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CORPORATE PARTICIPANTS

William F. Osbourn *Xerox Corporation - Executive VP & CFO*

CONFERENCE CALL PARTICIPANTS

Mark Alan Moskowitz *Barclays PLC, Research Division - Research Analyst*

PRESENTATION

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Let's get started here. Welcome back from the lunch break. My name is Mark Moskowitz, your IT, hardware and data networking analyst here at Barclays. Today, we have with us from Xerox, Bill Osbourn, EVP and CFO. This is going to be a fun discussion, talking about the company now post-split. They've done some good stuff already and more to come. But before we do that, [Mafay Kaya] is going to read a safe harbor agreement before we get started. Thank you.

Unidentified Company Representative

During this meeting, Xerox executives may make comments that contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995 that, by their nature, address matters that are in the future and are uncertain. These statements reflect management's current's beliefs, assumptions and expectations and are subject to a number of factors that may cause actual results to differ materially.

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Xerox does not intend to update these forward-looking statements as a result of new information or future events or developments, except as required by law.

And you can commence now.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Thanks, [Mafay]. And Bill, thank you very much for attending today, appreciate it.

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Great to be here.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

So what I'll do is I'll ask questions for about 15 minutes or so, and then we'll see if the investors have questions. If not, I'll keep going. But hopefully, they do. So let's get started.

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Sounds good.

QUESTIONS AND ANSWERS

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Excellent. So in the September quarter, there's definitely reference to the new product roadmap in terms of the rollout and the conversion to revenue. Jeff kind of talked about this being more of a late 2017 and then bigger in 2018 event. Can you kind of just help investors frame the story as to how they should think about that rollout and what are some of the signals they should point to or look to?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Yes, on the call, we tried to make it clear to everyone that we're very optimistic about the impact of the rollout on our Q4 results. And in particular, there were a few items to look to. First of all, we have the full portfolio out, all 29 new products, the largest product launch in Xerox's history, 12 A4s, 17 A3s. Some of them came out earlier in the year, a lot of the A3s came out in second quarter, but the last bit of the higher-end A4s came out in the September time frame. And we started seeing indications, September was the best month of the quarter year-over-year and -- as far as declines in ESR. For the full quarter, we had a 10% decline in ESR, equipment sales revenue, in constant currency. The month of September, year-over-year, September is always typically the strongest month of the third quarter, but still, the year-over-year comparison, it was less than half of that overall quarterly decline. So that gave us some confidence with the full product portfolio. Things are moving in the right direction. Other indicators we look to are our backlog, those sales that have taken place that are just we have to go out and install with respect to our base business, and that was the best it had been year-over-year and positive year-over-year at the end of September. So that gave us a good deal there and then finally, when we look at Managed Document Services and signings, we look to the 90-day pipeline. Our 90-day pipeline at the end of September was also the strongest it had been all year long. All those indicators gave us comfort and confidence in reaffirming our full year guidance on sales, on revenues and on operating margin.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay. Sounds like a lot of optimism there, [folding in] next year. I guess maybe for investors, though, can you kind of provide some context in terms of how does the pipeline post-launch in the backlog compare to maybe prior launches? I know this one was much bigger, but just in terms of maybe the excitement from the channel? What you're...

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Yes, so there is -- clearly, this is the biggest launch. So the last really big launch we had was in the 2013 time frame. And you do see a bump for several quarters to a year or so after a specific launch, this being the most significant launch. And then there's some aspects to this launch also that are really key that we believe are really going to help this even have a greater impact than launches we've had in the past, one of them being the A4 cost competitiveness. The A4 market is very price-sensitive. We believe we have a good quality A4 product that's cost competitive that we'll be able to put out there. On the A3 side, we've been the market leader there for a while, and but there was a gap at the lower end of the A3 market that we -- that this product portfolio fills in for us that'll make us stronger there. And just overall, the portfolio all fits together, the congruency, the look, the feel, and dealing with it, you have the same interactions with it, whether it's an A4, an A3. You have the same security there overriding, that we believe all that together will have a significant impact, and be able to sell not only to our existing customers, but also to new customers.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

So just to rephrase that, the decision-makers is the same essentially at the customer, with the A3 versus A4? Or is that a different decision-maker in terms of the go-to market?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

It is a similar decision-maker. But I would tell you that the A4 is more focused towards SMB, small medium businesses, as -- whereas the A3 has historically been more larger enterprise. That can crossover. Obviously, there are large enterprises that have a mix of A3 and A4s, and there'll be some SMBs that will have A3s involved. But the decision-makers are the same. But we believe that the A4 product, in particular, will allow us to have a bigger penetration in the SMB market, which is a growing channel.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Interesting. Is there any way you can give us, maybe not quantitatively, but qualitatively, like how much of the incremental momentum in the pipeline is driven by A4 versus A3? And I know that there are some with a zero base, but just as if you think about the absolute revenue contribution over the next 12 months, could a bigger piece actually come in terms of comps relative to A4 versus A3?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

So if you look at it and -- so if you look at our overall business, you have the high end, the production printing, is about 20% of our revenues. The A3, our sweet spot, where we're really strong, really profitable part of our business, is over 60% and less than 20% in the A4 area. Our goal is clearly, we want to -- we'll continue to expect to be strong in the high end, but dealing with the office products, the 29 that we just launched, our goal is not only grow in the A4 area. Right now, we're about a 5% market share. But also, even though A3 is more of a slight declining market, 1% to 2%, to try to take market share there. So I guess I'll say that the goal is to have both of them growing, but I wouldn't expect the mix of the overall revenues to change that much.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay. That's helpful, interesting. Have you talked -- or has the company talked about an aspiration in terms of what that 5% market share could look like in 5 to 7 years? Could we be talking about a 10%-plus market share?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

We have been -- we have talked -- fairly modest, but still strong expectations, right? So we're about 5% right now. And our goal is to grow that by at least 1% per year. So not 5 to 10 immediately, but over a period of time, we think that this cost-competitive, very feature-rich A4 product will allow us to do that over time.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

And spending more time here on A4. I want to get a sense in terms what is the opportunity for new logos. Is having A4, is it allowing you to maybe get into some of the branch offices of these bigger, larger enterprises that historically bought A3 from you?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Look at it, new logo, from 2 perspectives. First of all, in dealing with large enterprises, we clearly provides an opportunity. There is a mix, even in the large enterprise. They're not solely just looking at A3s anymore. They're looking at both A3s and A4s in the mix of what we provide them. And we specifically have been hiring new logo hunters to deal with the large enterprise-type customers. And then dealing with the SMBs, we're focusing, I think a lot of people are aware of this, on indirect channel, multi-branded resellers. As of the end of September, we brought on 40 of those year-to-date and we really believe that this new product portfolio, and in particular, the A4s, will make it so that these multi-branded resellers will find our products a better, more attractive than competitors or others that they're offering.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay. And then how should we think about the competitive landscape as you target A4 more and more and become more aggressive with these multi-branded approaches in the channel? Are you seeing new competitive response yet? Or do you think the competitive intensity manifests more in 2018 to '19?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Yes, the competitive landscape, we see it as fairly constant. Everybody's been asking about us moving into the A4 market, where HP is the clear leader. And then HP making a move into the A3 market, where we're the leader. From our move into the A4 market, there are approximately 7 or 8 competitors below HP that are in that 5% to 9% market share range. As I said before, we're at 5%. We believe to succeed in the A4 market, we don't have to take directly from HP, because there are a lot of other competitors out there, that we compare -- we compare favorably to everyone, but there are other competitors other than HP that we can make progress against. As far as the A3, it's a competitive market. It's -- overall, the market's declining 1% to 2% a year. We have low 20s in overall market share. Our goal is to try to grow that. It's kind of early days still to see as far as HP moving more aggressively in the market, so we haven't seen much yet.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay, that's helpful. Why don't we shift gears to Document Managed Services, if you will. Managed Services has been a growth target or vector for the company for a good number of years, but recently, kind of hit turbulence or air pockets. How should investors think about, one, when does that business stabilize and then maybe inflect higher? And then, two, what needs to happen for the first part to take place?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Yes, Managed Document Services is clearly one of the growth areas of the business that we want -- or growth areas of the industry that we want to focus on, in addition to A4, high-end color production and the right market. In recent quarters, it has, I think at last quarter, we were about 0.5% overall MDS growth in revenues at constant currency. The quarter before, we were slightly down year-over-year in a market that is growing 1% to 2%. But the way to think about MDS or the way we think about it is really in 2 segments. It's the large enterprise segment, about a $6 billion market. We're the clear market share leader there. We've had some weakness over the last 18 months or so, I'll go into that in a second, what we're doing to turn that around. And then there's the SMB portion of Managed Document Services. That's about a $7 billion market share and is growing. We have about a -- a smaller share of that, but it is a growing market that we believe that it's growing about 6% annually. And we think that we've been doing well there, we can do better. But going back to the large enterprise, you have seen, over the last 18 months, whether you have signings are kind of an indicator of that also, because our signings data is mainly large enterprise-related. And part of it is really that the product portfolio is really going to help us there. Because even those large enterprise, they aren't solely A3 anymore. There's a mix of A3 and A4, and having that competitive offering that includes a mix of A4s at the right price and that we think is going to really help us, and we've seen that in the 90-day pipeline discussions, the longer-term. Unlike the base business, MDS is very relationship-oriented. We have the new product portfolio. It's finally fully out at the end of September. And it takes time to go through and show what the new portfolio can do, but we're confident that, that's going to help turn that large enterprise piece of MDS around. Not that it's gone off a cliff in any way or anything. We're still strong, we're the market share leader, but we should be growing there, and our plan is, clearly, that we will be growing there with the new product portfolio.

On the SMB side, it's an area where, and we said this on our last earnings call, where we're being very successful. The overall market's growing at 6%. Last quarter, we doubled that in the SMB area. And (inaudible) really believe or we really believe that's a reflection of both the new product portfolio, especially A4 portfolio, but also dealing with our indirect multi-branded resellers and having them push not only these products, but push them on an MDS basis.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

All right, that's a good framework. We have about 11 minutes. Why don't we stop and see if investors ask questions before I continue. And sorry, we have no raffle today. So if you ask a question, there's no prize, but other than what Bill is able to impart in terms of insight. So we do encourage you to ask a question, if you have time. All right. Well, we'll come back to you guys.

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

One of the things I know -- one of the questions I've been getting a lot from folks when we talk (inaudible).

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Sure.

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Because I know you have a list and I didn't want to -- was dealing with the cash flows. And I know that's been top of mind with folks regarding we talked about a few things in Q3. So maybe just to go through it. So we had guidance this year on an operating cash flow basis of $700 million to $900 million of operating cash flow. We're a very strong operating cash flow business. We factored into that approximately $350 million of pension-related contributions during the year. Pretty much all of our pensions are frozen around the world, so our U.S. plan was underfunded, and we had told the market early on that we're going to have to be [contributing] back $800 million over the next 2 years: $350 million this year, $450 million next year. We specifically took the opportunity, while refinancing some of our debt coming due next year, to take an additional $500 million in debt out to pre-fund, essentially, our U.S. pension plan to the extent of an additional $500 million. So our $350 million plan for this year became $850 million. And when we did that, we said in our press release, we're revising our operating cash flow down from the $700 million to $900 million, to $200 million to $400 million. And really, it made sense. First of all, the debt that we were issuing in the market was at attractive rates. But it's the regular debt is just a much more stable debt than pension debt. And unfunded pension obligations is viewed by the ratings agencies similar to regular debt, and we thought it made sense to do this. And it also allowed us going forward to have more stable pension contributions on an annual basis, whereas it was going to be $350 million this year, $450 million next year. It could have been -- This pretty much took away most of the required contributions, higher level of required contributions of the U.S. plan the coming years. And we can guide to -- it'd be somewhere in the $200 million range. We'll give more formal guidance, but $200 million on an annual basis will be relatively consistent. It will be more simple to explain what's going on with our operating cash flows rather than trying to adjust and normalize for what's going on with the pension contribution. So that made a lot of sense. The other thing that we decided to do that we're implementing at the end of the year, is we have been, as a company, historically selling receivables since like the '08, '09 period, as a working capital tool. It really didn't make sense for us to be doing that. We are a strong cash-generating company, strong balance sheet, that we didn't need to borrow in short notice and we have plenty of cash flow, over $1 billion of cash flow on our balance sheet going into next year. If we need to borrow, we have a $1.8 billion unused line of credit, it will be a more efficient way of using it. So we decided to cease most of that program, which has a onetime timing effect of about $350 million. Essentially, we'll be pulling forward the next 30- to 60-day receivables, January's and February's, into this year that we won't be doing. The impact of it in recent years hasn't been significant. Really, the big impact is when you start up a program back in '08, '09, and then when you cease such a program. But one of the main reasons, simplify the way we operate, it saves us about $10 million a year in interest and administrative costs. And it was just something we didn't have to do. So those 2 things, though, caused the reported operating cash flow guidance to go down to negative 50 to positive 150. So that also reflects our -- if you normalize out for those 2 items, that $700 million to $900 million that I talked about at the beginning of the year, we actually have had strong cash flow through 9 months, to give us confidence to, before those 2 adjustments, upping it to $800 million to $1 billion. So roughly, $100 million in the midpoint of $800 million before to a midpoint of $900 million now. And given the lower pension contributions in future years, we're confident in having $1 billion-plus of operating cash flow, 150, say, CapEx we're guiding to, so $850 million-plus on a free cash flow basis. So strong cash-generating company.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

And you were ready for that question. You were ready.

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

I wanted to clarify. If I wasn't clear in the third quarter earnings call, I wanted to be clear now.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

That's good. I think it's good that you're aware of some of the investor frustration that was out there, and it seems like it's a reasonable explanation for what's going on. I guess, are there any other items that could happen? You talked about receivables, you talked about the pension. Is there anything else that could be a surprise in the next 6 to 9 months that investors should think about, when you look at the (inaudible)?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

No, I mean, we're constantly working at trying to be more efficient and optimize it from a balance sheet, cash flow optimization. Those were the most -- the bigger, heavy-lifting items. We're always working to try to improve working capital from a restructuring perspective. We're in the middle of our 3-year strategic transformation. And involved in that, you will have restructuring payments at a higher level. We have guided before this year, we'll be at about $230 million. We said we'd be $200 million-plus next year, as opposed to more normalized levels, because we'll always be trying to optimize and restructure. But the more normalized level is around, say $100 million or so historically. But it would still be $200 million-plus next year. And even factoring that in, the operating cash flow would still be north of $1 billion.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay. Sounds like it can be good timing in terms of more stable cash flow and then also the prospects of a return of share repurchase down the road. Speaking of expectations for longer term, can you give investors a framework to understand in terms of R&D, how we should think about R&D relative to the past 12 months and then going forward? Because historically, Xerox was a good R&D shop and able to monetize that. And then you had the disruption from the Xerox ACS merger and the challenges during those years. But now that the Services is no longer part of the equation, could we see R&D maybe shape new market entries, whether it's in graphics or 3D or other industries out there?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

That's great. We feel really good about what's going on in the R&D area at Xerox. It's always been a strength of Xerox historically. Over the last number of years, with ACS or Conduent being a part, it was somewhat distracting, specifically PARC, and focusing some of the resources on that. With the separation, our R&D is solely focused on us, the document technology side of the business. We're committed to continue investing to being the digital print leader that we are, and continue investing in that and improving in that area. And we're clearly investing in other areas that are adjacent to our business. And we believe that we have top-notch R&D facilities. And also, we are coordinating quite a bit with Fuji Xerox, our JV partner, who produces a lot of our equipment. We work closely with them in managing our R&D.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

How about 3D?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

We get that, and we're a little bit there, involved in 3D area, as far as printheads, but there is just a lot of different, it really isn't settled, where 3D printing is going to go. So we're not that big into 3D printing. Our -- we're looking more towards Horizon 3. It's more print on packaging, printing on packaging we're looking at more. We're looking at workflow automation. We're already into that a little bit, expanding a very fragmented market in workflow automation and combining that with our MDS services. And printed electronics is an area that is kind of cool. There will be, at the next investor conference, there will be some examples of what we're developing in that area. But we are looking at those Horizon 3-types items, what's the next big thing, and yes, we're very confident with what we're doing.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay. You mentioned Fuji Xerox. Maybe it's a good segue to currency translation. How should investors model 2018 relative to where the U.S. dollar is now versus the yen? And how that relates to your Japanese-based purchases?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Yes, currency, I was going to say it's bound to turn to be in your favor someday, right? So over the last 2 years, it has hit us both on a top line perspective, and from a cost perspective. So it's been a headwind on revenues. In '16, it was about 5 points of headwind. In '17, it was -- or '15, it was 5 points. In '16, it was 2 points. And so far, this year, it's been a negative 1 point of headwind on the top line. However, in Q3 for the first time in 13 quarters, I think it was, it actually was a slight tailwind, based upon current rates. And we expect that to continue into Q4. On the cost side, the last 2 years transaction currency, which is primarily related, as you noted, related to our purchases from Fuji Xerox and the dollar-yen exchange rate. It's been a headwind in both '16 and '17. In '16, it was about $50 million or 50 basis points of headwind; and in '17 year-to-date, it's been about $70 million or 70 basis points of headwind. We do see that, based upon current exchange rates, moderating into the fourth quarter, being less of a headwind. And we'll comment more on '18 once we see where rates are at the end of the year, but our expectation is that it will be moderating, it'd be less of an impact.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay. Maybe a loaded question, or maybe it's not. But -- or difficult, maybe. With currency, if it does turn where the purchasing power is better overseas, where it's been kind of challenged for a while, could you actually see maybe pent-up demand step in, where folks who felt like they didn't have as many dollars to use, now can use their local currency to buy more Xerox products. Can we actually see a bigger lift that coincides with this monster new product launch?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

You -- clearly, that would be a potential benefit. Yes, I mean, clearly, predicting foreign currency rates -- but yes, that clearly could be a benefit.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay, guys, we have 1 minute left. Any investor questions? I alluded to it earlier in terms of stock buyback. How should we think about stock buyback? When could it return in 2018 and what would the pace be? And then the second derivative would be, what is the impact on the dividend? Would you actually try to grow the dividend yields, too? Or are they kind of independent?

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

No, I would say they're not -- so when I'm looking at our capital allocation, our #1 priority has been maintaining investment grade, paying down debt to the extent needed to maintain that investment grade is important. Number two, right now, it's looking at those tactical acquisitions, primarily in GIS-related small workflow automation, we're looking at the $100 million and $200 million a year. Number three is return to shareholders. And yes, we've committed, we've been out there since our Investor Day last December, committing to greater than 50% over time, and via dividends and share buyback. Right now, we have a dividend with a pretty attractive yield of 3.5%. And clearly, we're looking internally, I'm not going to (inaudible), but we'll talk to our return to shareholders at the end of January when we discuss our Q4 earnings. But we are looking to a balanced approach in return of cash to shareholders.

Mark Alan Moskowitz - *Barclays PLC, Research Division - Research Analyst*

Okay. Thanks for your time. Bill Osbourn, CFO of Xerox.

William F. Osbourn - *Xerox Corporation - Executive VP & CFO*

Thanks, appreciate it. Thank you, everyone.
