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EDITED TRANSCRIPT

XRX - Q1 2015 Xerox Corp Earnings Call

EVENT DATE/TIME: APRIL 24, 2015 / 2:00PM GMT

OVERVIEW:

Co. reported 1Q15 total revenue of $4.5b and adjusted EPS of $0.21. Expects 2015 total Co. revenue to be down about 1 point YoverY and adjusted EPS to be $0.95-1.01. Expects 2Q15 constant currency revenue to be down about 2 points and adjusted EPS to be $0.21-0.23.

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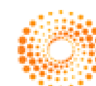

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PRESENTATION

Operator

Good morning and welcome to the Xerox Corporation first-quarter 2015 earnings release conference call hosted by Ursula Burns, Chairman of the Board and Chief Executive Officer. She is joined by Kathy Mikells, Executive Vice President and Chief Financial Officer.

During this call, Xerox executives will refer to slides that are available on the web at www.xerox.com/investor. At the request of Xerox Corporation, today's conference call is being recorded. Other recording and/or rebroadcasting of this call are prohibited without the express permission of Xerox. (Operator Instructions)

During this conference call, Xerox executives will make comments that contain forward-looking statements, which by their nature address matters that are in the future and are uncertain. Actual future financial results may be materially different than those expressed herein.

Ms. Burns, you may begin the call.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Good morning and thanks for joining our call. Today we reported our first-quarter results and provided full-year guidance, lowering expectations. I will start with a brief reminder of our direction and then provide an overview of our Q1 performance. Kathy will review the financials and then we will take your questions.

Our diversified portfolio, strong annuity business, and solid cash flow enable us to participate and invest in attractive markets that will drive growth. Services represents 56% of our total revenue and we expect that proportion to continue to grow. We are the leader in diversified business process services and we are maintaining leadership in document technology.

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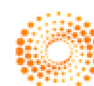

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Over the last few years we have taken significant steps to lay the foundation for sustainable, long-term success. We are differentiating ourselves by incorporating greater automation and intelligence in our solutions and products, all with the goal of helping our clients better manage their critical business processes.

As an example, we recently launched the Midas+ readmission forecaster, an advanced analytics healthcare solution to help hospitals drive quality improvement around patient care and reduce Medicare penalties for excess hospital readmissions. Additionally, we introduced our new mobility analytics platform, which makes it significantly easier for transport and parking operators to understand and even predict commuter needs. VINCI Park, the world's leading parking space provider, is testing the system in a town in the suburbs of Paris.

Within Document Technology, we retained our number one position in equipment revenue market share for the 21st straight quarter and we launched eight new products plus workflow solutions, reinforcing our leadership in mobile printing, inkjet technology, and digital color. Lastly, our solid balance sheet and strong free cash flow, along with the proceeds from the pending ITO divestiture, will enable us to continue to deliver strong shareholder returns.

We have returned more than 50% of free cash flow to shareholders over the last four years and plan to do the same this year by repurchasing up to $1 billion in shares and returning approximately $300 million to shareholders in dividends. At the same time, we will continue to invest in our business organically and through acquisitions.

Let's look at our performance in the quarter.

In the first quarter we reported total revenue of $4.5 billion, down 6%, 2% in constant currency, and we delivered adjusted earnings per share of $0.21. Earnings were in line with our guidance, but the performance of our Services business was below our expectations, principally because of implementation issues in certain legacy health enterprise platform accounts.

It is important to note that many areas of our Services business performed quite well in the quarter. This includes document outsourcing and several of our commercial vertical industry groups. We continued to perform well in commercial healthcare.

As many of you may have seen, we finalized the New York Medicaid contract that we were awarded last year. We have invested in advance to ensure our good start and we look forward to working with the state to serve their Medicaid population.

That said, in Services we have more work to do to improve our financial performance. We continue to align our go-to-market resources along vertical industries and we are investing in sales coverage and training. At the same time, we are focused on driving more consistent delivery and capturing efficiencies through our new operating model.

And specifically within our health enterprise accounts, we have taken action to address the issues. We continue to add expertise in the most critical areas of this business. Our operating performance and delivery quality continue to improve, and I am confident in the Services and healthcare teams.

Kathy will go into more detail on the financials in a moment and we can have additional discussion during the Q&A.

Our Document Technology results, which included the increased impact from foreign currency, largely met our expectations. It continues to be a business where we generate strong profits and cash. In quarter one we delivered shareholder value by repurchasing shares, supporting our dividend program, and acquiring Intrepid Learning Systems to enhance our Services capabilities.

Now I will turn over to Kathy, who will provide more details on the quarter and cover guidance.

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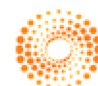

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Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

Thanks, Ursula, and good morning, everyone. We delivered Q1 EPS in the middle of our range with solid cash flow of $113 million. However, as Ursula mentioned, the quarter was challenging in many respects.

Some challenges have been contemplated such as negative currency impacts, higher pension expense, and in Services, the timing of investments relative to improved productivity from our global capabilities. However, we failed to accurately call the incremental financial pressure we are experiencing in our government healthcare business from the rollout of our health enterprise Medicaid platform. Our delivery quality and operating performance continued to improve, but the financials were a clear signal that we have more work ahead.

I will take you through more details on that when I cover the Services segment, but first let me walk you through the total company results for the quarter.

Total revenue in the quarter was down 6% in actual currency and 2% at constant currency as growth in Services was offset by declines in Document Technology. The negative currency impact of 4 points in the quarter was at the high end of our expectations and reflected the continued strengthening of the dollar within the quarter.

Gross margin of 31.2% was down 30 basis points year-over-year, driven by Services. RD&E was modestly lower year-over-year, driven by reductions in Document Technology. SAG in absolute dollar terms was lower year-over-year, driven by currency. However, as a percent of revenue, SAG was up 70 basis points year-over-year to 20.5% as productivity benefits were more than offset by higher pension expense and the investments in Services.

As a result, our first-quarter operating margin decreased 110 basis points year-over-year and operating profit declined 18%, with the largest drivers being pension expense, the financial pressure from our health enterprise implementation, and currency.

Moving down the income statement, adjusted other net expense was $5 million lower year-over-year. Within that, lower gains on sales of assets and higher currency losses were offset by lower restructuring costs and lower interest expense.

Equity income was $34 million in the quarter, down $8 million year-over-year, driven by the impact of negative translation currency. Our Q1 adjusted tax rate of 24.5% was at the low end of our range and up 4 percentage points year-over-year. Adjusted EPS of $0.21 was at the midpoint of our guidance and $0.05 lower year-over-year, driven by the operating profit decline.

I will now move to Services segment to review those results in a little more detail. Services revenue declined 3% and was up 1% at constant currency, which was a bit shy of where we expected to come in. Document outsourcing constant currency growth of 2% was in line with our expectations.

BPO growth of 1% at constant currency was a bit light of what we were targeting, with the health enterprise platform implementations producing less revenue than we had anticipated. We continue to see good BPO growth in commercial healthcare and other commercial industry verticals.

We anticipate our revenue growth rate will improve in the second half as we lap the impact of last year's larger contract losses and begin to ramp the New York Medicaid and Florida tolling deals. M&A also remains a variable factor to growth, depending on timing of acquisitions.

Our renewal rate in the quarter was 91%, evidence that overall we are delivering well for our clients. I should note that we are now including document outsourcing in our renewal rate in addition to BPO. Overall, it was a really strong renewal quarter.

Total signings in the quarter were down 13%, driven by both lower new business signings and lower renewal opportunities. New business signings declined 26% year-over-year.

We mentioned on our last call that we have aligned our salesforce to specific industry verticals. We recently moved our document outsourcing salesforce into the same structure to better enable cross-selling opportunities. We are continuing to invest in increased sales coverage and training, which takes time to yield results and should positively impact new business signings as we move through 2015.

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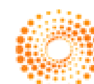

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Additionally, our signings did not include the New York Medicaid contract, which was finalized after the end of the quarter, and the new Florida tolling contract, which is still pending. These new signings will reverse the downward signings trend this quarter.

Turning to margin, segment margin was 7.5% in the quarter, which was down 110 basis points year-over-year and well below our objective of modest year-over-year improvement. As referenced earlier, the driver of the Services margin miss was lower revenue and more costs than anticipated with our health enterprise platform implementation.

California had the largest impact on our results in the quarter. We successfully implemented the first phase at the end of last year; however, recent estimates to deliver the remaining phases are higher. We also had startup costs in New York with no revenue offset as the contracts didn't get finalized until April.

Margin excluding those impacts would have been up 10 basis points year-over-year, so a very modest improvement. We saw margin improvements in a number of lines of business, including document outsourcing, as well as some of our commercial verticals. At the same time, we are continuing to invest in our industry and capability operating model, sales coverage and training, as well as some new offerings, which Ursula discussed.

As we move through the year we expect to see our investments mature and produce more value. We should also see further productivity gains as we rollout our initiatives across our operating groups.

Before moving on, I'm going to take a minute to further discuss the financial challenges we are facing in our health enterprise implementations. With the exception of the New York Medicaid contract, these deals were signed before we finished development of the core software platform. We had delays finishing the new platform and meeting client delivery dates, resulting in cost increases.

In the case of California, as the new project plan was built out further, we recognized that the cost to complete the entire program would increase, which triggered an adjustment in the quarter. In contrast, New York was bid after the health enterprise platform was completed and we have been investing ahead to position us for a strong start.

Operationally the platform is performing well in the states where it has been rolled out and we are progressing on the implementations in other states. However, we have more work ahead to turn around the financial performance.

We're taking a number of additional actions to improve the picture and have adjusted our expectations to reflect what we believe is required to meet our customer commitment. This is the main driver of our revised Services margin guidance, which I will get to in more detail when I review guidance in a few minutes.

Now I'm going to turn to Document Technology.

Document Technology revenue in the quarter was largely aligned with our guidance, with adverse currency coming in at the high-end of our expectations. On a constant currency basis, revenue was down 6%, which was consistent with last year's rate of decline. Currency was a 4 point drag on revenue with revenue at actual currency down 10%.

While we don't typically include developing markets in our constant currency calculation, we are impacted when currencies devalue quickly. In the first quarter, revenue at constant currency would've been down 5% if we excluded the impact of currency on developing markets.

Relative to our performance in the fourth quarter, we saw some moderation of equipment revenue declines in constant currency as we began to see some benefits from the second half 2014 new product launches. Offsetting this were modestly worse annuity revenue declines driven by supplies revenue declines in the entry segment.

Looking at entry, it continues to be impacted by economic weakness and uncertainty in developing markets, especially Eurasia and Brazil. We anticipate some improvement in the rate of declines as benefits from new products grow, but overall we continue to expect economic headwinds to weigh on entry.

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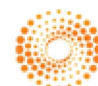

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Mid-range model and color activity were relatively flat year-over-year and overall mid-range results showed improvement. High end continues to show good annuity revenue performance, although equipment was weaker in the quarter, driven by the timing of new product launches as well as a couple of deals slipping into the second quarter.

Document Technology margins were down 110 basis points with almost the entire decline driven by higher pension expense. As previously discussed, the higher pension expense this year is a function of higher pension settlements given lower discount rates, as well as last year's mortality table change. So overall, core Doc Tech business performance continues to be strong and we are focused on improving top line by capitalizing on our growth opportunities in the market.

Before I go through the cash flow, I'd like to remind everyone that while our ITO results are included in discontinued operations pending the sale to Atos, ITO is still in our operating cash flow until we close the transaction. ITO was a use of $13 million in the quarter and a use of $32 million in free cash flow.

Overall, cash flow from operations was $113 million in the quarter, solidly positive and reflecting the progress that we've made smoothing working capital impact over the past couple of years.

A couple of highlights to note within operating cash flow. The add-back for depreciation is lower than last year by about $50 million and reflects in part the write-down of the carrying value of the ITO assets to fair value now that it's being held for sale. Working capital is a use of cash, which is consistent with our normal seasonality and largely consistent with 2014.

Inventory was a larger use this year, reflecting a higher level of in-transit inventory and timing of sales. Additionally, accounts receivable was a higher use this year, primarily due to the strong fourth-quarter collections, particularly in Services.

Moving down the cash flow statement, investing cash flows were a $98 million use, including $95 million spent on CapEx in the quarter and $28 million on acquisition. Cash flow from financing was a use of $485 million, which included net debt payments of approximately $150 million, $216 million spent on share repurchases, and $76 million used for preferred and common stock dividends.

Now I'm going to quickly go over our capital structure. We ended the first quarter with $7.6 billion in debt. During the quarter we retired $1 billion in senior notes and issued $400 million in 5-year notes with a coupon of 2.75% and $250 million in 20-year notes with a coupon of 4.8%.

Applying 7-to-1 leverage on customer financing assets, our allocated financing debt at the end of the first quarter was $3.9 billion, leaving core debt of $3.7 billion. We manage our core debt to maintain credit metrics consistent with our investment-grade rating, so our capital structure remains pretty stable. If we go on to the next slide, I will review where we are at in terms of capital allocation.

Our capital allocation plans for the year are unchanged, and as previously communicated, incorporates the redeployment of the expected net proceeds of roughly $850 million from the ITO sale, which should close later this quarter. On share repurchases, we spent $216 million in the quarter and continue to plan to spend about $1 billion repurchasing stock this year. We continue to view our shares as attractively priced and a good investment.

On acquisitions, we closed one acquisition in the quarter, Intrepid Learning Systems, for $28 million. We continue to look to spend up to $900 million in 2015 and plan to roll over any unspent funds into 2016. Acquisitions are a priority for us as we believe it is an important element of our portfolio management strategy to evolve our portfolio at higher value services as well as supporting BPO expansion internationally.

We are very disciplined in our approach. Our pipeline is strong and we have actively considered more deals year-to-date than last year. We're working to further build our business development capabilities so we can be more acquisitive and expand our pipeline of potential targets.

Now on to debt. We have one more tranche of debt coming due this year, $250 million in June. We expect debt to temporarily decline in conjunction with the receipt of the ITO proceeds and plan to complete additional refinancing activity as needed in the second half. We continue to expect to end the year at roughly $7.7 billion in debt.

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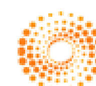

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And finally, on dividends, we spent just under $300 million, which contemplates the recent 12% dividend increase we announced on our last earnings call.

Before I turn it back to Ursula I would like to summarize our expectations for the second quarter and for the full year. For the second quarter we expect adjusted EPS in the range of $0.21 to $0.23 with constant currency revenue down about 2 points and currency pressuring top line by another 5 points, reflecting the dollar strengthening a bit from the first quarter.

For Document Technology revenue, we expect the constant currency rate of decline to modestly improve from the first quarter with a negative currency impact of 5 to 6 points. Margins should be within our 11% to 13% range for the year, up sequentially but down year-over-year, driven by the increased pension cost and currency.

For Services, we expect the second-quarter year-over-year revenue growth to be roughly flat at constant currency with a negative currency impact of 4 to 5 points. Slow growth reflect softer signings, as well as the timing of new contract ramps versus lost contract run off and slower acquisition activity. We anticipate second-quarter margins will be approximately flat sequentially, reflecting period-compare headwinds in document outsourcing, continued higher costs to implement our health enterprise platforms, and incremental investments not yet fully offset by productivity gains.

Document outsourcing margins continue to be strong, with normal year-over-year comparison in the second half. For the full year, at constant currency, we expect Services revenue will now be at the low end of the 2% to 4% range; no change to Document Technology, with revenue expected to decline 4% to 5%; and total company revenue now expected to be down about a point year-over-year. We expect currency will have a negative 4 point impact to total revenue for the year.

We are maintaining our Document Technology margin expectations, but reducing our Services margin guidance to 8.5% to 9%, due to higher costs within our health enterprise implementation and not as much net benefit from enhanced productivity relative to investments. In total, we expect this to yield adjusted EPS of $0.95 to $1.01.

To conclude, while we are disappointed with the guidance revision, we are making decisions for the long term to ensure that we are taking necessary actions to drive sustainable growth and margin improvement in the future.

With that, I will have it back over to you, Ursula.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Thanks, Kathy. I want to get your questions, so I will summarize quickly.

Although our earnings met expectations, it was a challenging quarter. As Kathy detailed a moment ago, we are lowering our full-year guidance. We know we have work to do to achieve sustainable long-term success. I am confident in our business strategy, our strong portfolio, and our ability to succeed in the many industries that we serve.

Going forward in Services, we are focused on revenue and margin expansion. Improved signings and executing on our new operating model will help us there. Document Technology continues to execute well and we remain focused on leading in the most attractive segments of the market. Overall, we anticipate positive results from the changes that we have made and I am certain that the actions that we are taking today will ensure a healthy Xerox for tomorrow and beyond.

Thank you for listening and now I will turn it over to Leslie.

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Leslie Varon - *Xerox Corporation - Corporate VP & VP, IR*

Thanks, Ursula. Joining Ursula and Kathy today is Bob Zapfel, Head of our Services business. Also let me point out that we have several supplemental slides at the end of our deck. They provide more financial detail to support today's presentation and complement our prepared remarks.

For the Q&A, I would ask participants to limit follow-on and multipart questions so we can get to everyone. At the end of our Q&A session, I will turn it back to Ursula for closing comments.

Operator, please open the line for questions now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Bill Shope, Goldman Sachs.

Bill Shope - *Goldman Sachs - Analyst*

Okay, great. Thank you. I have a question on the Services segment in general. The volatility and the unexpected shortfalls we have seen in Services margins has obviously been a problem for some time now; different reasons for different quarters.

But I guess when we look at this quarter specifically and the cost overruns for the California case, what safeguards are being put in place to ensure that we don't see this happen again with other contracts that maybe we can't see from the outside? And why aren't we seeing more substantial restructuring to deal with what appears to be a pretty uncertain margin pass this business overall?

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

Bill, it's Bob; let me start. So relative to -- actions relative to our enterprise platform with government healthcare, we are taking a number of actions to try to drive improved visibility and predictability there. We are increasing the leadership focus and we have added additional external talent.

These are five accounts, so this is not across our broad portfolio. This is the implementation of a new system in the five states we talked about at the investor conference. We've added project management oversight in each of these projects to try to drive better predictability.

We're working to consolidate the customized instances into a standardized platform that would then be less costly to implement and manage going forward. We are lining up additional partners to help us with software development integration capability and trying to better leverage low-cost resources for platform development. And we are pursuing add-on work with a number of these clients to give us some incremental revenue.

Relative to your question on restructuring, we were down 2,000 people from the end of the fourth quarter to the end of the first quarter in our Services business overall. So we are just trying to manage to drive improved productivity broadly across our Services portfolio.

Bill Shope - *Goldman Sachs - Analyst*

If I could just add on to that, when we look at sort of the metrics you are judging this stabilization by, is this something that you expect by the time we get to 2016 we are back on track?

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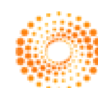

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Obviously, we saw your full-year margin guidance, so we get some color on the path you are looking at for this year. But sort of what are you putting in front of you as targets to get back on track and show that some of these safeguards are actually bearing fruit?

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

Overall, in terms of some of the incremental actions that we are taking to make sure that we have fully considered what's going to be needed, we have obviously made more room in our margin guidance, so health enterprise costs generally expected to also be a year-over-year headwind for us in the second quarter. We have added additional both financial management resources and expanded the financial teams in this area that sit over the accounts, specifically in California, which is where we had the big adjustment for the quarter.

As we look out to 2016, the most important influence is getting more and more of these of implementations under our belt. So Bob mentioned we have five accounts: two have already been implemented, another one will be implemented next year. So getting these implementations under our belt where the contracts were signed three-plus years ago is what we really need to get behind us, and you can see that we have taken a big adjustment on California to really reflect the expectation of higher go-forward costs.

Bill Shope - *Goldman Sachs - Analyst*

Okay, that's it for me. Thank you.

Operator

Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

Thank you very much. I have another Services-oriented question. Bob, sort of taking a step back because in the last question you discussed a lot on the healthcare side, can you talk a bit about what you are seeing in the other parts of the business? How you are sort of thinking about some of those areas in terms of growth and margin opportunity once we get through this healthcare issue?

And then I have a question on acquisitions, thanks.

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

Thanks, Shannon. I would say, as you and others have got good visibility to, we've moved to this new industry go-to-market and global capability model, and I would say that early indications are very positive on both elements of that. So we are finding the pipeline data doesn't look great quarter to quarter, but we found that from January, February, March we had an improved pipeline. As we put new resources in place, we bolstered up the sales team that we think will drive to improvements in our second-half results.

In the global capability model, if you think back to our margin improvement track, we think we are going to get very good yield out of that. So, overall, I would say that we've got positive signs relative to the model in general and the customer feedback has largely been favorable.

Shannon Cross - *Cross Research - Analyst*

Okay. And then can you talk a bit about -- I'm not sure who wants to take it. But from an acquisition standpoint $900 million, you've talked about you made a very small acquisition during the first quarter. What kind of acquisition, sort of what size?

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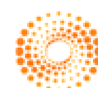

Is this something where we can actually assume that we will get done this year? Because I know you're talking about pushing cash now into 2016. I'm just looking at, with the stock down double digits right now, perhaps share repurchase might be a better use of cash. Or just how are you thinking about cash as we go forward here? Thank you.

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

So this is Kathy. Overall, if you look at our activity year-over-year, I would describe us as having more activity this year than last year. Now, activity doesn't always immediately translate into getting things done, but that activity has been more focused on I think what I described on our last call as chunkier-sized deals. So we are looking to not just do the deal size of the one deal that we did this quarter, but looking at things that are a little larger, which can make more of a difference for us.

We are targeting specific areas. When you look across our portfolio we've got a great business in commercial healthcare. There are places we would like to continue to build out that business. Transportation is an area of target for us.

We've talked about the continued move into workflow within our document outsourcing group, so that's an area. Then as we look to continue to expand internationally, we do need a bigger footprint and acquisitions can help us in that space as well. So they are, as you can imagine, tough to call. It's tough to call in which quarter are we actually going to land things, but we are certainly generating more activity and looking to do larger deals.

And then, in the second part of your question, so what about share repurchases? We are committed to doing about $1 billion of share repurchases this year. We know M&A timing is hard to call. It is important for us as we continue to look at evolving our portfolio, and so if we don't spend the $900 million, we will roll it over into next year.

Operator

Tien-tsin Huang, JPMorgan.

Tien-tsin Huang - *JPMorgan - Analyst*

Great, thanks. Just on the healthcare side, I just I guess heard the incremental $30 million spend. I guess that was on top of the $20 million maybe last year.

So I'm just curious, in hindsight here is this just... I heard the platform implementation issues you called out, but in hindsight was it a missed pricing issue just thinking about what went wrong? I get, again, the implementation problems, but could this have been resolved if you had priced these contracts differently?

And then I just want to pull that forward into New York, and just being confident here that you have a good line of sight into the ramp there as the (multiple speakers).

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

If you look at the situation in California which triggered the adjustment that we took this quarter, we had made a decision with the state of California to do this in a staged implementation rather than a single cutover. And that caused us to have to basically kind of re-stage and re-work our project plan.

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As we got into the further details of what that was going to cost, the cost for the overall implementation went up and that triggered us to have to take an adjustment this quarter. So we scrubbed much further what that project plan was going to look like. It's the right answer for the client and for us to do a staged implementation.

It reduces the risk of execution, but at the end of the day we now understand that it's going to cost more. And this is a contract was signed years ago and in advance of our standard platform being completed.

If I contrast that then, because you asked about New York, New York is very different because New York we actually bid a standard contract. And in addition to bidding a standard contract, we were awarded this contract last May. We started standing up resources toward the end of the third quarter in order to really get us on a right track with New York, so we are very excited about New York. It's a different situation than I would say the legacy implementations that we had pre-New York.

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

I would just add on New York; I think the dominant difference is that we were able to bid an already-working system, which, as opposed to what we did in the other states, we hadn't already completed the core software asset. And as Kathy mentioned, we have been in front of the contract being finalized. We have been investing to ensure a very rapid start, which on the other implementations we didn't start until after the contract was signed.

So we are very optimistic that we are well positioned to deliver well, both for New York and for our shareholders, with that opportunity.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

We are focused on making sure that California for sure, but New York very specifically in this conversation, starts well. And we -- before we had revenue -- knowing that we were investing before we had revenue, we took that risk because it's really important.

The long-game here is very important to keep an eye on. So we took a hit in the quarter for New York as well because we didn't get it signed in the quarter, but it's the right thing to do. But we got it signed obviously after the quarter.

Tien-tsin Huang - *JPMorgan - Analyst*

Understood. That's good to know. Just two quick follow-ups just on the Florida tolling.

I know there was some disputes in the past on that. Is that getting closer to being done? It sounds like it could happen in the second quarter. And then just any client feedback on the ITO divestiture in terms of feedback? Just any update there would be great, thank you.

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

Florida it is getting closer. It is not yet complete, but it is getting closer. And on the ITO transaction with Atos, the feedback has been very positive. The consent process, both for the pure IT outsourcing clients and for the large volume of clients that we have BPO relationships with that then Atos will become a subsidiary provider, has also gone very well. So we are pleased with that.

Operator

Jim Suva, Citigroup.

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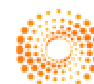
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Jim Suva - *Citigroup - Analyst*

Thanks very much. I know a lot of the question has been on the Services. Seeing how that is the strategy of your company and really one of the key go-forward vehicles, I think it's very appropriate.

And so when we think about the new reset to goals of operating margins of 8.5% to 9%, previously you said your long-term goal is 10% to 12%. Is that still valid? Has that been now you have to revisit that all together? And if so, what timeline should we think? Most people will think of long term of 2-3 years, you can actually reach it, it's not some far-flung dream. Can you address that please?

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

We're not going to do all the guidance thing here before the November conference. But my view is clearly the long term goal is still our target. We're disappointed with our operating performance and we have shared that. But I do not have a view that's not attainable long-term margin perspective for us with this set of actions that we are taking relative to portfolio management, go-to-market by industry, global capabilities so I don't expect us to change our view on that.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Jim, if I may, I will just add we're not talking -- we're talking long-term in my lifetime and I mean that really clearly. We definitely take a step to the side today and this year, but getting to 10% to 12% is something that we can do in the foreseeable future. In the near term, not in the long term.

Jim Suva - *Citigroup - Analyst*

Then my follow-up is, regarding the margins of 8.5% to 9%, am I correct that folds in the New York, the California, the not-yet-closed Florida but likely to close contract? And is there anything about accounting, Kathy, that we need to be aware of, like percentage of completion versus booking upfront costs to invest today that have been in a few quarters? Just the way you recognize the profitability of it in a couple quarters becomes less risky of another disappointment like we saw today.

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

So as much as I don't like to talk about accounting on these calls, I am happy to take a little bit of a diversion to do that. You know, I mentioned we took an adjustment for California so when we are implementing the platform we are using percent of completion accounting. In that case, as we got in and did the more detailed planning for the now-phased implementation and costed out that more detailed plan, that is what triggered us to take the adjustment in the quarter.

That adjustment in the quarter is not all cash that kind of lands in the quarter. That is a software platform that we will be delivering over the course of this year and next through these stages. So I would call that a pretty isolated adjustment, not the kind of adjustment that we would expect we would be taking on an ongoing basis. It's part of the reason earlier I talked about the fact that this area gets less risky for us as we complete more and more of these implementations with the states where we signed contracts three-plus years ago.

Once we get beyond the implementation, then the economics move to I will call it the regular Medicaid transaction processing. And in addition to that, we typically -- and even in the couple of clients that we have already cut over with the new platform, we typically have the opportunity to then do add-on things and get additional revenue from those clients, which we have been successfully doing and will continue to do.

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

Just on the other part of your question, so New York and Florida are contemplated then within the guidance that we have shared.

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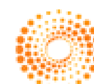

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Jim Suva - *Citigroup - Analyst*

Thank you.

Operator

George Tong, Piper Jaffray.

George Tong - *Piper Jaffray & Co. - Analyst*

Thanks, good morning. A question for both Ursula and Kathy. This last round of investments in Services and prior investments in Services have been predominantly focused on government healthcare.

Strategically, Ursula, when you think about returns on investment, how do you think about the long-term opportunity in government healthcare? And when can we begin to see returns from these investments in terms of incremental revenues and profits?

Then, Kathy, related to healthcare expenses, how do you think about the staging of expenses related to the New York contract? And in light of potential unforeseen investments, does the updated guidance range build in room for multiple scenarios? And then I have a follow-up.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

The first part of the question is important for you to ask and for us to get out on this call and just lay a foundation. Government healthcare is something that, I think that Bob said it earlier, we have been in it for more than 40 years. And it is a business that will be around and growing with a lot of focus because of the aging population, regulation changes in the United States, all of the foundational elements.

We make, in this business, above-average margins. This is an above-average Services margins in this business. It's important to know that and that we are very successful and liked by our clients. We do business in many, many states. We service millions of recipients of benefit from those states and it's a very profitable business for us.

Once we get past laying down the platform, which is really complicated -- and what we did for good, for bad, or for ugly, but the facts are that we actually implemented a brand-new platform in these five states that readies us for this future of aging and new regulation, etc. It's been more challenging than even I would like for it to be, but it is one that with many -- with continuous review we keep coming down on the fact that this is a business and a business that could be profitable for sure. It is already in the historic counts and we just have to make it that way in the new accounts.

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

I have one quick add and I will get your question with regard staging on the health enterprise accounts.

Overall, when we talk about investments in Services outside of our government healthcare group, we are investing in things like sales leadership, training, tools, new offerings, this shift to our new industry business group vertical approach and adding leadership in there. So when we talk about investments, it's clearly outside of the government healthcare solution business as well.

With regard to the staging, so clearly the first quarter we took a big adjustment in California. As I described, that's a pretty isolated instance. If I look over 2015 for the pattern of what we are expecting in the health enterprise accounts, I would describe this as first-half sort of heavy on incremental costs and expecting in the second half that we are actually going to get a reasonable amount of pickup.

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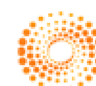

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Now it's still going to be a drag on a full-year basis, so if you look at the adjustment that we made overall to our margins, originally when we gave guidance back in November we said we thought we were going to get 25 to 50 basis points largely, candidly, from these health enterprise accounts improving. I would describe that now on a full-year basis embedded in our guidance as taking into consideration we might actually see a little bit of dilution overall on our margins for the year.

So we think as we've revised our guidance that we have really taken into consideration that some of these things are tough to call. They are pretty complicated projects and we need to make sure that we have room if there's any changes, and we've taken that into account.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

I think Kathy said in her notes that without the health accounts in the first quarter we would've been up 10 basis points in margin. And this year, as Kathy said, we expected 25 to 50 basis points of improvement so our margin expansion to come from health enterprises, as she said -- again, I'm just repeating it -- so we can actually get it clear, that will not happen. That 25 to 50 basis points will not happen.

It will probably be a little bit of a headwind for us in 2015, not a tailwind. And so the margin adjustment that we have taken for the full company and for Services comprehends that pressure that we are not going to make the progress that we wanted to make in government health from a financial perspective. Operationally -- the great news about this operationally is that we are doing fairly well I think across all of the accounts. There is some struggles in maybe one, but we're doing fairly well operationally across these accounts.

George Tong - *Piper Jaffray & Co. - Analyst*

Got it.

Operator

Keith Bachman, BMO Capital Markets.

Keith Bachman - *BMO Capital Markets - Analyst*

Bob, for you, please. If you could talk a little bit about the new business signings away from New York and Florida. Continues to trend weak and if you could just talk about why you think the new business signings down 26% year-over-year and 17% trailing 12 months, why they are weak and what is the plan to try to right that ship?

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

Thanks, Keith. They are weak for a couple of reasons. Not getting the bigger deals is the primary cause. You look on a trailing 12-month basis, and having -- it's not just not having New York or Florida in the compare, but not having anything that is really substantially large deal certainly hurts those trailing 12-month compares.

Going forward, obviously we expect both of those -- New York being finalized and Florida -- that will help our dynamics through the second quarter. And I think in the second half of the year the changes that we have made relative to the industry go-to-market model, we have been beefing up the salesforce. We're 90% of the key sales positions now filled; that's up from where we were at the time of the investor conference.

We expect to get the improvement in the second half coming from the industry go-to-market model, the investments that we have made in leadership positions, and the investments that we have made in increasing our sales capacity.

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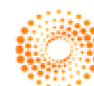

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Keith Bachman - *BMO Capital Markets - Analyst*

The corollary is, or the follow-on question is: are you becoming more concentrated if you are relying more on the New York MOAS deal and the Florida toll roads? As you look out over the course of the year, it would seem to suggest more concentration. Therefore, if there's any issues in those contracts or other large deals from profitability, does it put you more at risk for future margin-related issues because, in fact, you're getting more concentration in your customer base without the new business signings?

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

I would say that if you look at having two deals of that size in your overall signings portfolio that is not an atypical level of concentration. Again, I think the weakness over a trailing 12-month is not having anything big in that set of signings.

When we move and both grow the smaller deal component and have those in what has been signed, that would be to me a more typical kind of mix of signings. So I don't think -- obviously when you add big clients then that individual client is kind of a bigger share of your revenue stream. But from an overall signings mix, no, I don't think a portfolio for the year that would include Florida, New York, and then the rest of our book of business would be more concentrated than 2012, 2013, what our historical rate has been.

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

And I would just add on to that, Keith, if you put those two aside and we just looked at the composition of our signings up until this point in time, I would describe our book of signings as very diversified across our industry verticals. So the addition of these two contracts doesn't really sort of sway things really materially.

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

They are both diversified across our industry verticals and across our offerings, so this is not -- may be wrongly, but this is not a big worry for us at this point in terms of concentration risk of where our signings come from.

Keith Bachman - *BMO Capital Markets - Analyst*

Okay.

Operator

Ananda Baruah, Brean Capital.

Ananda Baruah - *Brean Capital - Analyst*

Good morning and thanks for taking the questions. Just two if I could, Kathy and maybe Ursula. The first one is could you list order of magnitude on the $0.05 guide down how much comes from each of the factors from FX and then from Services revenue and from the cost side of the Services equation? And then I have a follow-up, thanks.

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

Overall, in terms of the $0.05, I would characterize most of it as coming from the additional costs that we are seeing in the health enterprise accounts.

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With regard to FX, if I look at how rates changed, where we are today versus the last time we were on this call in January, the biggest change that we saw was in the euro, which has weakened by about 4%. It was partially offset by the yen weakening, which helps us a little, and so net-net I would say that is a negative, but it's not materially a negative.

And then I would say very modestly a little bit lighter on investment -- I'm sorry, on productivity relative to investment, so how that ramps over the course of the year for us is a little bit lighter. But the overwhelming majority of the $0.05 move is for the additional costs we are anticipating in the health enterprise platform implementation.

Ananda Baruah - *Brean Capital - Analyst*

Got it. Thanks, Kathy, that's helpful. Then, to that end, just with regards to the dynamic that you are seeing from health enterprise platforms, Kathy, you mentioned that the biggest -- the best way to sort of handle the situation is just get the other three stood up and running and normalized.

Does that mean that you guys could continue to be at risk? I guess the way to ask it maybe is can you provide us the appropriate context of which to sort of gauge and how you are gauging what the risk to the cost side ongoing has given that you still have three to stand up and that the contract was signed previously?

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

Sure. We have one that is cutting over later this year. We're pretty close on it and so we are pretty close to the finish line on that one. And the closer you get to the finish line basically the less risk you have.

We talked about California and we made a big adjustment for California. Last year we actually made an adjustment for the one other state that hasn't been cut over yet, so we had sort of resized what we thought our cost expectations were going to be. So I would characterize as we're -- we have already taken a hit on California. We have adjusted the other state that hasn't yet been implemented and we are close on the one that we are going to cut over this year.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

And New York doesn't have the same type of risk, so we think that we have gotten most of the ordinary cost of the business contract rollout costs associated with the rollout comprehended.

Ananda Baruah - *Brean Capital - Analyst*

Okay, got it. Got it, thanks.

Operator

Brian Essex, Morgan Stanley.

Brian Essex - *Morgan Stanley - Analyst*

Good morning. Thank you for taking the question. I guess I'll pig pile on MMIS for a question.

I have seen a number of different comments out in the press about it being on a pretty aggressive timeline. So first of all, congratulations on getting finally across the goal line. Then, as we think about the schedule going forward and that it may be an aggressive schedule, I guess the question is

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how does that timeline compare to I guess comparable contracts? And I know you have been pre-spending, but what sort of kind of I guess benchmarks do we need to consider going forward as you finally start to implement the contracts?

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

This is Bob, so let me try to address that. It is a shorter timeline than historic contracts; that's the reason we started investing more than six months in advance.

If you measure the timeline from date of finalization, it's shorter. If you measure the timeline from date that we started pre-investing, it's aggressive but reasonable. And we think that, again, it's a different situation, in our view, compared to the ones that we have previously done with the health enterprise platform, because we are starting from a working code base rather than starting from something that was still in design.

So while it is a more aggressive time period than you might look at some historical artifacts, the combination of both those two factors starting in advance and working off an existing software asset, we believe makes it a timeline that we will be able to achieve for the state.

Brian Essex - *Morgan Stanley - Analyst*

Bob, how does that matchup with any kind of issues you might have had with previous contracts, where maybe you've already had this code base already developed? Previously has most of the contracts been on the application development side or has it been on backend integration or what gives you the confidence that in an aggressive timeline you can meet those goals?

Bob Zapfel - *Xerox Corporation - Corporate EVP & President, Xerox Services*

I'm sorry, Brian, so really the previous contracts we have not yet completed the code base. There has been a three-year-plus gap between the last one and now New York, so the book of business that we signed previously we had some of the code base solidified, but some of it still, if you will, in design mode.

And for New York it's not as though we don't have some level of customization to do. It's not just taking a software asset and making no modifications or changes to it, but it is largely often existing proven code base that we are running in one of the other states.

Brian Essex - *Morgan Stanley - Analyst*

Got it. And maybe I can sneak one in on the printing side of the business.

I guess bookings seem a little bit weak and I think you've noted in the previous quarter that we were kind of caught a little bit of a product upgrade cycle. So I guess maybe can we put that in context of what to expect for growth there through the rest of the year, given the product cycle and that there was only a little bit in last quarter and that booking seemed a little bit light this Q?

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

What I would say is, as you look at that, our expectations as we head into the second quarter is that we will see a little bit better performance overall in high end. That was weak in the first quarter. It is a place of I'd say generally strength for us from a product offering perspective, and we also have other new products coming out in the second half in that area.

And we certainly expect, as I mentioned in my prepared remarks, that entry is going to continue to be weak. We expect it will, I will call it modestly, improve with new products helping, but it is a big DMO-centric area and DMO markets just continue to be weak economically.

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Leslie Varon - *Xerox Corporation - Corporate VP & VP, IR*

I think we have time for one last question, please.

Operator

Kulbinder Garcha, Credit Suisse.

Kulbinder Garcha - *Credit Suisse - Analyst*

Thank you. I know this has been asked in different ways. I just have a broad question on Services, which is if we go back over a long period of time, I think once upon a time Xerox stock (inaudible).

Kathy Mikells - *Xerox Corporation - Corporate EVP & CFO*

Kulbinder, I think you need to speak up. It's very difficult to hear you.

Kulbinder Garcha - *Credit Suisse - Analyst*

Can you hear me now? Okay, sorry about that. My question is over a long period of time, Xerox once thought the Services business could do margins of almost 12%. We're a long way from that now and I guess just is there anything more structural at hand here over the longer-term, competitive or otherwise?

And is there anymore kind of a deeper strategic review going on so that we don't have these kind of continuous issues where it has been a gradual step down over many years, like whether it's addressing the cost base, rethinking the strategies, any of that going on? Or do you see this very much as just a kind of normal one-time hit in 2015 from the enterprise health accounts?

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Kulbinder, it's a good question and I think a good last question as well. We obviously spend -- the leadership team, the Board, we spend a lot of time looking at performance versus strategy to make sure that the loop is continually closed and that we are on the right stack of mail. Separating operational challenges are we on the right stack of mail for 10% to 12% margins, revenue growth overall, and being valuable to our clients.

And the answer is, yes, we still believe that the fundamental strategy of a diversified Services portfolio globalized, which we're still working on doing, that is supported by a good level of acquisitions in the areas that we are in -- we are doing portfolio management and trimming out things that we are not great at and investing in areas that we are really good. That strategy still holds.

Document Technology, as a good cash generator, a good base for us to grow Services from also that strategy still holds, so I think with --. We look at it all the time. We look at it against our financial goals and against our capabilities. We can get to 10% to 12% margins for sure.

Government healthcare is a place that we have to continue to focus and continue to improve, and hopefully not talk about a lot as we go on. We have to just get this stuff behind us.

New York, we think we have a good start. We have these five contracts, etc., etc. So government health is the place that we are spending a lot of time on this call and rightfully so, but the rest of the mix of the business that we have in the remainder of the strategy is one that absolutely still holds water and still works for us. And so I think it will work for the shareholders over time and that is what we are focused on.

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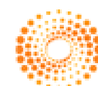

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With that, I think I can actually transition to a close. Let me just thank all of you for taking the time to ask questions and listen to the call. We're working hard to advance our business objectives in 2015 and beyond.

Leslie Varon - *Xerox Corporation - Corporate VP & VP, IR*

Thanks, Ursula. That concludes our call for today. If you have further questions, please contact me or any member of our investor relations team.

Operator

Thank you. Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program and you may now disconnect. Everyone, have a good day.

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