized in investment income during the three months ended March 31, 2014 and 2013. Tax amounts related to these items are insignificant.

Note 10. Share-Based Payments

During the three months ended March 31, 2014, the Company granted the following awards under the MasterCard Incorporated 2006 Long Term Incentive Plan, as amended and restated ("LTIP"). The LTIP is a shareholder-approved omnibus plan that permits the grant of various types of equity awards to employees.

	Granted in 2014	Weighted-Average Grant-Date Fair Value
	(in thousands)	
Non-qualified stock options	1,685	$14
Restricted stock units	1,162	$76
Performance stock units	133	$78

Stock options vest in four equal annual installments beginning one year after the date of grant, and have a term of ten years. The Company used the Black-Scholes option pricing model to estimate the grant date fair value of stock options and calculated the expected term and the expected volatility based on historical MasterCard information. As a result, the expected term of stock options granted in the first quarter 2014 was five years, while the expected volatility was determined to be 19.1%.

Vesting of the shares underlying the restricted stock units and performance stock units will generally occur three years after the date of grant. The fair value of restricted stock units is determined and fixed on the grant date based on the Company's Class A common stock price, adjusted for the exclusion of dividend equivalents. The Monte Carlo simulation valuation model was used to determine the grant date fair value of performance stock units granted in the first quarter of 2014.

Compensation expense is recorded net of estimated forfeitures over the shorter of the vesting period or the date the individual becomes eligible to retire under the LTIP. The Company uses the straight-line method of attribution over the requisite service period for expensing equity awards.

Note 11. Income Taxes

The effective income tax rates were 32.0% and 30.5% for the three months ended March 31, 2014 and 2013, respectively. For the three months ended March 31, 2014, the effective tax rate was higher than for the three months ended March 31, 2013, due primarily to a less favorable geographic mix of taxable earnings.

The Company conducts operations in multiple countries and, as a result, is subjected to tax examinations in various jurisdictions, including the United States. Uncertain tax positions are reviewed on an ongoing basis and are adjusted after considering facts and circumstances, including progress of tax audits, developments in case law and closing of statute of limitations. The Company has effectively settled its U.S. federal income tax obligations through 2008. With limited exception, the Company is no longer subject to state and local or foreign examinations by taxing authorities for years before 2002. It is possible that the amount of unrecognized benefit with respect to the Company's uncertain tax positions may change within the next twelve months. An estimate of the range of the possible changes cannot be made until the issues are further developed, the examinations close, or the statutes expire.

Note 12. Legal and Regulatory Proceedings

MasterCard is a party to legal and regulatory proceedings with respect to a variety of matters in the ordinary course of business. Some of these proceedings are based on complex claims involving substantial uncertainties and unascertainable damages. Accordingly, except as discussed below, it is not possible to determine the probability of loss or estimate damages, and therefore, MasterCard has not established reserves for any of these proceedings. When the Company determines that a loss is both probable and estimable, MasterCard records a liability and discloses the amount of the liability if it is material. When a material loss contingency is only reasonably possible, MasterCard does not record a liability, but instead discloses the nature and the amount of the claim, and an estimate of the loss or range of loss, if such an estimate can be made. Unless otherwise stated below with respect to these matters, MasterCard cannot provide an estimate of the possible loss or range of loss based on one or more of the following reasons: (1)

actual or potential plaintiffs have not claimed an amount of monetary damages or the amounts are unsupportable or exaggerated, (2) the matters are in early stages, (3) there is uncertainty as to the outcome of pending appeals or motions, (4) there are significant factual issues to be resolved, (5) the existence in many such proceedings of multiple defendants or potential defendants whose share of any potential financial responsibility has yet to be determined, and/or (6) there are novel legal issues presented. Furthermore, except as identified with respect to the matters below, MasterCard does not believe that the outcome of any existing legal or regulatory proceedings to which it is a party will have a material adverse effect on its results of

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operations, financial condition or overall business. However, with respect to the matters discussed below, an adverse judgment or other outcome or settlement with respect to any such proceedings could result in fines or payments by MasterCard and/or could require MasterCard to change its business practices. In addition, an adverse outcome in a regulatory proceeding could lead to the filing of civil damage claims and possibly result in damage awards in amounts that could be significant. Any of these events could have a material adverse effect on MasterCard's results of operations, financial condition and overall business.

Department of Justice Antitrust Litigation and Related Private Litigations

In April 2005, a complaint was filed in California state court on behalf of a putative class of consumers under California unfair competition law (Section 17200) and the Cartwright Act (the "Attridge action"). The claims in this action seek to leverage a 1998 action by the U.S. Department of Justice against MasterCard International, Visa U.S.A., Inc. and Visa International Corp. In that action, a federal district court concluded that both MasterCard's Competitive Programs Policy and a Visa bylaw provision that prohibited financial institutions participating in the respective associations from issuing competing proprietary payment cards (such as American Express or Discover) constituted unlawful restraints of trade under the federal antitrust laws. The state court in the Attridge action granted the defendants' motion to dismiss the plaintiffs' state antitrust claims but denied the defendants' motion to dismiss the plaintiffs' Section 17200 unfair competition claims. In September 2009, MasterCard executed a settlement agreement that is subject to court approval in the separate California consumer litigations (see "U.S. Merchant and Consumer Litigations"). The agreement includes a release that the parties believe encompasses the claims asserted in the Attridge action. In August 2010, the Court in the California consumer actions granted final approval to the settlement. The plaintiff from the Attridge action and three other objectors filed appeals of the settlement approval. In January 2012, the Appellate Court reversed the trial court's settlement approval and remanded the matter to the trial court for further proceedings. In August 2012, the parties in the California consumer actions filed a motion seeking approval of a revised settlement agreement. The trial court granted final approval of the settlement in April 2013, to which the objectors have appealed.

U.S. Merchant and Consumer Litigations

Commencing in October 1996, several class action suits were brought by a number of U.S. merchants against MasterCard International and Visa U.S.A., Inc. challenging certain aspects of the payment card industry under U.S. federal antitrust law. The plaintiffs claimed that MasterCard's "Honor All Cards" rule (and a similar Visa rule), which required merchants who accept MasterCard cards to accept for payment every validly presented MasterCard card, constituted an illegal tying arrangement in violation of Section 1 of the Sherman Act. In June 2003, MasterCard International signed a settlement agreement to settle the claims brought by the plaintiffs in this matter, which the Court approved in December 2003. Pursuant to the settlement, MasterCard agreed, among other things, to create two separate "Honor All Cards" rules in the United States - one for debit cards and one for credit cards.

In addition, individual or multiple complaints have been brought in 19 states and the District of Columbia alleging state unfair competition, consumer protection and common law claims against MasterCard International (and Visa) on behalf of putative classes of consumers. The claims in these actions largely mirror the allegations made in the U.S. merchant lawsuit and assert that merchants, faced with excessive interchange fees, have passed these overhead charges to consumers in the form of higher prices on goods and services sold. MasterCard has successfully resolved the cases in all of the jurisdictions except California, where there continues to be outstanding cases. As discussed above under "Department of Justice Antitrust Litigation and Related Private Litigations," in September 2009, the parties to the California state court actions executed a settlement agreement subject to approval by the California state court. In August 2010, the court granted final approval of the settlement, subsequent to which MasterCard made a payment of $6 million required by the settlement agreement. As noted above in more detail, the plaintiff from the Attridge action and three other objectors have filed appeals of the trial court's final approval in April 2013 of a revised settlement.

ATM Non-Discrimination Rule Surcharge Complaints

In October 2011, a trade association of independent Automated Teller Machine ("ATM") operators and 13 independent ATM operators filed a complaint styled as a class action lawsuit in the U.S. District Court for the District of Columbia against both MasterCard and Visa (the "ATM Operators Complaint"). Plaintiffs seek to represent a class of non-bank operators of ATM terminals that operate ATM terminals in the United States with the discretion to determine the price of the ATM access fee for the terminals they operate. Plaintiffs allege that MasterCard and Visa have violated Section 1 of the Sherman Act by imposing rules that require ATM operators to charge non-discriminatory ATM surcharges for transactions processed over MasterCard's and Visa's respective networks that are not greater than the surcharge for transactions over other networks accepted at the same ATM. Plaintiffs seek both injunctive and monetary relief equal to treble the damages they claim to have sustained as a result of the alleged violations and their costs of suit, including attorneys' fees. Plaintiffs have not quantified their damages although they allege that they expect damages to be in the tens of millions of dollars.

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Subsequently, multiple related complaints were filed in the U.S. District Court for the District of Columbia alleging both federal antitrust and multiple state unfair competition, consumer protection and common law claims against MasterCard and Visa on behalf of putative classes of users of ATM services (the "ATM Consumer Complaints"). The claims in these actions largely mirror the allegations made in the ATM Operators Complaint described above, although these complaints seek damages on behalf of consumers of ATM services who pay allegedly inflated ATM fees at both bank and non-bank ATM operators as a result of the defendants' ATM rules. Plaintiffs seek both injunctive and monetary relief equal to treble the damages they claim to have sustained as a result of the alleged violations and their costs of suit, including attorneys' fees. Plaintiffs have not quantified their damages although they allege that they expect damages to be in the tens of millions of dollars.

In January 2012, the plaintiffs in the ATM Operators Complaint and the ATM Consumer Complaints filed amended class action complaints that largely mirror their prior complaints. MasterCard moved to dismiss the complaints for failure to state a claim. In February 2013, the district court granted MasterCard's motion to dismiss the complaints. The plaintiffs' motion seeking approval to amend their complaints was denied by the district court in December 2013. The plaintiffs have appealed the dismissal of both their complaints and their motion to amend their complaints.

Interchange Litigation and Regulatory Proceedings

Interchange fees represent a sharing of payment system costs among the financial institutions participating in a four-party payment card system such as MasterCard's. Typically, interchange fees are paid by the acquirer to the issuer in connection with purchase transactions initiated with the payment system's cards. These fees reimburse the issuer for a portion of the costs incurred by it in providing services which are of benefit to all participants in the system, including acquirers and merchants. MasterCard or financial institutions establish default interchange fees in certain circumstances that apply when there is no other interchange fee arrangement between the issuer and the acquirer. MasterCard establishes a variety of interchange rates depending on such considerations as the location and the type of transaction, collects the interchange fee on behalf of the institutions entitled to receive it and remits the interchange fee to eligible institutions. MasterCard's interchange fees and other practices are subject to regulatory and/or legal review and/or challenges in a number of jurisdictions, including the proceedings described below. At this time, it is not possible to determine the ultimate resolution of, or estimate the liability related to, any of these interchange proceedings (except as otherwise indicated below), as the proceedings involve complex claims and/or substantial uncertainties and, in some cases, could include unascertainable damages or fines. Except as described below, no provision for losses has been provided in connection with them. Some of the proceedings described below could have a significant impact on our customers in the applicable country and on MasterCard's level of business in those countries. The proceedings reflect the significant and intense legal, regulatory and legislative scrutiny worldwide that interchange fees and acceptance practices have been receiving. When taken as a whole, the resulting decisions, regulations and legislation with respect to interchange fees and acceptance practices may have a material adverse effect on the Company's prospects for future growth and its overall results of operations, financial position and cash flows.

United States. In June 2005, the first of a series of complaints were filed on behalf of merchants (the majority of the complaints are styled as class actions, although a few complaints were filed on behalf of individual merchant plaintiffs) against MasterCard International Incorporated, Visa U.S.A., Inc., Visa International Service Association and a number of financial institutions. Taken together, the claims in the complaints are generally brought under both Sections 1 and 2 of the Sherman Act, which prohibit monopolization and attempts or conspiracies to monopolize a particular industry, and some of these complaints contain unfair competition law claims under state law. The complaints allege, among other things, that MasterCard, Visa, and certain financial institutions conspired to set the price of interchange fees, enacted point of sale acceptance rules (including the no surcharge rule) in violation of antitrust laws and engaged in unlawful tying and bundling of certain products and services. The cases have been consolidated for pre-trial proceedings in the U.S. District Court for the Eastern District of New York in MDL No. 1720. The plaintiffs have filed a consolidated class action complaint that seeks treble damages, as well as attorneys'

fees and injunctive relief.

In July 2006, the group of purported merchant class plaintiffs filed a supplemental complaint alleging that MasterCard's initial public offering of its Class A Common Stock in May 2006 (the "IPO") and certain purported agreements entered into between MasterCard and financial institutions in connection with the IPO: (1) violate U.S. antitrust laws and (2) constituted a fraudulent conveyance because the financial institutions allegedly attempted to release, without adequate consideration, MasterCard's right to assess them for MasterCard's litigation liabilities. In November 2008, the district court granted MasterCard's motion to dismiss the plaintiffs' supplemental complaint in its entirety with leave to file an amended complaint. The class plaintiffs repled their complaint. The causes of action and claims for relief in the complaint generally mirror those in the plaintiffs' original IPO-related complaint although the plaintiffs have attempted to expand their factual allegations based upon discovery that has been garnered in the case. The class plaintiffs seek treble damages and injunctive relief including, but not limited to, an order reversing and unwinding the IPO. In July 2009, the class plaintiffs and individual plaintiffs served confidential expert reports detailing the plaintiffs' theories of liability and alleging damages in the tens of billions of dollars. The defendants served their expert reports in December 2009 rebutting the plaintiffs' assertions both with respect to liability and damages.

In February 2011, MasterCard and MasterCard International Incorporated entered into each of: (1) an omnibus judgment sharing and settlement sharing agreement with Visa Inc., Visa U.S.A. Inc. and Visa International Service Association and a number of financial institutions; and (2) a MasterCard settlement and judgment sharing agreement with a number of financial institutions. The agreements provide for the apportionment of certain costs and liabilities which MasterCard, the Visa parties and the financial institutions may incur, jointly and/or severally, in the event of an adverse judgment or settlement of one or all of the cases in the merchant litigations. Among a number of scenarios addressed by the agreements, in the event of a global settlement involving the Visa parties, the financial institutions and MasterCard, MasterCard would pay 12% of the monetary portion of the settlement. In the event of a settlement involving only MasterCard and the financial institutions with respect to their issuance of MasterCard cards, MasterCard would pay 36% of the monetary portion of such settlement.

In October 2012, the parties entered into a definitive settlement agreement with respect to the merchant class litigation and the defendants separately entered into a settlement agreement with the individual merchant plaintiffs (the terms of which were consistent with a memorandum of understanding that was executed by the parties in July 2012). The settlements included cash payments that were apportioned among the defendants pursuant to the omnibus judgment sharing and settlement sharing agreement described above. MasterCard also agreed to provide class members with a short-term reduction in default credit interchange rates and to modify certain of its business practices, including its No Surcharge Rule. The court granted final approval of the settlement in December 2013, which has been appealed by objectors to the settlement.

Merchants representing slightly more than 25% of the MasterCard and Visa purchase volume over the relevant period chose to opt out of the class settlement. MasterCard anticipates that most of the larger merchants who opted out of the settlement will initiate separate actions seeking to recover damages, and over 30 opt-out complaints have been filed on behalf of numerous merchants in various jurisdictions. Those cases are in the early stages and the defendants have consolidated all of these matters (except for one state court action) in front of the same court that is overseeing the approval of the settlement. In addition, certain competitors have raised objections to the settlement, including Discover. Discover’s objections include a challenge to the settlement on the grounds that certain of the rule changes agreed to in the settlement constitute a restraint of trade in violation of Section 1 of the Sherman Act.

MasterCard recorded a pre-tax charge of $770 million in the fourth quarter of 2011 and an additional $20 million pre-tax charge in the second quarter of 2012 relating to the settlement agreements described above. In 2012, MasterCard paid $790 million with respect to the settlements, of which $726 million was paid into a qualified cash settlement fund related to the merchant class litigation. At December 31, 2013 and March 31, 2014, MasterCard had $723 million and $540 million, respectively, in the qualified cash settlement fund classified as restricted cash on its balance sheet. The class settlement agreement provided for a return to the defendants of a portion of the class cash settlement fund, based upon the percentage of purchase volume represented by the opt out merchants. This resulted in $164 million from the cash settlement fund being returned to MasterCard in January 2014 and reclassified at that time from restricted cash to cash and cash equivalents. In the fourth quarter of 2013, MasterCard recorded an incremental net pre-tax charge of $95 million related to these opt out merchants, representing a change in its estimate of probable losses relating to these matters. Accordingly, as of March 31, 2014, MasterCard had accrued a liability of $799 million as a reserve for both the merchant class litigation and the filed and anticipated opt out merchant cases.

The portion of the accrued liability relating to the opt out merchants does not represent an estimate of a loss, if any, if the opt out merchant matters were litigated to a final outcome, in which case MasterCard cannot estimate the potential liability. MasterCard’s estimate involves significant judgment and may change depending on progress in settlement negotiations or depending upon decisions in any opt out merchant cases. In addition, in the event that the merchant class litigation settlement approval is overturned on appeal, a negative outcome in the litigation could have a material adverse effect on MasterCard’s results of operations, financial position and cash flows.

Canada. In December 2010, the Canadian Competition Bureau (the “CCB”) filed an application with the Canadian Competition Tribunal to strike down certain MasterCard rules related to point-of-sale acceptance, including the “honor

all cards" and "no surcharge" rules. In July 2013, the Competition Tribunal issued a decision in MasterCard's favor and dismissed the CCB's application, which was not appealed. In December 2010, a complaint styled as a class action lawsuit was commenced against MasterCard in Quebec on behalf of Canadian merchants. That suit essentially repeated the allegations and arguments of the CCB application to the Canadian Competition Tribunal and sought compensatory and punitive damages in unspecified amounts, as well as injunctive relief. In March 2011, a second purported class action lawsuit was commenced in British Columbia against MasterCard, Visa and a number of large Canadian financial institutions, and in May 2011 a third purported class action lawsuit was commenced in Ontario against the same defendants. These suits allege that MasterCard, Visa and the financial institutions have engaged in a conspiracy to increase or maintain the fees paid by merchants on credit card transactions and establish rules which force merchants to accept all MasterCard and Visa credit cards and prevent merchants from charging more for payments with MasterCard and Visa premium cards. The British Columbia suit seeks compensatory damages in unspecified amounts, and

the Ontario suit seeks compensatory damages of $5 billion. The British Columbia and Ontario suits also seek punitive damages in unspecified amounts, as well as injunctive relief, interest and legal costs. In April 2012, the Quebec suit was amended to include the same defendants and similar claims as in the British Columbia and Ontario suits. With respect to the status of the proceedings: (1) the Quebec suit has been stayed, (2) the Ontario suit is being temporarily suspended while the British Columbia suit proceeds, and (3) the British Columbia court issued an order in March 2014 certifying a number of the merchants' causes of action. The parties have appealed the certification decision. Additional complaints styled as class actions have been filed in Saskatchewan and Alberta. The claims in these complaints largely mirror the claims in the British Columbia and Ontario suits. If the class action lawsuits are ultimately successful, negative decisions could have a significant adverse impact on the revenue of MasterCard's Canadian customers and on MasterCard's overall business in Canada and could result in substantial damage awards.

European Union. In September 2003, the European Commission issued a Statement of Objections challenging MasterCard Europe's cross-border default interchange fees and, in June 2006, it issued a supplemental Statement of Objections covering credit, debit and commercial card fees. In December 2007, the European Commission announced a decision that applies to MasterCard's default cross-border interchange fees for MasterCard and Maestro branded consumer payment card transactions in the European Economic Area ("EEA") (the European Commission refers to these as "MasterCard's MIF"), but not to commercial card transactions (the European Commission stated publicly that it has not yet finished its investigation of commercial card interchange fees). The decision required MasterCard to stop applying the MasterCard MIF, to refrain from repeating the conduct, and not apply its then recently adopted (but never implemented) Maestro SEPA and Intra-Eurozone default interchange fees to debit card payment transactions within the Eurozone. The decision did not impose a fine on MasterCard, but provides for a daily penalty of up to 3.5% of MasterCard's daily consolidated global turnover in the preceding business year (which MasterCard estimates to be approximately $0.8 million per day) in the event that MasterCard fails to comply. To date, MasterCard has not been assessed any such penalty. In March 2008, MasterCard filed an application for annulment of the European Commission's decision with the General Court of the European Union.

Following discussions with the European Commission, MasterCard announced that, effective in June 2008, MasterCard would temporarily repeal its then current default intra-EEA cross-border consumer card interchange fees in conformity with the decision. In October 2008, MasterCard received an information request from the European Commission in connection with the decision concerning certain pricing changes that MasterCard implemented as of October 2008. In March 2009, MasterCard gave certain undertakings to the European Commission and, in response, in April 2009, the Commissioner for competition policy and the Directorate-General for Competition informed MasterCard that, subject to MasterCard's fulfilling its undertakings, they do not intend to pursue proceedings for non-compliance with or circumvention of the December 2007 decision or for infringing the antitrust laws in relation to the October 2008 pricing changes, the introduction of new cross-border consumer default interchange fees or any of the other MasterCard undertakings. MasterCard's undertakings include: (1) repealing the October 2008 pricing changes; (2) adopting a specific methodology for the setting of cross-border consumer default interchange fees; (3) establishing new default cross-border consumer card interchange fees as of July 2009 such that the weighted average interchange fee for credit card transactions does not exceed 30 basis points and for debit card transactions does not exceed 20 basis points; (4) introducing a new rule prohibiting its acquirers from requiring merchants to process all of their MasterCard and Maestro transactions with the acquirer; and (5) introducing a new rule requiring its acquirers to provide merchants with certain pricing information in connection with MasterCard and Maestro transactions. The undertakings were effective until the General Court of the European Union issued a judgment in May 2012.

In May 2012, the General Court of the European Union issued a judgment dismissing the Company's appeal and upholding the European Commission's decision. In August 2012, the Company appealed the judgment to the European Union Court of Justice (the "ECJ"). The Advocate General to the ECJ issued a non-binding opinion in January 2014 recommending that the ECJ reject MasterCard's appeal. Historically, in a majority of cases, the ECJ has followed the Advocate General's opinions. MasterCard anticipates that the ECJ will issue its final decision sometime in 2014.

Should the ECJ ultimately reject MasterCard's appeal, the European Commission's December 2007 decision will be upheld. Although the interim agreement with the European Commission, by its terms, formally ended on the day of the General Court's judgment, MasterCard intends to act consistent with the terms of the agreement.

In addition, the European Commission decision could lead to additional competition authorities in European Union member states commencing investigations or proceedings regarding domestic interchange fees or initiating regulation. The possibility of such actions has increased due to the judgment of the General Court. The judgment also increases the possibility of an adverse outcome for the Company in related and pending matters (such as the interchange proceedings in Hungary, Italy and Poland, as indicated below). In addition, the European Commission's decision could lead, and in the case of the United Kingdom and Belgium (as described below) has led, to the filing of private actions against MasterCard Europe by merchants and/or consumers which, if MasterCard is unsuccessful in its appeal of the General Court decision, could result in MasterCard owing substantial damages.

In April 2013, the European Commission announced that it has opened proceedings to investigate: (1) MasterCard's interregional interchange fees that apply when a card issued outside the EEA is used at a merchant location in the EEA, (2) central acquiring rules, which apply when a merchant uses the services of an acquirer established in another country and (3) other business rules and practices (including the "honor all cards" rule).

Additional Litigations in Europe. In the United Kingdom, beginning in May 2012, a number of retailers filed claims against MasterCard seeking damages for alleged anti-competitive conduct with respect to MasterCard's cross-border interchange fees and its U.K. and Ireland domestic interchange fees. More than 20 different retailers have filed claims or notice of claims. An additional 13 potential claimant retailers have agreed to delay filing their claims in exchange for MasterCard agreeing to suspend the running of the time limitations on their damages claims. Although the claimants have not quantified the full extent of their compensatory and punitive damages, their purported damages exceed $2 billion. MasterCard has submitted statements of defense to the retailers' claims disputing liability and damages. The litigations are at an early stage, and the courts in two of the actions will address preliminary issues (such as the time period for which the retailers could seek damages) before addressing issues concerning any liability and damages. Similarly, in Belgium, a retailer filed claims in December 2012 for unspecified damages with respect to MasterCard's cross-border and domestic interchange fees paid in Belgium, Greece and Luxembourg.

Additional Interchange Proceedings. In February 2007, the Office for Fair Trading of the United Kingdom (the "OFT") commenced an investigation of MasterCard's current U.K. default credit card interchange fees and so-called "immediate debit" cards to determine whether such fees contravene U.K. and European Union competition law. The OFT had informed MasterCard that it did not intend to issue a Statement of Objections or otherwise commence formal proceedings with respect to the investigation prior to the judgment of the General Court of the European Union with respect to MasterCard's appeal of the December 2007 cross-border interchange fee decision of the European Commission, and this period was extended until the completion of MasterCard's appeal to the Court of Justice. If the OFT ultimately determines that any of MasterCard's U.K. interchange fees contravene U.K. and European Union competition law, it may issue a new decision and possibly levy fines accruing from the date of its first decision. Such a decision could lead to the filing of private actions against MasterCard by merchants and/or consumers which could result in an award or awards of substantial damages and could have a significant adverse impact on the revenue of MasterCard International's U.K. customers and MasterCard's overall business in the U.K.

Regulatory authorities in a number of other jurisdictions around the world, including Hungary, Italy and Poland, have commenced competition-related proceedings or inquiries into interchange fees and acceptance practices. In some of these jurisdictions, fines have been or could be assessed against MasterCard. These matters could have a negative impact on MasterCard's business in the specific country where the regulatory authority is located but would not be expected to have a material impact on MasterCard's overall revenue. In addition, regulatory authorities and/or central banks in certain other jurisdictions, including Brazil, Chile, Denmark, Germany, Latvia, Portugal, Russia, Singapore and South Africa, are reviewing MasterCard's and/or its customers' interchange fees and/or other practices and may seek to commence proceedings related to, or otherwise regulate, the establishment of such fees and/or such practices.

Other Regulatory Proceedings

In addition to challenges to interchange fees, MasterCard's other standards and operations are also subject to regulatory and/or legal review and/or challenges in a number of jurisdictions from time to time. These proceedings tend to reflect the increasing global regulatory focus to which the payments industry is subject and, when taken as a whole with other regulatory and legislative action, such actions could result in the imposition of costly new compliance burdens on MasterCard and its customers and may lead to increased costs and decreased transaction volumes and revenue.

Note 13. Settlement and Other Risk Management

MasterCard's rules guarantee the settlement of many of the MasterCard, Cirrus and Maestro branded transactions between its issuers and acquirers ("settlement risk"). Settlement exposure is the outstanding settlement risk to customers under MasterCard's rules due to the difference in timing between the payment transaction date and subsequent

settlement. While the term and amount of the guarantee are unlimited, the duration of settlement exposure is short term and typically limited to a few days. Gross settlement exposure is estimated using the average daily card volume during the quarter multiplied by the estimated number of days to settle. The Company has global risk management policies and procedures, which include risk standards, to provide a framework for managing the Company's settlement risk. Customer-reported transaction data and the transaction clearing data underlying the settlement exposure calculation may be revised in subsequent reporting periods.

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In the event that MasterCard effects a payment on behalf of a failed customer, MasterCard may seek an assignment of the underlying receivables of the failed customer. Subject to approval by the Board of Directors, customers may be charged for the amount of any settlement loss incurred during these ordinary course activities of the Company.
The Company's global risk management policies and procedures are aimed at managing the settlement exposure. These risk management procedures include interaction with the bank regulators of countries in which it operates, requiring customers to make adjustments to settlement processes, and requiring collateral from customers. MasterCard requires certain customers that are not in compliance with the Company's risk standards in effect at the time of review to post collateral, typically in the form of cash, letters of credit, or guarantees. This requirement is based on management's review of the individual risk circumstances for each customer that is out of compliance. In addition to these amounts, MasterCard holds collateral to cover variability and future growth in customer programs. The Company may also hold collateral to pay merchants in the event of an acquirer failure. Although the Company is not contractually obligated under its rules to effect such payments to merchants, the Company may elect to do so to protect brand integrity. MasterCard monitors its credit risk portfolio on a regular basis and the adequacy of collateral on hand. Additionally, from time to time, the Company reviews its risk management methodology and standards. As such, the amounts of estimated settlement exposure are revised as necessary.
The Company's estimated settlement exposure from MasterCard, Cirrus and Maestro branded transactions was as follows:

	March 31, 2014	December 31, 2013
	(in millions)	
Gross settlement exposure	$39,032	$40,657
Collateral held for settlement exposure	(3,641)	(3,167)
Net uncollateralized settlement exposure	$35,391	$37,490

General economic and political conditions in countries in which MasterCard operates affect the Company's settlement risk. Many of the Company's financial institution customers have been directly and adversely impacted by political instability and uncertain economic conditions. These conditions present increased risk that the Company may have to perform under its settlement guarantee. This risk could increase if political, economic and financial market conditions deteriorate further. The Company's global risk management policies and procedures are revised and enhanced from time to time. Historically, the Company has experienced a low level of losses from financial institution failures.
MasterCard also provides guarantees to customers and certain other counterparties indemnifying them from losses stemming from failures of third parties to perform duties. This includes guarantees of MasterCard-branded travelers cheques issued, but not yet cashed of $501 million and $503 million at March 31, 2014 and December 31, 2013, respectively, of which $400 million and $403 million at March 31, 2014 and December 31, 2013 is mitigated by collateral arrangements. In addition, the Company enters into business agreements in the ordinary course of business under which the Company agrees to indemnify third parties against damages, losses and expenses incurred in connection with legal and other proceedings arising from relationships or transactions with the Company. Certain indemnifications do not provide a stated maximum exposure. As the extent of the Company's obligations under these agreements depends entirely upon the occurrence of future events, the Company's potential future liability under these agreements is not determinable. Historically, payments made by the Company under these types of contractual arrangements have not been material.
Note 14. Foreign Exchange Risk Management
The Company enters into foreign currency forward contracts to manage risk associated with anticipated receipts and disbursements which are either transacted in a non-functional currency or valued based on a currency other than its functional currency. The Company also enters into foreign currency derivative contracts to offset possible changes in value due to foreign exchange fluctuations of earnings, assets and liabilities denominated in currencies other than the functional currency of the entity. The objective of these activities is to reduce the Company's exposure to gains and

losses resulting from fluctuations of foreign currencies against its functional currencies.
The Company does not designate foreign currency derivatives as hedging instruments pursuant to the accounting guidance for derivative instruments and hedging activities. The Company records the change in the estimated fair value of the outstanding derivatives at the end of the reporting period to its consolidated balance sheet and consolidated statement of operations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

As of March 31, 2014, all forward contracts to purchase and sell foreign currency had been entered into with customers of MasterCard. MasterCard’s derivative contracts are summarized below:

	March 31, 2014		December 31, 2013	
	Notional	Estimated Fair Value	Notional	Estimated Fair Value
	(in millions)			
Commitments to purchase foreign currency	$80	$ —	$23	$ (1)
Commitments to sell foreign currency	2,008	(13)	1,722	1
Balance Sheet Location:				
Accounts Receivable [1]		$ 11		$ 13
Other Current Liabilities [1]		(24)		(13)

[1] The fair values of derivative contracts are presented on a gross basis on the balance sheet and are subject to enforceable master netting arrangements, which contain various netting and setoff provisions.

The amount of loss recognized in income for the contracts to purchase and sell foreign currency is summarized below:

	Three Months Ended March 31,	
	2014	2013
	(in millions)	
Foreign currency derivative contracts		
General and administrative	$(4)	$(23)
Net revenue	—	—
Total	$(4)	$(23)

The fair value of the foreign currency forward contracts generally reflects the estimated amounts that the Company would receive (or pay), on a pre-tax basis, to terminate the contracts at the reporting date based on broker quotes for the same or similar instruments. The terms of the foreign currency forward contracts are generally less than 18 months. The Company had no deferred gains or losses related to foreign exchange in accumulated other comprehensive income as of March 31, 2014 and December 31, 2013 as there were no derivative contracts accounted for under hedge accounting.

The Company’s derivative financial instruments are subject to both market and counterparty credit risk. Market risk is the risk of loss due to the potential change in an instrument’s value caused by fluctuations in interest rates and other variables related to currency exchange rates. The effect of a hypothetical 10% adverse change in foreign currency rates could result in a fair value loss of approximately $216 million on the Company’s foreign currency derivative contracts outstanding at March 31, 2014 related to the hedging program. Counterparty credit risk is the risk of loss due to failure of the counterparty to perform its obligations in accordance with contractual terms. To mitigate counterparty credit risk, the Company enters into derivative contracts with selected financial institutions based upon their credit ratings and other factors. Generally, the Company does not obtain collateral related to derivatives because of the high credit ratings of the counterparties.

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

The following discussion and analysis supplements management's discussion and analysis of MasterCard Incorporated for the year ended December 31, 2013 as contained in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission on February 14, 2014. It also should be read in conjunction with the consolidated financial statements and notes of MasterCard Incorporated and its consolidated subsidiaries, including MasterCard International Incorporated (“MasterCard International”) (together, “MasterCard” or the “Company”), included elsewhere in this Report. Certain prior period amounts have been reclassified to conform to the 2014 presentation. Percentage changes provided throughout “Management’s Discussion and Analysis of Financial Condition and Results of Operations” were calculated on amounts rounded to the nearest thousand.

Overview

MasterCard is a technology company in the global payments industry that connects consumers, financial institutions, merchants, governments and businesses worldwide, enabling them to use electronic forms of payment instead of cash and checks. As the operator of the world’s fastest payments network, we facilitate the processing of payment transactions, including authorization, clearing and settlement, and deliver related products and services. We make payments easier and more efficient by creating a wide range of payment solutions and services using our family of well-known brands, including MasterCard®, Maestro® and Cirrus®. We also provide value-added offerings such as loyalty and reward programs, information services and consulting. Our network is designed to ensure safety and security for the global payments system. A typical transaction on our network involves four participants in addition to us: cardholder, merchant, issuer (the cardholder’s financial institution) and acquirer (the merchant’s financial institution). We do not issue cards, extend credit, determine or receive revenue from interest rates or other fees charged to cardholders by issuers, or establish the “merchant discount” rate charged in connection with the acceptance of cards and other payment devices that carry our brands. In most cases, cardholder relationships belong to, and are managed by, our financial institution customers.

Our ability to grow is influenced by personal consumption expenditure growth, driving paper-based forms of payment toward electronic forms of payment and increasing our share in electronic payments and providing other value-added products and services. We continue to drive growth by:

- Growing our core businesses globally, both as to our products - credit, debit, prepaid and commercial - and increasing the number of payment transactions we process;
- Diversifying our business by seeking new areas of growth in markets around the world by focusing on:
- Existing and new markets;
- Encouraging consumers and businesses to use MasterCard products for new payment areas, such as transit, parking, person-to-person transfers and paying bills;
- Small merchants and merchants who have not historically accepted MasterCard products; and
- Financial inclusion for the unbanked and underbanked; and
- Building our business by:
- Taking advantage of the opportunities presented by the ongoing convergence of the physical and digital worlds; and
- Using our data analytics, loyalty solutions and fraud protection and detection services to add value.

Our technology, expertise and data make payments safe, simple and fast. We work with merchants to help them enable new sales channels, create better purchase experiences, increase revenues and fight fraud. We help national, state and local governments drive increased financial inclusion and efficiency, reduce costs, increase transparency to reduce crime and corruption and advance social programs. For consumers, we provide better, safer and more convenient ways to pay. We provide financial institutions with solutions to help them increase revenue and increase preference for their MasterCard-branded products.

We generate revenue by charging fees to issuers and acquirers for providing transaction processing and other payment-related products and services, as well as by assessing these customers based, primarily, on the dollar volume of activity, or gross dollar volume (“GDV”), on the cards and other devices that carry our brands.

See "-Business Environment" for a discussion of considerations related to our long-term strategic objectives.
We recorded net income of $870 million, or $0.73 per diluted share, for the three months ended March 31, 2014 versus net income of $766 million, or $0.62 per diluted share, for the three months ended March 31, 2013.
Our net revenue increased 14% for the three months ended March 31, 2014, versus the comparable period in 2013, primarily driven by increased growth in dollar volume of activity on cards carrying our brands and the number of transactions processed by the Company. For the three months ended March 31, 2014, our processed transactions increased 14% versus the comparable period in 2013. Our volumes also increased 14% for the three months ended March 31, 2014, on a local currency basis, versus the comparable period in 2013. Rebates and incentives as a percentage of gross revenue were 25% for the three months ended March 31, 2014, versus 26% for the comparable period in 2013.
Operating expenses increased 12% for the three months ended March 31, 2014 versus the comparable period in 2013, primarily due to higher general and administrative expenses. We generated net cash flows from operations of $568 million for the three months ended March 31, 2014, compared to $872 million for the comparable period in 2013.
The following table provides a summary of our operating results for the three months ended March 31, 2014 and 2013:

	Three Months Ended March 31,		Percent Increase
	2014	2013	(Decrease)
	(in millions, except per share data and percentages)		
Net revenue	$2,177	$1,906	14%
Operating expenses	892	799	12%
Operating income	1,285	1,107	16%
Operating margin	59.0 %	58.1 %	**
Income tax expense	411	336	22%
Effective income tax rate	32.0 %	30.5 %	**
Net income	$870	$766	14%
Diluted earnings per share	$0.73	$0.62	18%
Diluted weighted-average shares outstanding	1,189	1,230	(3)%

** Not meaningful

Business Environment

We process transactions from more than 210 countries and territories and in more than 150 currencies. Net revenue generated in the United States was 40% and 39% of total revenue for the three months ended March 31, 2014 and 2013, respectively. No individual country, other than the United States, generated more than 10% of total revenue in any such period, but differences in market growth, economic health and foreign exchange fluctuations in certain countries can have an impact on the proportion of revenue generated outside the United States over time. While the global nature of our business helps protect our operating results from adverse economic conditions in a single or a few countries, the significant concentration of our revenue generated in the United States makes our business particularly susceptible to adverse economic conditions in the United States.
The competitive and evolving nature of the global payments industry provides both challenges to and opportunities for the continued growth of our business. Adverse economic events (including continued distress in the credit environment, continued equity market volatility and additional government intervention) have impacted the financial markets around the world. The economies of the United States and numerous countries around the world have been

significantly impacted by this economic turmoil. Countries have experienced credit ratings actions by ratings agencies, including several in Europe as well as the United States. In addition, some existing customers have been placed in receivership or administration or have a significant amount of their stock owned by their governments. Many financial institutions are facing increased regulatory and governmental influence, including potential

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further changes in laws and regulations. Many of our financial institution customers, merchants that accept our brands and cardholders who use our brands have been directly and adversely impacted.
MasterCard's financial results may be negatively impacted by actions taken by individual financial institutions or by governmental or regulatory bodies. In addition, further political instability or a decline in economic conditions in the countries in which the Company operates may accelerate the timing of or increase the impact of risks to our financial performance. As a result, our revenue may be negatively impacted, or the Company may be impacted in several ways. MasterCard continues to monitor political and economic conditions around the world to identify opportunities for the continued growth of our business and to evaluate the evolution of the global payments industry. The extent and pace of economic recovery in various regions remains uncertain and the overall business environment may present challenges for MasterCard to grow its business. For further discussion see, "Risk Factors - Business Risks" in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2013.
In addition, our business and our customers' businesses are subject to regulation in many countries. Regulatory bodies may seek to impose rules and price controls on certain aspects of our business and the payments industry. For further discussion, see Note 12 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1 and our risk factors in "Risk Factors - Legal and Regulatory Risks" in Part I, Item 1A (Risk Factors) of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and in Part II, Item 1A (Risk Factors) of this Report. Further, information security risks for global payments and technology companies such as MasterCard have significantly increased in recent years. Although to date we have not experienced any material impacts relating to cyber-attacks or other information security breaches, there can be no assurance that we will be immune to these risks and not suffer such losses in the future. See our risk factor in "Risk Factors - Business Risks" in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 related to a failure or breach of our security systems or infrastructure as a result of cyber-attacks.
Impact of Foreign Currency Rates
Our overall operating results can be impacted by changes in foreign currency exchange rates, especially the strengthening or weakening of the U.S. dollar versus the euro and Brazilian real. The functional currency of MasterCard Europe, our principal European operating subsidiary, is the euro, and the functional currency of our Brazilian subsidiary is the Brazilian real. Accordingly, the strengthening or weakening of the U.S. dollar versus the euro and Brazilian real impacts the translation of our European and Brazilian subsidiaries' operating results into the U.S. dollar. For the three months ended March 31, 2014, as compared to the same period in 2013, the U.S. dollar strengthened against the Brazilian real but weakened against the euro. The net foreign currency impact of changes in the U.S. dollar average exchange rates against the euro and Brazilian real increased net revenue and operating expenses by less than 1 percentage point for the three months ended March 31, 2014.
In addition, changes in foreign currency exchange rates directly impact the calculation of gross dollar volume ("GDV") and gross euro volume ("GEV"), which are used in the calculation of our domestic assessments, cross-border volume fees and volume-related rebates and incentives. In most non-European regions, GDV is calculated based on local currency spending volume converted to U.S. dollars using average exchange rates for the period. In Europe, GEV is calculated based on local currency spending volume converted to euros using average exchange rates for the period. As a result, our domestic assessments, cross-border volume fees and volume-related rebates and incentives are impacted by the strengthening or weakening of the U.S. dollar versus primarily non-European local currencies and the strengthening or weakening of the euro versus primarily European local currencies. The strengthening or weakening of the U.S. dollar is evident when GDV growth on a U.S. dollar-converted basis is compared to GDV growth on a local currency basis. For the three months ended March 31, 2014, as compared to the same period in 2013, GDV on a U.S. dollar converted basis increased 10% while GDV grew on a local currency basis 14%. The Company attempts to limit the impact from these foreign currency exposures through its foreign exchange risk management activities, which are discussed further in Note 14 (Foreign Exchange Risk Management) to the consolidated financial statements included in Part I, Item 1 of this Report.
The Company generates revenue and has financial assets in countries at risk for currency devaluation. While these revenues and financial assets are not material to MasterCard on a consolidated basis, they could be negatively impacted if a devaluation of local currencies occurs relative to the U.S. dollar.

Revenue

Revenue Description

MasterCard's business model involves four participants in addition to us: cardholders, merchants, issuers (the cardholders' financial institutions) and acquirers (the merchants' financial institutions). Our gross revenue is generated by assessing our customers based primarily on the dollar volume of activity on the cards and other devices that carry our brands and from the fees that we charge

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our customers for providing transaction processing and other payment-related products and services. Our revenue is based upon transactional information accumulated by our systems or reported by our customers. Our primary revenue billing currencies are the U.S. dollar, euro and Brazilian real.

The price structure for our products and services is complex and is dependent on the nature of volumes, types of transactions and type of products and services we offer to our customers. Our net revenue can be significantly impacted by the following:

- Domestic or cross-border transactions;
- Signature-based or PIN-based transactions;
- Geographic region or country the transaction occurs in;
- Volumes/transactions subject to tiered rates;
- Processed or not processed by MasterCard;
- Amount of usage of our other products or services; and
- Amount of rebates and incentives provided to customers.

The Company classifies its net revenue into the following five categories:

1. Domestic assessments: Domestic assessments are fees charged to issuers and acquirers based primarily on the dollar volume of activity on cards and other devices that carry our brands where the merchant country and the issuer country are the same. Domestic assessments include items such as card assessments, which are fees charged on the number of cards issued or assessments for specific purposes, such as acceptance development or market development programs.
2. Cross-border volume fees: Cross-border volume fees are charged to issuers and acquirers based on the volume of activity on cards and other devices that carry our brands where the merchant country and the issuer country are different. In general, a cross-border transaction generates higher revenue than a domestic transaction since cross-border fees are higher than domestic fees, and in most cases also include fees for currency conversion.
3. Transaction processing fees: Transaction processing fees are charged for both domestic and cross-border transactions and are primarily based on the number of transactions. Transaction processing fees include charges to issuers for the following:

- Transaction Switching fees for the following services:

Authorization is the process by which a transaction is routed to the issuer for approval. In certain circumstances such as when the issuer’s systems are unavailable or cannot be contacted, MasterCard or others on behalf of the issuer approve in accordance with either the issuer’s instructions or applicable rules (also known as “stand-in”).

Clearing is the exchange of financial transaction information between issuers and acquirers after a transaction has been successfully conducted at the point of interaction. MasterCard clears transactions among customers through our central and regional processing systems.

Settlement is facilitating the exchange of funds between parties.

- Connectivity fees are charged to issuers and acquirers for network access, equipment and the transmission of authorization and settlement messages. These fees are based on the size of the data being transmitted through and the number of connections to the Company’s network.

4. Other revenues: Other revenues consist of other payment-related products and services and are primarily associated with the following:

- Consulting and research fees are primarily generated by MasterCard Advisors, the Company’s professional advisory services group.
- Fraud products and services used to prevent or detect fraudulent transactions. This includes fees for warning bulletins provided to issuers and acquirers either electronically or in paper form.
- Loyalty and rewards solution fees are charged to issuers for benefits provided directly to consumers with MasterCard-branded cards, such as insurance, assistance for lost cards, locating ATMs and rewards programs.

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- Program management services provided to prepaid card issuers consist of foreign exchange margin, commissions, load fees and ATM withdrawal fees paid by cardholders on the sale and encashment of prepaid cards.
- The Company also charges for a variety of other payment-related products and services, including account and transaction enhancement services, rules compliance and publications.

5. Rebates and incentives (contra-revenue): Rebates and incentives are provided to certain MasterCard customers and are recorded as contra-revenue.

Revenue Analysis

In the three months ended March 31, 2014, gross revenue increased $347 million, or 14%, versus the comparable period in 2013. Gross revenue growth in the three months ended March 31, 2014 was primarily driven by increased growth in dollar volume of activity on cards carrying our brands, increased transactions and increased other payment-related products and services. Rebates and incentives in the three months ended March 31, 2014 increased $76 million, or 12%, versus the comparable period in 2013 primarily due to the impact from new and renewed agreements. Our net revenue increased 14% for the three months ended March 31, 2014 versus the comparable period in 2013.

Our revenue is primarily based on volumes and transactions, which are driven by the dollar volume of activity on cards and other devices carrying our brands and the number of transactions. During the three months ended March 31, 2014, our GDV increased 14% on a local currency basis and our processed transactions also increased 14%.

The following table provides a summary of the trend in volume and transaction growth:

	Three Months Ended March 31,			
	2014		2013	
	Growth (USD)	Growth (Local)	Growth (USD)	Growth (Local)
MasterCard-Branded GDV [1]	10%	14%	11%	12%
Asia Pacific/Middle East/Africa	12%	19%	20%	22%
Canada	(2)%	7%	3%	3%
Europe	14%	15%	13%	13%
Latin America	3%	16%	11%	15%
United States	9%	9%	4%	4%
Cross-border Volume Growth [1]		17%		16%
Processed Transactions Growth		14%		12%

[1] Excludes volume generated by Maestro and Cirrus cards.

A significant portion of our revenue is concentrated among our five largest customers. The loss of any of these customers or their significant card programs could adversely impact our revenue. In addition, as part of our business strategy, MasterCard, among other efforts, enters into business agreements with customers. These agreements can be terminated in a variety of circumstances.

The significant components of our net revenue for the three months ended March 31, 2014 and 2013 were as follows:

	Three Months Ended March 31,		Percent Increase
	2014	2013 [1]	(Decrease)
	(in millions, except percentages)		
Domestic assessments	$938	$873	7%
Cross-border volume fees	695	589	18%
Transaction processing fees	936	821	14%
Other revenues	341	280	22%
Gross revenue	2,910	2,563	14%
Rebates and incentives (contra-revenue)	(733)	(657)	12%
Net revenue	$2,177	$1,906	14%

[1] Certain prior period amounts have been reclassified to conform to the 2014 presentation. Net revenue is not impacted.

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The following table summarizes the primary drivers of net revenue growth in the three months ended March 31, 2014 versus the three months ended March 31, 2013:

	For the Three Months Ended March 31,							
	Volume		Foreign Currency [1]		Other		Total	
	2014	2013 [2]	2014	2013 [2]	2014	2013 [2]	2014	2013 [2]
Domestic assessments	13 %	12 %	(1)%	(1)%	(5)% [3]	(1)% [3]	7 %	10 %
Cross-border volume fees	14 %	13 %	1 %	— %	3 % [4]	1 %	18 %	14 %
Transaction processing fees	12 %	10 %	— %	(1)%	2 %	(1)%	14 %	8 %
Other revenues	**	**	1 %	— %	21 % [5]	7 % [5]	22 %	7 %
Rebates and incentives	7 %	10 %	— %	(1)%	5 %	6 %	12 %	15 %
Net revenue	13 %	10 %	— %	(1)%	1 %	(1)%	14 %	8 %

** Not applicable

[1] Reflects translation from the euro and Brazilian real to the U.S. dollar.

[2] Certain prior period amounts have been reclassified to conform to the 2014 presentation. Net revenue is not impacted.

[3] Includes impact of the allocation of revenue to service deliverables, which are recorded in other revenue when services are performed.

[4] Positively impacted by pricing, which is primarily offset by unfavorable regional mix.

[5] Positively impacted by consulting fees, fraud service fees and other payment-related products and services.

Operating Expenses

Our operating expenses are comprised of general and administrative, advertising and marketing and depreciation and amortization expenses. Operating expenses increased $93 million, or 12%, for the three months ended March 31, 2014 versus the comparable period in 2013, primarily due to higher general and administrative expenses. The components of operating expenses for the three months ended March 31, 2014 and 2013 were as follows:

	Three Months Ended March 31,		Percent Increase (Decrease)
	2014	2013	
	(in millions, except percentages)		
General and administrative	$670	$608	10%
Advertising and marketing	149	129	15%
Depreciation and amortization	73	62	19%
Total operating expenses	$892	$799	12%
Total operating expenses as a percentage of net revenue	41.0 %	41.9 %	

General and Administrative

General and administrative expenses increased $62 million, or 10%, for the three months ended March 31, 2014 versus the comparable period in 2013, primarily due to an increase in personnel expenses.

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The significant components of our general and administrative expenses for the three months ended March 31, 2014 and 2013 were as follows:

	Three Months Ended March 31,		Percent Increase
	2014	2013	(Decrease)
	(in millions, except percentages)		
Personnel	$450	$412	9%
Professional fees	60	46	30%
Data processing and telecommunications	61	53	16%
Foreign exchange activity	(19)	(1)	*
Other	118	98	18%
General and administrative expenses	$670	$608	10%

* Not Meaningful

- Personnel expense increased for the three months ended March 31, 2014 versus the comparable period in 2013, due to an increase in the number of employees to support the Company's strategic initiatives.
- Professional fees consist primarily of third-party services, legal costs to defend our outstanding litigation and the evaluation of regulatory developments that impact our industry and company. Professional fees for the three months ended March 31, 2014 versus the comparable period in 2013, increased primarily due to support required for strategic development efforts.
- Data processing and telecommunication expense consists of expenses to support our global payments network infrastructure, expenses to operate and maintain our computer systems and other telecommunication system. These expenses vary with business volume growth, system upgrades and usage.
- Foreign exchange activity includes gains and losses on foreign exchange derivative contracts and the impact of remeasurement of assets and liabilities denominated in foreign currencies. See Note 14 (Foreign Exchange Risk Management) to the consolidated financial statements included in Part I, Item 1 of this Report. Since the Company does not designate foreign currency derivatives as hedging instruments pursuant to the accounting standards for derivative instruments and hedging activities, it records gains and losses on foreign exchange derivatives on a current basis, with the associated offset being recognized as the exposures materialize.
- Other expenses include costs to provide loyalty and rewards programs, travel and entertainment, rental expense for our facilities, litigation settlements not related to the U.S. merchant class litigation, investment related expenses and other miscellaneous operating expenses. Other expenses increased for the three months ended March 31, 2014 versus the comparable period in 2013, primarily due to expenses incurred to support strategic development efforts.

Advertising and Marketing

Our brands are valuable strategic assets that drive acceptance and usage of our products and facilitate our ability to successfully introduce new service offerings and access new markets globally. Our advertising and marketing strategy is to increase global MasterCard brand awareness, preference and usage through integrated advertising, sponsorship, promotions, interactive media and public relations programs on a global scale. We will continue to invest in marketing programs at the regional and local levels and sponsor diverse events aimed at multiple target audiences. Advertising and marketing expenses increased $20 million, or 15%, for the three months ended March 31, 2014 versus the comparable period in 2013, mainly due to increased media spend to support our strategic initiatives.

Depreciation and Amortization

Depreciation and amortization expenses increased $11 million, or 19% for the three months ended March 31, 2014 versus the comparable period in 2013. The increase in depreciation and amortization expense was primarily due to increased amortization of capitalized software costs.

Other Income (Expense)

Other income (expense) is comprised primarily of investment income, interest expense, our share of income (losses) from equity method investments and other gains and losses. Other income (expense) for the three months ended March 31, 2014 was consistent with the comparable period in 2013.

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Income Taxes

The effective income tax rates were 32.0% and 30.5% for the three months ended March 31, 2014 and 2013, respectively. For the three months ended March 31, 2014, the effective tax rate was higher than for the three months ended March 31, 2013, due primarily to a less favorable geographic mix of taxable earnings.

Liquidity and Capital Resources

We need liquidity and access to capital to fund our global operations, credit and settlement exposure, capital expenditures, investments in our business and current and potential obligations. The Company generates the cash required to meet these needs through operations. The following table summarizes the cash, cash equivalents and investment securities balances and credit available to the Company at March 31, 2014 and December 31, 2013:

	March 31, 2014	December 31, 2013
	(in billions)	
Cash, cash equivalents and available-for-sale investment securities [1]	$6.6	$ 6.3
Unused line of credit [2]	3.0	3.0

[1] Excludes restricted cash related to the U.S. merchant class litigation settlement of $540 million and $723 million at March 31, 2014 and December 31, 2013, respectively.

[2] The Company did not use any funds from the line of credit during the periods presented.

Cash, cash equivalents and available-for-sale investment securities held by our foreign subsidiaries (i.e., any entities where earnings would be subject to U.S. tax upon repatriation) was $3.7 billion and $3.6 billion at March 31, 2014 and December 31, 2013, respectively, or 57% of our total cash, cash equivalents and available-for-sale investment securities as of such dates. It is our present intention to permanently reinvest the undistributed earnings associated with our foreign subsidiaries as of December 31, 2013 outside of the United States (as disclosed in Note 17 (Income Tax) to the consolidated financial statements included in Part II, Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2013), and our current plans do not require repatriation of these earnings. If these earnings are needed for U.S. operations or can no longer be permanently reinvested outside of the United States, the Company would be subject to U.S. tax upon repatriation.

Our liquidity and access to capital could be negatively impacted by global credit market conditions. The Company guarantees the settlement of many of the MasterCard, Cirrus and Maestro branded transactions between our issuers and acquirers. See Note 13 (Settlement and Other Risk Management) to the consolidated financial statements in Part I, Item 1 of this Report for a description of these guarantees. Historically, payments under these guarantees have not been significant; however, historical trends may not be an indication of the future. The risk of loss on these guarantees is specific to individual customers, but may also be driven significantly by regional or global economic conditions, including, but not limited to the health of the financial institutions in a country or region.

Our liquidity and access to capital could also be negatively impacted by the outcome of any of the legal or regulatory proceedings to which we are a party. For additional discussion of these and other risks facing our business, see Part I, Item 1A - Risk Factors of the Company's Annual Report on Form 10-K for the year ended December 31, 2013; and in Part II, Item 1A (Risk Factors) of this Report; Note 12 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1 of this Report; and "-Business Environment".

Cash Flow

The table below shows a summary of the cash flows from operating, investing and financing activities for the three months ended March 31, 2014 and 2013:

	Three Months Ended March 31,	
	2014	2013
	(in millions)	
Cash Flow Data:		
Net cash provided by operating activities	$568	$872
Net cash provided by (used in) investing activities	130	(107)
Net cash used in financing activities	(279)	(783)

Net cash provided by operating activities was $568 million and $872 million for the three months ended March 31, 2014 and 2013, respectively. Net cash provided by operating activities for the three months ended March 31, 2014 was primarily due to net income, partially offset by the net change in customer settlements. Net cash provided by operating activities for the three months ended March 31, 2013 was primarily due to net income and the collection of income tax receivables.

Net cash provided by investing activities for the three months ended March 31, 2014 primarily related to the net proceeds from sales and maturities of investment securities and a reduction in restricted cash, partially offset by purchases of investment securities and acquisitions. Net cash used in investing activities for the three months ended March 31, 2013 primarily related to the purchases of investment securities, partially offset by net proceeds from sales and maturities of investment securities.

Net cash used in financing activities for the three months ended March 31, 2014 primarily related to the repurchase of the Company’s Class A common stock. In addition, the Company completed its debt offering on March 31, 2014. Net cash used in financing activities for the three months ended March 31, 2013 primarily related to the repurchase of the Company’s Class A common stock.

The table below shows a summary of the balance sheet data at March 31, 2014 and December 31, 2013:

	March 31, 2014	December 31, 2013
	(in millions)	
Balance Sheet Data:		
Current assets	$11,342	$ 10,950
Current liabilities	5,994	6,032
Long-term liabilities	2,230	715
Equity	6,578	7,495

The Company believes that its existing cash, cash equivalents and investment securities balances, its cash flow generating capabilities, its borrowing capacity and its access to capital resources are sufficient to satisfy its future operating cash needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with its existing operations and potential obligations.

Debt and Credit Availability

In March 2014, MasterCard Incorporated issued $500 million aggregate principal amount of 2.000% Notes due April 1, 2019 (the “2019 Notes”) and $1 billion aggregate principal amount of 3.375% Notes due April 1, 2024 (the “2024 Notes”) (collectively the “Notes”). The effective interest rates were 2.081% and 3.426% on the 2019 Notes and 2024 Notes, respectively. The net proceeds from the issuance of the Notes, after deducting the underwriting discount and offering expenses, were $1,484 million. The Company is not subject to any financial covenants under the Notes. Interest on the Notes is payable semi-annually on April 1 and October 1, commencing on October 1, 2014. The Notes may be redeemed in whole, or in part, at our option at any time for a specified make-whole amount. The Notes are senior unsecured obligations and would rank equally with any future unsecured and unsubordinated indebtedness. The proceeds of the Notes are to be used for general corporate purposes.

The Company has a $3 billion committed unsecured revolving credit facility (the “Credit Facility”) which expires on November 15, 2018. The Credit Facility decreases to $2.95 billion during the final year of the Credit Facility agreement. Borrowings under the Credit Facility are available to provide liquidity for general corporate purposes, including providing liquidity in the event of one or more settlement failures by the Company’s customers. The Credit Facility contains customary representations, warranties, events of default and affirmative and negative covenants, including a financial covenant limiting the maximum level of consolidated debt to earnings before interest, taxes, depreciation and amortization. MasterCard was in compliance in all material respects with the covenants of the Credit Facility at March 31, 2014 and December 31, 2013. The majority of Credit Facility lenders are customers or affiliates of customers of MasterCard.

Dividends and Share Repurchases

MasterCard has historically paid quarterly dividends on its outstanding Class A common stock and Class B common stock. Subject to legally available funds, we intend to continue to pay a quarterly cash dividend. However, the

declaration and payment of future dividends is at the sole discretion of our Board of Directors after taking into account various factors, including our financial condition, operating results, available cash and current and anticipated cash needs.

On December 10, 2013, our Board of Directors declared a quarterly cash dividend of $0.11 per share paid on February 10, 2014 to holders of record on January 9, 2014 of our Class A common stock and Class B common stock. The aggregate amount of this dividend was $131 million.

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On February 4, 2014, our Board of Directors declared a quarterly cash dividend of $0.11 per share payable on May 9, 2014 to holders of record on April 9, 2014 of our Class A common stock and Class B common stock. The aggregate amount of this dividend will be $129 million.

Aggregate payments for quarterly dividends totaled $131 million and $37 million for the three months ended March 31, 2014 and 2013, respectively.

Shares in the Company's common stock that are repurchased are considered treasury stock. The timing and actual number of additional shares repurchased will depend on a variety of factors, including the operating needs of the business, legal requirements, price and economic and market conditions. In December 2013, our Board of Directors approved a new share repurchase program authorizing the Company to repurchase up to $3.5 billion of our Class A common stock. During January 2014, the Company exhausted its purchases under its February 2013 share repurchase program. As of April 24, 2014, the cumulative repurchases by the Company under its December 2013 share repurchase program totaled approximately 25.6 million shares of its Class A common stock for an aggregate cost of approximately $2.0 billion at an average price of $76.52 per share of Class A common stock. As of April 24, 2014, the Company had approximately $1.5 billion remaining under its December 2013 share repurchase program.

The following table summarizes the Company's share repurchase authorizations of its Class A common stock through March 31, 2014, as well as historical purchases:

	Authorization Dates			
	December 2013	February 2013	June 2012	Total
	(in millions, except average price data)			
Board authorization	$3,500	$2,000	$1,500	$7,000
Remaining authorization at December 31, 2013	$3,500	$161	$—	$3,661
Dollar value of shares repurchased during the three months ended March 31, 2014	$1,508	$161	$—	$1,669
Remaining authorization at March 31, 2014	$1,992	$—	$—	$1,992
Shares repurchased during the three months ended March 31, 2014	19.4	1.9	—	21.3
Average price paid per share during the three months ended March 31, 2014	$77.70	$83.22	$—	$78.20
Cumulative shares repurchased through March 31, 2014	19.4	31.1	31.1	81.6
Cumulative average price paid per share	$77.70	$64.26	$48.16	$61.31

See Note 8 (Stockholders' Equity) to the consolidated financial statements included in Part I, Item 1 of this Report for further discussion.

Off-Balance Sheet Arrangements

MasterCard has no off-balance sheet debt other than lease arrangements and other commitments as presented in the future obligations table in Item 7 (Liquidity and Capital Resources) in Part II of the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

Recent Accounting Pronouncements

Refer to Note 1 (Summary of Significant Accounting Policies) to the consolidated financial statements included in Part I, Item 1.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the potential for economic losses to be incurred on market risk sensitive instruments arising from adverse changes in market factors such as interest rates, foreign currency exchange rates and equity price risk. Our exposure to market risk from changes in interest rates, foreign exchange rates and equity price risk is limited. Management establishes and oversees the implementation of policies governing our funding, investments and use of derivative financial instruments. We monitor risk exposures on an ongoing basis. The effect of a hypothetical 10% adverse change in foreign currency rates could result in a fair value loss of approximately $216 million on our foreign currency derivative contracts outstanding at March 31, 2014 related to the hedging program. A 100 basis point adverse

change in interest rates would not have a material impact on the Company's financial assets or liabilities at March 31, 2014 or December 31, 2013. In addition, there was no material equity price risk at

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March 31, 2014 or December 31, 2013. The Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States includes provisions related to derivative financial instruments. The Company believes the adoption of such provisions will not have a material adverse effect on the Company's financial position or results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) are designed to ensure that information that is required to be disclosed in the reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and to ensure that information required to be disclosed is accumulated and communicated to management, including our President and Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding disclosure. The President and Chief Executive Officer and the Chief Financial Officer, with assistance from other members of management, have reviewed the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Report and, based on their evaluation, have concluded that the disclosure controls and procedures were effective as of such date.

Changes in Internal Control over Financial Reporting

There was no change in MasterCard’s internal control over financial reporting that occurred during the last three months ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, MasterCard's internal control over financial reporting.

Other Financial Information

With respect to the unaudited consolidated financial information of MasterCard Incorporated and its subsidiaries as of March 31, 2014 and for the three months ended March 31, 2014 and 2013, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their report dated May 1, 2014 appearing below, states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (the “Act”) for their report on the unaudited consolidated financial information because that report is not a “report” or a “part” of a registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
of MasterCard Incorporated:

We have reviewed the consolidated balance sheet of MasterCard Incorporated and its subsidiaries (the “Company”) as of March 31, 2014, and the related consolidated statements of operations and comprehensive income for the three-month period ended March 31, 2014 and 2013, and the consolidated statement of changes in equity for the three-month period ended March 31, 2014, and the consolidated statement of cash flows for the three-month period ended March 31, 2014 and 2013 included within Part I, Item 1 of this Form 10-Q. These interim financial statements are the responsibility of the Company’s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial information for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2013, and the related consolidated statements of operations, of comprehensive income, of changes in equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 14, 2014, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2013, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
New York, New York
May 1, 2014

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings
Refer to Note 12 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1.
Item 1A. Risk Factors

The following supplements our risk factor set forth in our Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Form 10-K"), entitled "Interchange fees and acceptance practices receive significant and intense legal, regulatory and legislative scrutiny worldwide, and the resulting decisions, regulations and legislation may have a material adverse impact on our overall business and results of operations." This supplemental risk factor specifically provides an update to our discussion on legislation proposed in July 2013 by the European Commission, relating to payment system regulation of cards issued and acquired within the European Economic Area (the "EEA").

On April 3, 2014, the legislation was amended and approved by the European Union Parliament. In particular, the European Union Parliament's amended legislation extended the proposed cap on credit and debit interchange fees to include commercial, as well as the previous inclusion of consumer, transactions. The proposed legislation, as amended, includes, among other things, the following elements: (1) a cap on consumer and commercial credit and debit interchange fees of 30 basis points per credit transaction and 20 basis points or 7 cents (whichever amount is lower) per debit transaction, for domestic and intra-EEA cross-border transactions (other than for commercial transactions, these cross border rates are comparable to the consumer rates MasterCard has applied for Europe on a weighted basis since July 2009); (2) restrictions on our "honor all cards" rule with respect to products with different levels of interchange; (3) a prohibition of surcharging by merchants for products that are subject to regulated interchange rates; (4) the prohibition of rules that prevent a consumer from requesting a "co-badged" card (that is, a credit or debit card on which an issuer has put a competing brand); and (5) the separation of brand and processing in terms of legal form, organization and decision making. Procedurally, the proposed legislation will next be debated, and potentially amended, by the Council of Ministers and the European Commission before it could be adopted. Accordingly, any final legislation could be different than what is in the amended proposal.

Consistent with the risk factor set forth in the 2013 Form 10-K, if interchange fees are required to be reduced as a result of any final legislation enacted by the European Union, issuers could be unable to use interchange fees to recoup as much of the costs that they incurred for their services previously. This could reduce the number of financial institutions willing to participate in our four-party payments system, lower overall transaction volumes, and/or make proprietary end-to-end networks or other forms of payment more attractive. Issuers could also choose to charge higher fees to consumers or businesses to attempt to recoup a portion of the costs incurred for their services, thereby making our card programs less desirable to consumers and businesses and reducing our transaction volumes and profitability. Any of the above actions could also result in less innovation and fewer product offerings. In addition, issuers could attempt to seek a reduction in the fees that we charge to them. The potential outcome of this proposed legislation could have a more positive or negative impact on MasterCard relative to certain of its competitors. As a result of this type of legislative activity, as well as in regulatory proceedings and litigation where we are defending interchange fees, we are dedicating substantial management time and financial resources that are being, and could continue to be, diverted from our core business. Any final legislation may have a material adverse impact on our overall business and results of operations.

For a discussion of the Company's additional risk factors, see Item 1A (Risk Factors) in Part I of the 2013 Form 10-K.

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

ISSUER PURCHASES OF EQUITY SECURITIES

During the first quarter of 2014, MasterCard repurchased a total of approximately 21.3 million shares for $1.7 billion at an average price of $78.20 per share of Class A common stock. See Note 8 (Stockholders' Equity) to the consolidated financial statements included in Part I, Item 1 of this Report for further discussion with respect to the Company's share repurchase programs. The Company's repurchase activity during the first quarter of 2014 consisted of open market share repurchases and is summarized in the following table:

Period	Total Number of Shares Purchased	Average Price Paid per Share (including commission cost)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Dollar Value of Shares that may yet be Purchased under the Plans or Programs [1]
January 1 – 31	6,002,200	$82.05	6,002,200	$ 3,168,832,077
February 1 – 28	7,974,102	$75.91	7,974,102	$ 2,563,545,233
March 1 – 31	7,366,970	$77.54	7,366,970	$ 1,992,335,426
Total	21,343,272	$78.20	21,343,272	

[1] Dollar value of shares that may yet be purchased under the Repurchase Programs is as of the end of the period.

Item 6. Exhibits

Refer to the Exhibit Index included herein.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

		MASTERCARD INCORPORATED (Registrant)	
Date: May 1, 2014		By:	/S/ AJAY BANGA Ajay Banga President and Chief Executive Officer (Principal Executive Officer)
Date: May 1, 2014		By:	/S/ MARTINA HUND-MEJEAN Martina Hund-Mejean Chief Financial Officer (Principal Financial Officer)
Date: May 1, 2014		By:	/S/ ANDREA FORSTER Andrea Forster Corporate Controller (Principal Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Exhibit Description
4.1	Indenture, dated as of March 31, 2014, between the Company and Deutsche Bank Trust Company Americas, as trustee (incorporated by reference to Exhibit 4.1 of the Company's Current Report on Form 8-K filed on March 31, 2014 (File No. 001-32877)).
4.2	Officer's Certificate of the Company, dated as of March 31, 2014 (incorporated by reference to Exhibit 4.2 of the Company's Current Report on Form 8-K filed on March 31, 2014 (File No. 001-32877)).
4.3	Form of Global Note representing the Company's 2.000% Notes due 2019 (included in Exhibit 4.2)(incorporated by reference to Exhibit 4.3 of the Company's Current Report on Form 8-K filed on March 31, 2014 (File No. 001-32877)).
4.4	Form of Global Note representing the Company's 3.375% Notes due 2024 (included in Exhibit 4.2)(incorporated by reference to Exhibit 4.4 of the Company's Current Report on Form 8-K filed on March 31, 2014 (File No. 001-32877)).
10.1+*	Form of Restricted Stock Unit Agreement for awards under 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2014).
10.2+*	Form of Stock Option Agreement for awards under 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2014).
10.3+*	Form of Performance Unit Agreement for awards under 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2014).
12.1*	Computation of Ratio of Earnings to Fixed Charges.
15*	Awareness Letter from the Company's Independent Registered Public Accounting Firm.
31.1*	Certification of Ajay Banga, President and Chief Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Martina Hund-Mejean, Chief Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Ajay Banga, President and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Martina Hund-Mejean, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Scheme Document

101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

+Management contracts or compensatory plans or arrangements.
*Filed or furnished herewith.
The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure other than with respect to the terms of the agreements or other documents themselves, and should not be relied upon for that purpose. In particular, any representations and warranties made by the Company in these agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs as of the date they were made or at any other time.