

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: March 31, 1999

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 1-4471

XEROX CORPORATION
(Exact Name of Registrant as
specified in its charter)

New York 16-0468020

(State or other jurisdiction (IRS Employer Identification No.)
of incorporation or organization)

P.O. Box 1600
Stamford, Connecticut 06904-1600
(Address of principal executive offices)
(Zip Code)

(203) 968-3000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at April 30, 1999
Common Stock	661,308,844 shares

This document consists of 33 pages.

Forward-Looking Statements

From time to time Xerox Corporation (the Registrant or the Company) and its representatives may provide information, whether orally or in writing, including certain statements in this Form 10-Q under "Management's Discussion and Analysis of Results of Operations and Financial Condition," which are deemed to be "forward-looking" within the meaning of the Private Securities Litigation Reform Act of 1995 ("Litigation Reform Act"). These forward-looking statements and other information relating to the Company are based on the beliefs of management as well as assumptions made by and information currently available to management.

The words "anticipate," "believe," "estimate," "expect," "intend," "will," and similar expressions, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Registrant with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated or expected. The Registrant does not intend to update these forward-looking statements.

In accordance with the provisions of the Litigation Reform Act we are making investors aware that such "forward-looking" statements, because they relate to future events, are by their very nature subject to many important factors which could cause actual results to differ materially from those contained in the "forward-looking" statements. Such factors include but are not limited to the following:

Competition - the Registrant operates in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. There are a number of companies worldwide with significant financial resources which compete with the Registrant to provide document processing products and services in each of the markets served by the Registrant, some of whom operate on a global basis. The Registrant's success in its future performance is largely dependent upon its ability to compete successfully in its currently-served markets and to expand into additional market segments.

Transition to Digital - presently black and white light-lens copiers represent approximately 35% of the Registrant's revenues. This segment of the general office is mature with anticipated declining industry revenues as the market transitions to digital technology. Some of the Registrant's new digital products replace or compete with the Registrant's current light-lens equipment. Changes in the mix of products from light-lens to digital, and the pace of that change as well as competitive developments could cause actual results to vary from those expected.

Pricing - the Registrant's ability to succeed is dependent upon its ability to obtain adequate pricing for its products and services which provide a reasonable return to shareholders. Depending on competitive market factors, future prices the Registrant can obtain for its products and services may vary from historical levels. In addition, pricing actions to offset devaluations may not prove sufficient to offset further devaluations or may not hold in the face of customer resistance and/or competition.

Financing Business - a significant portion of the Registrant's profits arise from the financing of its customers' purchase of the Registrant's equipment. On average, 75 to 80 percent of equipment sales are financed through the Registrant. The Registrant's ability to provide such financing at competitive rates and realize profitable spreads is highly dependent upon its own costs of borrowing which, in turn, depend upon its credit ratings. Significant changes in such ratings could reduce the profitability of such financing business and/or make the Registrant's financing less attractive to customers thus reducing the volume of financing business done. The Registrant's present credit ratings permit ready access to the credit markets. There is no assurance that these credit ratings can be maintained and/or ready access to the credit markets can be assured.

Productivity - the Registrant's ability to sustain and improve its profit margins is largely dependent on its ability to maintain an efficient, cost-effective operation. Productivity improvements through process reengineering, design efficiency and supplier cost improvements are required to offset labor cost inflation and potential materials cost changes and competitive price pressures.

International Operations - the Registrant derives approximately half its revenue from operations outside of the United States. In addition, the Registrant manufactures many of its products and/or their components outside the United States. The Registrant's future revenue, cost and profit results could be adversely affected by a number of factors, including changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country's political conditions, trade protection measures, licensing requirements and local tax issues.

New Products/Research and Development - the process of developing new high technology products and solutions is inherently complex and uncertain. It requires accurate anticipation of customers' changing needs and emerging technological trends. The Registrant must then make long-term investments and commit significant resources before knowing whether these investments will eventually result in products that achieve customer acceptance and generate the revenues required to provide anticipated returns from these investments.

Revenue Growth - Registrant's ability to attain a consistent trend of revenue growth over the intermediate to longer term is largely dependent upon expansion of its equipment sales worldwide. The ability to achieve equipment sales growth is subject to the successful implementation of our initiatives to provide industry-oriented global solutions for major customers and expansion of its distribution channels in the face of global competition and pricing pressures. Our inability to attain a consistent trend of revenue growth could materially affect the trend of our actual results.

Restructuring - the Registrant's ability to ultimately reduce pre-tax annual

expenditures by approximately \$1 billion is dependent upon its ability to successfully implement the 1998 restructuring program including the elimination of 9,000 jobs, net, worldwide, the closing and consolidation of facilities, and the successful implementation of process and systems changes.

Year 2000 - the Registrant's ability to complete its Year 2000 plan is dependent upon the availability of resources, the Registrant's ability to discover and correct the potential Year 2000 sensitive problems which could have a serious impact on the Registrant's information management systems, facilities and products, and the ability of the Registrant's suppliers and customers to bring their systems into Year 2000 compliance.

Xerox Corporation
Form 10-Q
March 31, 1999

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For additional information about The Document Company Xerox, please visit our World-Wide Web site at www.xerox.com/investor

PART I - FINANCIAL INFORMATION

	Xerox Corporation	
	Consolidated Statements of Income (Unaudited)	
	Three months ended	
	March 31,	
(In millions, except per-share data)	1999	1998
Revenues		
Sales	\$ 2,116	\$ 2,205
Service and rentals	1,922	1,833
Finance income	262	266
Total Revenues	4,300	4,304
Costs and Expenses		

Cost of sales	1,114	1,228
Cost of service and rentals	1,080	1,001
Equipment financing interest	133	142
Research and development expenses	251	234
Selling, administrative and general expenses	1,171	1,196
Other, net	57	58
Total Costs and Expenses	3,806	3,859

Income before Income Taxes, Equity Income and Minorities' Interests	494	445
Income taxes	153	147
Equity in net income of unconsolidated affiliates	10	14
Minorities' interests in earnings of subsidiaries	8	11
Income from Continuing Operations	343	301
Discontinued Operations	-	(190)
Net Income	\$ 343	\$ 111

Basic Earnings (Loss) per Share		
Continuing Operations	\$ 0.50	\$ 0.44
Discontinued Operations	-	(0.29)
Basic Earnings per Share	\$ 0.50	\$ 0.15

Diluted Earnings (Loss) per Share		
Continuing Operations	\$ 0.48	\$ 0.42
Discontinued Operations	-	(0.26)
Diluted Earnings per Share	\$ 0.48	\$ 0.16

See accompanying notes.

Xerox Corporation
Consolidated Balance Sheets

(In millions, except share data in thousands)	March 31, 1999 (Unaudited)	December 31, 1998
Assets		
Cash	\$ 106	\$ 79
Accounts receivable, net	2,758	2,671
Finance receivables, net	4,876	5,220
Inventories	3,309	3,269
Deferred taxes and other current assets	1,322	1,236
Total Current Assets	12,371	12,475
Finance receivables due after one year, net	8,652	9,093
Land, buildings and equipment, net	2,335	2,366
Investments in affiliates, at equity	1,402	1,456
Goodwill, net	1,724	1,731
Other assets	1,233	1,233
Investment in discontinued operations	1,559	1,670
Total Assets	\$ 29,276	\$ 30,024
Liabilities and Equity		
Short-term debt and current portion of long-term debt	\$ 4,159	\$ 4,104
Accounts payable	789	948
Accrued compensation and benefit costs	537	722
Unearned income	229	210
Other current liabilities	1,956	2,523
Total Current Liabilities	7,670	8,507
Long-term debt	11,806	10,867
Postretirement medical benefits	1,103	1,092
Deferred taxes and other liabilities	2,513	2,711
Discontinued operations liabilities -		

policyholders' deposits and other	797	911
Deferred ESOP benefits	(370)	(370)
Minorities' interests in equity of subsidiaries	107	124
Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company	638	638
Preferred stock	683	687
Common shareholders' equity	4,329	4,857
Total Liabilities and Equity	\$ 29,276	\$ 30,024
Shares of common stock issued	659,940	657,196
Shares of common stock outstanding	659,940	656,787

See accompanying notes.

Xerox Corporation
Consolidated Statements of Cash Flows (Unaudited)

Three months ended March 31 (In millions)	1999	1998
Cash Flows from Operating Activities		
Income from Continuing Operations	\$ 343	\$ 301
Adjustments required to reconcile income to cash flows from operating activities:		
Depreciation and amortization	223	200
Provisions for doubtful accounts	60	45
Provision for postretirement medical benefits, net of payments	11	11
Charges against 1998 restructuring reserve	(90)	-
Minorities' interests in earnings of subsidiaries	8	11
Undistributed equity in income of affiliated companies	(10)	(9)
Increase in inventories	(319)	(346)
Increase in on-lease equipment	(35)	(64)
Increase in finance receivables	(144)	(45)
Increase in accounts receivable	(122)	(125)
Decrease in accounts payable and accrued compensation and benefit costs	(333)	(472)
Net change in current and deferred income taxes	(7)	(16)
Decrease in other current and noncurrent liabilities	(336)	(298)
Other, net	(106)	8
Total	(857)	(799)
Cash Flows from Investing Activities		
Cost of additions to land, buildings and equipment	(116)	(88)
Proceeds from sales of land, buildings and equipment	17	7
Other, net	(25)	1
Total	(124)	(80)
Cash Flows from Financing Activities		
Net change in debt	1,106	894
Dividends on common and preferred stock	(146)	(133)
Proceeds from sale of common stock	79	26
Repurchase of common and preferred stock	-	(1)
Dividends to minority shareholders	(23)	(3)
Total	1,016	783
Effect of Exchange Rate Changes on Cash	(4)	5
Cash Provided (Used) by Continuing Operations	31	(91)
Cash Provided (Used) by Discontinued Operations	(4)	35
Increase (Decrease) in Cash	27	(56)
Cash at Beginning of Period	79	75
Cash at End of Period	\$ 106	\$ 19

See accompanying notes.

1. The unaudited consolidated interim financial statements presented herein have been prepared by Xerox Corporation ("the Company") in accordance with the accounting policies described in

its 1998 Annual Report to Shareholders and should be read in conjunction with the notes thereto.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary for a fair statement of operating results for the interim periods presented have been made.

Prior years' financial statements have been restated to reflect certain reclassifications to conform with the 1999 presentation. The impact of these changes is not material and did not affect net income.

References herein to "we" or "our" refer to Xerox and consolidated subsidiaries unless the context specifically requires otherwise.

2. Inventories consist of (in millions):

	March 31, 1999	December 31, 1998
Finished products	\$ 1,965	\$ 1,923
Work in process	137	111
Raw materials and supplies	511	464
Equipment on operating leases, net	696	771
Total	\$ 3,309	\$ 3,269

3. On January 25, 1999, the Board of Directors approved a two-for-one split of the Company's common stock. The effective date of the stock split was February 23 for shareholders of record as of February 4. Shareholders' equity has been restated to give retroactive recognition to the stock split in prior periods by reclassifying from additional paid-in capital to common stock the par value of the additional shares arising from the split. In addition, all references in the financial statements to number of shares and per-share amounts have been restated.

4. On April 7, 1998, we announced a worldwide restructuring program associated with enhancing our competitive position and lowering our overall cost structure. In connection with this program, in the second quarter of 1998 we recorded a pre-tax provision of \$1,644 million (\$1,107 million after taxes and including our \$18 million share of a restructuring charge recorded by Fuji Xerox). The program includes the elimination of approximately 9,000 jobs, net, worldwide, the closing and consolidation of facilities, and the write-down of certain assets. The charges associated with this restructuring program include \$113 million of inventory charges recorded as cost of revenues and \$316 million of asset impairments. Included in the asset impairment charge are facility fixed assets write-downs of \$156 million and other asset write-downs of \$160 million. For facility fixed assets classified as assets to be disposed of, the impairment loss recognized is based on fair value less cost to sell, with fair value based on third-party valuations as well as our internal estimates of existing market prices for similar assets. The effect of suspending depreciation on assets no longer in use for the first quarter of 1999 is not material. The remaining \$160 million of asset impairments includes the write-down of certain technology assets and other items impacted by the consolidation activities described below. Key initiatives of the restructuring include:

- 1) Consolidating 56 European customer support centers into one facility and implementing a shared services organization for order entry, invoicing, and other back-office and sales operations.
- 2) Streamlining manufacturing, logistics, distribution and service operations. This will include centralizing U.S. parts depots and outsourcing storage and distribution.
- 3) Overhauling our internal processes and associated resources, including closing one of four geographically-organized U.S. customer administrative centers.

The reductions are occurring primarily in administrative functions, but also impact service, research and manufacturing.

The following table summarizes the status of the restructuring reserve (in millions):

	Total Reserve	Charges Against Reserve	March 31, 1999 Balance
Severance and related costs	\$1,017	\$387	\$630
Asset impairment	316	316	-
Lease cancellation and other costs	198	35	163
Inventory charges	113	113	-
Total	\$1,644	\$851	\$793

As of March 31, 1999, approximately 6,400 employees have left the Company under the restructuring program.

There have been no material changes to the program since its announcement in April 1998, and the majority of the remaining reserve will be utilized throughout the remainder of 1999 and 2000.

5. Common shareholders' equity consists of (in millions):

	March 31, 1999	December 31, 1998
Common stock	\$ 663	\$ 660
Additional paid-in-capital	1,393	1,265
Retained earnings	3,889	3,712
Translation adjustments	(1,616)	(761)
Treasury stock	-	(19)
Total	\$ 4,329	\$ 4,857

Comprehensive income for the three months ended March 31, 1999 and 1998 is as follows (in millions):

	March 31, 1999	March 31, 1998
Net income	\$ 343	\$ 111
Translation adjustments	(855)	(71)
Comprehensive income (loss)	\$ (512)	\$ 40

6. Interest expense totaled \$206 million and \$177 million for the three months ended March 31, 1999 and 1998, respectively.

7. Operating segment profit or loss information for the three months ended March 31, 1999 and 1998 is as follows (in millions):

	Core Business	Paper and Media	Other	Total
1999				
Revenue from external customers	\$3,480	\$281	\$277	\$4,038
Finance income	261	-	1	262
Intercompany revenues	(34)	-	34	-
Total segment revenues	\$3,707	\$281	\$312	\$4,300
Segment profit (loss)	\$ 486	\$ 17	\$ (9)	\$ 494
1998				
Revenue from external customers	\$3,468	\$299	\$271	\$4,038
Finance income	266	-	-	266
Intercompany revenues	(59)	-	59	-
Total segment Revenues	\$3,675	\$299	\$330	\$4,304
Segment profit (loss)	\$ 456	\$ 16	\$ (27)	\$ 445

Our 50% share of the income from Fuji-Xerox, which is accounted for under the equity method, included in Equity in net income of unconsolidated affiliates and is shown net of tax.

8. Litigation

Continuing Operations

On March 10, 1994, a lawsuit was filed in the United States District Court for the District of Kansas by two independent service organizations (ISOs) in Kansas City and St. Louis and

their parent company. Subsequently, a single corporate entity, CSU, L.L.C. ("CSU") was substituted for the three affiliated companies. CSU claimed damages predominately resulting from the Company's alleged refusal to sell parts for high volume copiers and printers to CSU prior to 1994. The Company's policies and practices with respect to the sale of parts to ISOs were at issue in an antitrust class action in Texas, which was settled by the Company during 1994. Claims for individual lost profits of ISOs who were not named parties, such as CSU, were not included in that class action. The Company asserted counterclaims against CSU alleging patent and copyright infringement relating to the copying of diagnostic software and service manuals. On April 8, 1997, the District Court granted partial summary judgment in favor of the Company on CSU's antitrust claims, ruling that the Company's unilateral refusal to sell or license its patented parts cannot give rise to antitrust liability. On January 8, 1999, the Court dismissed with prejudice all of CSU's antitrust claims. CSU has preserved for appeal only its claims that Xerox unlawfully refused to sell critical parts (including patented parts), to sell manuals and to license patented and copyrighted software and its claim that the Company's refusal to sell non-critical parts was unlawful because it was in conjunction with an allegedly unlawful refusal to sell critical parts. The District Court also granted summary judgment in favor of the Company on its patent infringement claim, leaving open with respect to patent infringement only the issues of willfulness and the amount of damages, and granted partial summary judgment in favor of the Company with respect to some of its claims of copyright infringement. A judgment in the amount of \$1,039,282 was entered in favor of the Company and against CSU on the copyright infringement counterclaim. CSU has filed a notice of appeal to the United States Court of Appeals for the Federal Circuit.

On April 11, 1996, an action was commenced by Accuscan Corp. (Accuscan), in the United States District Court for the Southern District of New York, against the Company seeking unspecified damages for infringement of a patent of Accuscan which expired in 1993. The suit, as amended, was directed to facsimile and certain other products containing scanning functions and sought damages for sales between 1990 and 1993. On April 1, 1998, the jury entered a verdict in favor of Accuscan for \$40 million. However, on September 14, 1998, the Court granted the Company's motion for a new trial on damages. The Company is also seeking to appeal the issue of liability and believes that the liability verdict should be set aside. A new trial on damages is set for August, 1999.

On December 18, 1998, three former employees of Crum & Forster Holdings, Inc. (a former subsidiary of ours) ("C&F") filed a lawsuit in the United States District Court for the District of New Jersey claiming wrongful termination of their participation in the Xerox Corporation Employee Stock Ownership Plan ("ESOP"). Xerox, the ESOP, C&F and the company that acquired C&F are named defendants. Plaintiffs purport to bring this action on behalf of themselves and a class of approximately 10,000 persons who were employed by C&F (or one of its insurance subsidiaries which also participated in the ESOP) from July 1, 1989 through December 31, 1993. Plaintiffs assert violations of the Employee Retirement Income Security Act, breach of contract, conversion, unjust enrichment and fraudulent misrepresentation. They are seeking approximately \$250 million in damages.

The foregoing action is related to an action previously filed in the United States District Court for the Western District of Texas. The Texas plaintiffs did not specify their damages, but they sought certification of a similar class of former ESOP participants. Plaintiffs' motion for class certification was denied by the Court on March 26, 1999. The plaintiffs have asked the Court to reconsider its decision.

We deny any wrongdoing and we intend to vigorously defend both the Texas and New Jersey actions.

9. Subsequent Event

In May, 1999 Xerox Capital (Europe) plc, an indirect wholly owned subsidiary of ours, issued 5.75% debentures maturing May 15, 2002 for net proceeds of \$498 million and 5.875% debentures maturing

May 15, 2004 for net proceeds of \$496 million. The 5.75% debentures pay interest semi-annually and were issued at an effective interest rate of 5.82% per annum. The 5.875% debentures pay interest semi-annually and were issued at an effective interest rate of 5.99% per annum. The proceeds were used to reduce commercial paper borrowings.

Item 2 Xerox Corporation
Management's Discussion and Analysis of
Results of Operations and Financial Condition

Document Processing

Summary

Income from continuing operations increased 14 percent to \$343 million in the 1999 first quarter from \$301 million in the 1998 first quarter. The increase was primarily due to improved operating margins that reflected ongoing benefits from the company's worldwide restructuring program and a heightened focus on productivity and expense controls. The productivity and expense control actions included significant cost reductions in our Brazilian operations, encompassing branch consolidations and centralization of administrative support functions, as well as additional worldwide cost constraints.

Pre-currency revenues, excluding Brazil, grew 3 percent, reflecting revenue growth of 4 percent in the United States and 2 percent in Europe. U.S. and European revenue growth was depressed in the 1999 first quarter, reflecting the impact of the implementation of initiatives announced in January 1999 to provide industry-oriented global document solutions for major customers. These initiatives required substantial one-time investments, including enhanced sales training and development and some changes in customer relationships, which impacted first quarter sales productivity more than anticipated. Including Brazil and the effects of currency, revenues of \$4.3 billion were flat compared with the first quarter of 1998.

Diluted earnings per share from continuing operations increased 14 percent to \$0.48 in the 1999 first quarter from \$0.42 in the 1998 first quarter.

Pre-Currency Growth

To understand the trends in the business, we believe that it is helpful to adjust revenue and expense growth (except for ratios) to exclude the impact of changes in the translation of foreign currencies into U.S. dollars. We refer to this adjusted growth as "pre-currency growth." Latin American amounts are shown at actual exchange rates for both pre-currency and post-currency reporting, since these countries generally have volatile currency and inflationary environments, and our operations in these countries traditionally implement pricing actions to recover the impact of inflation and devaluation.

A substantial portion of our consolidated revenues is derived from operations outside of the United States where the U.S. dollar is not the functional currency. When compared with the average of the major European currencies on a revenue-weighted basis, the U.S. dollar was approximately 3 percent weaker in the 1999 first quarter than in the 1998 first quarter. As a result, European currency translation had a favorable impact of approximately 1 percentage point on revenue growth.

The total unfavorable impact of our Brazilian Operations on our revenue growth was approximately 4 percentage points. This included the very significant currency devaluation as the Real weakened to an average exchange rate of 1.73 in the 1999 first quarter compared with 1.13 in the 1998 first quarter, and weaker activity as interest rates in Brazil remained high. Operationally, significant price increases were implemented which are intended to offset the effect of the devaluation over time. Revenues denominated in currencies where the local currency is the functional currency, including the Brazilian Real, are not hedged for purposes of translation into U.S. dollars.

Revenues

Total pre-currency revenues declined 1 percent in the 1999 first quarter, but grew 3 percent excluding Brazil. For the major

product categories, the pre-currency revenue growth rates are as follows:

	1998					1999	
	Q1	Q2	Q3	Q4	FY	Q1	Q1 (Excl. Brazil)
Total Revenues	10%	10%	6%	7%	8%	(1)%	3%
Digital Products	34	41	38	33	36	28	33
Light-Lens Copiers	(4)	(8)	(15)	(16)	(11)	(24)	(20)

Digital product revenues, which grew 28 percent in the 1999 first quarter, 33 percent excluding Brazil, were driven by the continued outstanding revenue growth from our expanding family of black-and-white Document Centre digital multi-function products and reached 48 percent of total revenues compared with 38 percent of total revenues in the 1998 first quarter. Production publishing revenues grew 12 percent in the 1999 first quarter consistent with recent trends but production printing revenue declined 6 percent due primarily to lower activity. Color copying and printing growth was 8 percent in the 1999 first quarter with strong growth in DocuColor 40 revenues and excellent DocuColor 70 and indirect channels growth. Office color copier revenue declined as unit volumes declined, and pricing pressure and some shift to less-featured models continued. Our DocuPrint N series of monochrome laser printers and new and expanding line of monochrome digital copiers sold through indirect sales channels continued their excellent growth. Black-and-white light-lens copier revenues declined 24 percent in the 1999 first quarter as a result of weakness in Brazil, increased pricing pressures and customer transition to digital copiers.

Geographically, the pre-currency revenue growth rates are as follows:

	1998					1999
	Q1	Q2	Q3	Q4	FY	Q1
Total Revenues	10%	10%	6%	7%	8%	(1)%
United States	7	13	10	11	10	4
Europe	13	10	5	8	9	2
Other Areas	11	6	(4)	(4)	1	(16)
Memo: Fuji Xerox	2	(4)	(6)	(4)	(3)	(1)

First quarter revenue growth in both the U.S. and Europe was disappointing, slowing significantly from prior quarters due to substantial one-time investments, including enhanced sales training and development, and some changes in customer relationships, associated with the initiatives announced in January 1999 to provide industry-oriented global document solutions for major customers. These initiatives temporarily reduced sales time with customers and impacted sales productivity more than anticipated. Sales force retention in both the U.S. and Europe continued to be consistent with 1998 trends. In addition, statutory regulations and practices associated with the implementation of our pan-European approach for customer support and back office operations required considerable management time and diverted focus from revenue generation. Within Europe, revenues in Germany were flat in the first quarter and revenues in France and the U.K. declined modestly, while revenues grew in Italy and Eastern Europe. We are very confident that revenue growth in both the U.S. and Europe will improve as the year progresses.

Other Areas include operations principally in Latin America, Canada, China, Russia, the Middle East and Africa. Revenue in Brazil declined by 45 percent in the 1999 first quarter reflecting primarily the very significant currency devaluation and also the Brazilian recession. Brazilian revenues represented approximately 4 percent of Xerox revenues in the 1999 first quarter compared with 8 percent in the 1998 first quarter. Excluding Brazil, revenue in Other Areas had modest growth. China, the Middle East and Africa had strong revenue growth in the first quarter, Canada and Mexico had good revenue growth, while revenue declined in Argentina, Venezuela and Russia due to economic weakness.

Fuji Xerox Co., Ltd., an unconsolidated entity jointly owned by Xerox Limited and Fuji Photo Film Company Limited, develops,

manufactures and distributes document processing products in Japan, Australia, New Zealand, and other areas of the Pacific Rim. Fuji Xerox revenue declined by 1 percent in the 1999 first quarter reflecting a modest revenue decline in Japan partially offset by modest revenue growth in Fuji Xerox' other Asia Pacific territories.

The pre-currency growth rates by type of revenue are as follows:

	1998					1999	
	Q1	Q2	Q3	Q4	FY	Q1	Q1 (Excl. Brazil)
Total Revenues	10%	10%	6%	7%	8%	(1)%	3%
Sales	15	14	5	6	9	(5)	-
Equipment	17	19	7	10	12	(3)	4
Supplies	8	10	4	4	6	(3)	-
Paper	15	4	-	(6)	3	(6)	(5)
Service/Outsourcing/ Rentals/Other	4	6	6	7	6	4	7
Service	3	1	1	1	1	(5)	(3)
Document Outsourcing*	24	25	26	25	25	25	27
Finance Income	8	7	9	5	7	(2)	4
Memo:							
Revenues Excluding Equip. Sales	6	6	5	4	5	1	3

* Excludes equipment in outsourcing contracts that are accounted for as sales.

Equipment sales in the 1999 first quarter declined 3 percent and were impacted significantly by the currency devaluation and recession in Brazil. Excluding Brazil, equipment sales growth slowed to 4 percent as North American and European sales productivity was impacted more than anticipated by the effects of the January initiatives previously discussed. In addition, indirect channels equipment sales growth was temporarily below recent trends. Approximately 45 percent of 1999 first quarter equipment sales was derived from products introduced since 1997, including the company's expanding line of black-and-white Document Centre digital multi-function equipment, the DocuTech 6180 Production Publisher, and the expanding monochrome and color laser and inkjet product families sold through indirect channels. North American and European equipment sales growth should improve significantly beginning in the second quarter.

Excluding Brazil, supplies revenue was flat in the 1999 first quarter reflecting diversion of U.S. supplies revenue to document outsourcing and some impact of marketing agreements to expand supplies distribution providing royalties rather than supplies revenue.

Paper sales: Our strategy is to charge a spread over mill wholesale prices to cover our costs and value added as a distributor. The first quarter 1999 revenue decline reflects slight volume increases due to expanding distribution channels, which was more than offset by lower industry prices due to an excess of worldwide supply.

Combined service, document outsourcing, rentals and other revenues grew 4 percent in the 1999 first quarter and 7 percent excluding Brazil. Document Outsourcing revenues are split between Equipment Sales and Document Outsourcing. Where document outsourcing contracts include revenue accounted for as equipment sales, this revenue is included as Equipment Sales. All other document outsourcing revenue, including service, equipment rental, supplies, paper and labor, are included in Service/Outsourcing/ Rentals/Other. This has the effect of diverting significant revenues from supplies, paper, service and rental. The continuing excellent Document Outsourcing growth reflects the trend of customers focusing on their core businesses and outsourcing their document processing requirements to Xerox. The growth rate for total document outsourcing revenue is higher than the growth included in the Service/Outsourcing/Rentals/Other category, reflecting an increase in the proportion of equipment in outsourcing contracts accounted for as sales. Service revenues declined 3 percent (excluding Brazil) in the 1999 first

quarter compared with abnormal growth in the 1998 first quarter as the impact of higher machine populations resulting from higher equipment sales was more than offset by the impact of the strong customer preference for document outsourcing and competitive price pressures.

Finance income: Our strategy for financing equipment sales in the industrialized economies is to charge a spread over our cost of borrowing and to lock in that spread by match funding the finance receivables with borrowings of similar maturities. Excluding Brazil, modest growth in finance income in the 1999 first quarter is the result of continuing good growth in the financing of equipment sales in the U.S. partially offset by lower average interest rates.

Key Ratios and Expenses

The trend in key ratios was as follows:

	1998					1999
	Q1	Q2	Q3	Q4	FY	Q1
Gross Margin	44.9%	45.6%	46.3%	48.0%	46.3%	45.9%
SAG % Revenue	27.8	27.3	27.7	26.8	27.3	27.2

The gross margin improved by 1.0 percentage points in the 1999 first quarter from the 1998 first quarter as manufacturing and other productivity improvements and favorable currency were only partially offset by continuing competitive price pressures and business mix impact due primarily to higher revenue growth in both the document outsourcing and the indirect channels businesses.

Selling, administrative and general expenses (SAG) declined 2 percent in the 1999 first quarter from the 1998 first quarter driven by a substantial decline in general and administrative expenses reflecting the benefits of our 1998 restructuring program, our sharpened focus on productivity and expense controls implemented in January 1999 to mitigate the impact of the economic turmoil in Brazil, as well as the beneficial currency translation impact of the devaluation on SAG in Brazil. In the 1999 first quarter, SAG represented 27.2 percent of revenue, an improvement of 0.6 percentage points from the 1998 first quarter.

Research and development (R&D) expense in the 1999 first quarter increased 7 percent from the 1998 first quarter. We continue to invest in technological development to maintain our premier position in the rapidly changing document processing market with an added focus on increasing the effectiveness of that investment and time to market. Xerox R&D is strategically coordinated with that of Fuji Xerox which invested \$636 million in R&D in the 1998 full year, for a combined total of \$1.7 billion.

Worldwide employment increased by 100 in the 1999 first quarter to 92,800 as a result of the net hiring of 1,100 employees substantially offset by 1,000 employees leaving the company under the worldwide restructuring program. The hiring was primarily for the company's fast-growing document outsourcing and professional services businesses, staffing for the centralized European customer care and shared services operations in Ireland and research and development skills enhancement.

The \$1 million decrease in other expenses, net, from the 1998 first quarter was primarily due to a small gain on foreign currency transactions in 1999 compared with a loss in 1998, and several other one-time items which were essentially offset by increased non-financing interest expense. The increased non-financing interest expense was the result of higher debt balances partially offset by lower interest rates.

Income Taxes, Equity in Net Income of Unconsolidated Affiliates and Minorities' Interests in the Earnings of Subsidiaries

Income before income taxes increased 11 percent to \$494 million in the 1999 first quarter from \$445 million in the 1998 first quarter.

The effective tax rate, which was 31.0 percent in the 1999 first quarter compared with 33.0 percent in the 1998 first quarter, was generally consistent with the 1998 full year pre-restructuring

rate of 31.6 percent. We expect the 1999 full year tax rate to be in line with the 1999 first quarter rate.

Equity in the net income of unconsolidated affiliates is principally our 50 percent share of Fuji Xerox income. Total equity in net income decreased in the 1999 first quarter due to lower Fuji Xerox income, reflecting difficult economic conditions in Japan and other Asia Pacific countries. We expect the difficult economic conditions in Japan and the Pacific Rim to continue to adversely affect Fuji Xerox' operations and it is unlikely that their earnings, before currency translation, will contribute to Xerox earnings growth in 1999.

On April 7, 1998, we announced a worldwide restructuring program associated with enhancing our competitive position and lowering our overall cost structure. In connection with this program, in the second quarter of 1998 we recorded a pre-tax provision of \$1,644 million (\$1,107 million after taxes and including our \$18 million share of a restructuring charge recorded by Fuji Xerox). The program includes the elimination of approximately 9,000 jobs, net, worldwide, the closing and consolidation of facilities, and the write-down of certain assets. The charges associated with this restructuring program include \$113 million of inventory charges recorded as cost of revenues and \$316 million of asset impairments. Included in the asset impairment charge are facility fixed assets write-downs of \$156 million and other asset write-downs of \$160 million. For facility fixed assets classified as assets to be disposed of, the impairment loss recognized is based on fair value less cost to sell, with fair value based on third-party valuations as well as our internal estimates of existing market prices for similar assets. The effect of suspending depreciation on assets no longer in use for the first quarter of 1999 is not material. The remaining \$160 million of asset impairments includes the write-down of certain technology assets and other items impacted by the consolidation activities described below. Key initiatives of the restructuring include:

- 1) Consolidating 56 European customer support centers into one facility and implementing a shared services organization for order entry, invoicing, and other back-office and sales operations.
- 2) Streamlining manufacturing, logistics, distribution and service operations. This will include centralizing U.S. parts depots and outsourcing storage and distribution.
- 3) Overhauling our internal processes and associated resources, including closing one of four geographically-organized U.S. customer administrative centers.

The reductions are occurring primarily in administrative functions, but also impact service, research and manufacturing.

The following table summarizes the status of the restructuring reserve (in millions):

	Total Reserve	Charges Against Reserve	March 31, 1999 Balance
Severance and related costs	\$1,017	\$387	\$630
Asset impairment	316	316	-
Lease cancellation and other costs	198	35	163
Inventory charges	113	113	-
Total	\$1,644	\$851	\$793

As of March 31, 1999, approximately 6,400 employees have left the Company under the restructuring program.

There have been no material changes to the program since its announcement in April 1998, and the majority of the remaining reserve will be utilized throughout the remainder of 1999 and 2000.

In April 1998, we announced that we were reactivating our \$1 billion stock repurchase program, which was suspended when we acquired the remaining financial interest in Xerox Limited in 1997. During the 1999 first quarter the company did not repurchase any stock. Since inception of the program we have repurchased 20.6 million shares for \$594 million.

The Year 2000 (Y2K) problem is the result of computer programs written in two digits, rather than four, to define the applicable year. As a result, many information systems are unable to

properly recognize and process date-sensitive information beyond December 31, 1999. As with all major companies, certain of our information systems and products require remediation or replacement in order to render these systems Year 2000 compliant. Though a majority of our remediation and replacement work has been completed, 1999 will be used to finish any remaining mission-critical areas and develop and deploy business contingency plans.

We have divided the Year 2000 project into five major sections: Information Technology; and the non-Information Technology areas of Facilities, Vendor Compliance, Product Compliance and Facilities Management products and services. The general phases common to all sections are: 1) Awareness - a strategic approach was developed to address the Year 2000 problem. 2) Assessment - detailed plans and target dates were developed. 3) Programming - includes hardware and software upgrades, systems replacements, vendor certification and other associated changes. 4) Testing - includes testing and conversion of system applications. 5) Implementation - includes compliance achievement and user acceptance.

The Information Technology section includes applications (software), compute (mainframe/smaller computer environments), infrastructure (networks, servers, and workstations), and telecommunications. The status of each section as of March 31, 1999, is as follows:

Applications - 97 percent of the mission-critical applications are Y2K Compliant and tested. The remaining work is planned for completion by the third quarter of 1999.

Compute - 93 percent of our mainframe/smaller computer environments have been upgraded to be Y2K compliant with the remainder scheduled to be completed by mid-1999.

Infrastructure - 83 percent of networks, servers, and workstations have been upgraded to be Y2K compliant with the remainder to be completed by the third quarter of 1999.

Telecommunications - 74 percent of internal mission-critical components are Y2K compliant with the remainder planned for compliance by mid-1999. We continue to assess external public utility provider readiness and pursue status on those providers who do not respond.

The Facilities section, which includes building electrical systems, elevators, access control, security systems, etc., is primarily in the assessment phase. We are on track for achieving compliance of critical owned sites by August 31, 1999. Leased sites are on track and planned for compliance by December 31, 1999.

We began our efforts in the Vendor Compliance area in November 1997. A general awareness letter was sent to all external suppliers, and an assessment survey was sent to all business critical suppliers. Follow-up was then initiated to validate survey responses and provide a risk profile for each supplier.

To date, 70% of mission critical suppliers have been assessed. New suppliers have been added to the list and assessments are underway. Of the suppliers assessed, 87% are rated "high confidence" as of March 1999. We will continue to work with the 13% of suppliers rated "low confidence" to ensure supply continuity through 2000. Assessments for the remaining 30% of mission critical suppliers should be completed by June 1999.

The Y2K process as it relates to our manufacturing operations has primarily focused on our first tier suppliers, and given the vastness and complexity of our supplier base, we had growing concern about the adequacy of a single strategy approach. In response to these concerns, we expect to build an inventory hedge on selected key products and critical sole source parts. This inventory coupled with our normal inventory levels will provide us with a resolution window to resolve any Y2K issues. We currently expect to acquire up to \$100 million of this additional inventory which we believe can be utilized in the normal course of business during the first half of 2000. In summary, we believe the resolution period incorporated in the Y2K vendor strategy is adequate to provide supplier continuity coverage. This procedure is intended to provide a means of managing risk;

however, no assurance can be given that it will eliminate the potential disruption caused by third party failure.

Our 1999 efforts will include on-site inspection of 20 key suppliers in the second quarter of 1999 and contingency planning.

Regarding Product Compliance, 98% of our products, excluding end-of-life products, are Y2K compliant, or we have developed a software/hardware patch or have another solution in progress. We have implementation plans in place to deploy these Y2K solutions so that all in-field Xerox products worldwide will be made compliant by mid-1999.

In Facilities Management, we have completed inventory, compliance assessment, and action plans. Remediation activities are underway for all customers; 60% of required remediation of third party components has been accomplished. Completion of remediation, on-site integrated testing of components and full deployment is scheduled for mid-1999. Remediation of Xerox products at these sites is being coordinated with the product compliance area.

Contingency Planning--Certain of our processes have in place business resumption plans. In addition, we have established a contingency program which requires our critical business processes to develop alternative plans should our, or third party remediation efforts experience unforeseen difficulty.

We are also dependent upon our customers for sales and cash flows. Y2K interruptions in our customers' operations could result in reduced sales, increased inventory or receivable levels and cash flow reductions. While these events are possible, our customer base is sufficiently broad to minimize those risks.

In 1993, Xerox began a project to replace the majority of its legacy systems, which in many cases date back to the 1960s. These efforts continue today. As to remediation, we currently estimate that costs, exclusive of software and systems that are being replaced or upgraded in the normal course of business, and including our products and facilities, as well as legacy systems, will be \$183 million of which \$28 million was spent in 1997, \$92 million in 1998, \$18 million in the first quarter of 1999. We estimate \$45 million will be spent in the remainder of 1999.

We believe that the remediation of our information systems and products will occur in a timely fashion so that the Y2K problem will not result in significant operating problems with our operating systems, facilities and products. However, if such remediations are not completed in a timely manner or if third party suppliers of products or services have not completed their remediation efforts, the Y2K problem could potentially have a material adverse impact on our operations. Possible worst case consequences could include an interruption in our ability to: bill and apply collections from our customers; manufacture and deliver products to our customers; or meet our cash requirement needs.

New Accounting Standards. In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 requires companies to recognize all derivatives as assets or liabilities measured at their fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. We do not expect this Statement to have a material impact on our consolidated financial statements. This Statement is effective for fiscal years beginning after June 15, 1999. We will adopt this accounting standard beginning January 1, 2000.

Discontinued Operations

The net investment in the discontinued financial services businesses which includes Insurance, Other Financial Services and Third Party Financing and Real Estate totaled \$762 million at March 31, 1999 compared with \$759 million at December 31, 1998. The change in 1999 was primarily caused by the funding of reinsurance coverage for the former Talegen Holdings, Inc.

(Talegen) companies to Ridge Reinsurance Limited (Ridge Re) and interest for the period on the assigned debt, both of which were nearly entirely offset by the sale of six of our remaining eight financing leases and the sale of other Real Estate investments. A discussion of the discontinued businesses follows.

Status of Insurance

In 1995, we recorded a \$1,546 million after tax charge in connection with the disengagement activities for our five then remaining Talegen insurance companies and three related service companies.

In 1997, three of the insurance companies and one service company were sold. As part of the consideration for one of the companies, The Resolution Group, Inc. (TRG), which closed in the fourth quarter of 1997, we received a \$462 million performance-based instrument. In 1998, the remaining insurance and service companies were sold. In the first quarter, we completed the sale of the Westchester Specialty Group, Inc. (WSG) for \$338 million in cash, less approximately \$70 million in transaction-related costs. In the third quarter, we completed the sale of Crum & Forster Holdings, Inc. (CFI) for \$680 million, including the repayment of \$115 million in debt, less approximately \$75 million in transaction-related costs. With the completion of the CFI transaction, we have effectively completed our disengagement strategy from the Talegen companies. In the first quarter of 1998 an additional after-tax charge of \$190 million was recorded.

Xerox Financial Services, Inc. (XFSI) continues to provide aggregate excess of loss reinsurance coverage to certain of the former Talegen units and TRG through Ridge Re, a wholly owned subsidiary. The coverage limits total \$748 million, which is net of 15 percent coinsurance and exclusive of \$234 million in coverage which was reinsured under a retrocessional arrangement during the fourth quarter of 1998 for a total cost to Ridge Re of \$158 million. At March 31, 1999, Ridge Re had recognized the discounted value of approximately \$454 million of the available coverage and it is possible that some additional reserves could ultimately be needed, although this is not currently anticipated. In April 1999, Ridge Re entered into a novation agreement with another insurer to eliminate its obligations for WSG's reinsurance coverage. The coverage limit under WSG's policy was \$128 million. In connection with the agreement, Ridge Re paid the insurer \$95 million.

XFSI has guaranteed to certain of the former Talegen units and TRG that Ridge Re will meet all of its financial obligations under the Reinsurance Agreements. Related premium payments to Ridge Re are made by XFSI and guaranteed by us. As of March 31, 1999, there were three remaining annual premium installments of \$43 million, plus finance charges. We have also guaranteed that Ridge Re will meet its financial obligations on \$578 million of the Reinsurance Agreements and have provided a \$400 million partial guaranty of Ridge Re's \$800 million letter of credit facility. This facility is required to provide security with respect to aggregate excess of loss reinsurance obligations under contracts with certain of the former Talegen units and TRG.

XFSI may also be required, under certain circumstances, to purchase over time additional redeemable preferred shares of Ridge Re, up to a maximum of \$301 million.

Net Investment in Insurance

The net investment in Insurance at March 31, 1999 totaled \$595 million compared with a balance of \$513 million at December 31, 1998. The increase in 1999 is due to contractual payments to Ridge Re for annual premium installments and associated finance charges, payment for the settlement of litigation related to the sale of one of the former Talegen units and interest on the assigned insurance debt.

Other Financial Services

The net investment in Other Financial Services at March 31, 1999 was \$138 million compared with \$132 million at December 31, 1998. Debt associated with these assets totaled \$50 million at March 31, 1999 and December 31, 1998. The increase in the investment is primarily due to payment related to the settlement of certain

litigation and interest on the assigned debt.

On June 1, 1995, XFSI completed the sale of Xerox Financial Services Life Insurance Company and related companies (Xerox Life). In connection with the transaction, OakRe Life Insurance Company (OakRe), a wholly owned XFSI subsidiary, has assumed responsibility, via Coinsurance Agreements, for existing Single Premium Deferred Annuity (SPDA) policies issued by Xerox Life. The Coinsurance Agreements include a provision for the assumption (at their election) by the purchaser's companies, of all of the SPDA policies at the end of their current rate reset periods. A Novation Agreement with an affiliate of the new owner provides for the assumption of the liability under the Coinsurance Agreements for any SPDA policies not so assumed.

As a result of the Coinsurance Agreements, at March 31, 1999, OakRe retained approximately \$0.7 billion of investment portfolio assets (transferred from Xerox Life) and liabilities related to the reinsured SPDA policies. Interest rates on these policies are fixed and were established upon issuance of the respective policies. Substantially all of these policies will reach their rate reset periods through the year 2000 and will be assumed under the Agreements as described above. Xerox Life's portfolio was designed to recognize that policy renewals extended liability "maturities," thereby permitting investments with average duration somewhat beyond the rate reset periods. OakRe's practice is to selectively improve this match over time as market conditions allow.

In connection with the aforementioned sale, XFSI established a \$500 million letter of credit and line of credit with a group of banks to support OakRe's coinsurance obligations. The term of this letter of credit is five years and it is unused and available at March 31, 1999. Upon a drawing under the letter of credit, XFSI has the option to cover the drawing in cash or to draw upon the credit line.

Third Party Financing and Real Estate

Third Party Financing and Real Estate assets at March 31, 1999 and December 31, 1998 totaled \$123 million and \$250 million, respectively. The reduction primarily relates to the sale of six of our remaining eight financing leases as well as other asset sales and runoff activity that were consistent with the amounts contemplated in the formal disposal plan. Debt associated with these assets totaled \$44 million and \$86 million at March 31, 1999 and December 31, 1998, respectively.

Capital Resources and Liquidity

Total debt, including ESOP and Discontinued Operations debt not shown separately in our consolidated balance sheets, increased to \$16,059 million at March 31, 1999 or \$952 million more than at December 31, 1998. The changes in consolidated indebtedness during the first three months of 1999 and 1998 are summarized as follows (in millions):

	1999	1998
Total debt* as of January 1	\$15,107	\$12,903
Non-Financing Businesses:		
Document Processing operations cash usage	987	1,017
Brazil dollar debt reallocation	446	-
Discontinued businesses	4	(35)
Non-Financing Businesses	1,437	982
Financing Businesses	(505)	(99)
Shareholder dividends	146	133
Stock options exercised and other changes	(126)	(247)
Total debt* as of March 31	\$16,059	\$13,672

* Includes discontinued operations.

For analytical purposes, total equity includes common equity, ESOP preferred stock, mandatorily redeemable preferred securities and minorities' interests.

The following table summarizes the changes in total equity during the first three months of 1999 and 1998 (in millions):

	1999	1998
Total equity as of January 1	\$6,306	\$6,454
Income from Continuing Operations	343	301
Loss from Discontinued Operations	-	(190)
Shareholder dividends	(146)	(133)
Exercise of stock options	79	26
Change in minorities' interests	(17)	-
Translation adjustments	(855)	(71)
All other, net	47	19
Total equity as of March 31	\$5,757	\$6,406

Non-Financing Operations

The following table summarizes document processing non-financing operations cash generation and usage for the three months ended March 31, 1999 and 1998 (in millions):

	1999	1998
Document Processing Non-Financing:		
Income from continuing operations	\$ 266	\$ 239
Depreciation* and amortization	223	200
Loss from discontinued operations	-	(190)
Subtotal	489	249
Additions to land, buildings and equipment	(116)	(88)
Increase in inventories	(319)	(346)
Increase in on-lease equipment	(35)	(64)
Increase in accounts receivable	(122)	(125)
Decrease in other assets and liabilities	(794)	(643)
Subtotal	(897)	(1,017)
Cash charges against 1998 restructuring reserve	(90)	-
Net Cash Usage	\$(987)	\$(1,017)

* Includes rental equipment depreciation of \$105 and \$95 million in first quarter 1999 and 1998, respectively

Non-financing operations' cash usage during the first three months of 1999 totaled \$987 million or \$30 million less than in the first three months of 1998. Higher net income and non-cash charges, and lower inventory growth, were partially offset by higher capital spending, net changes in other assets and liabilities such as prepaid expenses, accounts payable and accrued compensation, and cash charges against the 1998 restructuring reserve.

Financing Businesses

Customer financing-related debt declined by \$505 million during the first three months of 1999 or \$406 more than in first quarter 1998. The decline is more than due to a reallocation to non-financing operations of a portion of Xerox do Brasil's U.S. dollar denominated debt used to fund customer finance receivables denominated in Brazilian currency. The reallocation is in line with our 8:1 debt to equity guideline for financing operations.

Debt related to discontinued third party financing and real estate activities, which is included in financing business debt, totaled \$44 million at March 31, 1999 or \$42 million less than at year end 1998. Asset sales and portfolio run-off account for the first quarter reduction. Third party financing and real estate debt was \$119 at March 31, 1998 essentially unchanged from the year end 1997 level.

Funding Plans for 1999

During the first quarter of 1999, the company filed a new \$4 billion shelf registration statement with the Securities and Exchange Commission. This shelf facility is available to Xerox

Corporation, Xerox Credit Corporation and Xerox Capital (Europe) plc. In May 1999, Xerox Capital (Europe) plc issued a total of \$1 billion of 3 and 5 year debt under this shelf facility.

Risk Management

Xerox is typical of multinational corporations because it is exposed to market risk from changes in foreign currency exchange rates and interest rates that could affect our results of operations and financial condition.

We have entered into certain financial instruments to manage interest rate and foreign currency exposures. These instruments are held solely for hedging purposes and include interest rate swap agreements, forward exchange contracts and foreign currency swap agreements. We do not enter into derivative instrument transactions for trading purposes and employ long-standing policies prescribing that derivative instruments are only to be used to achieve a set of very limited objectives.

Currency derivatives are primarily arranged in conjunction with underlying transactions that give rise to foreign currency-denominated payables and receivables. For example, an option to buy foreign currency to settle the importation of goods from foreign suppliers, or a forward exchange contract to fix the dollar value of a foreign currency-denominated loan.

With regard to interest rate hedging, virtually all customer-financing assets earn fixed rates of interest. Therefore, within industrialized economies, we "lock in" an interest rate spread by arranging fixed-rate liabilities with similar maturities as the underlying assets and fund the assets with liabilities in the same currency, except in developing economies where capital market access to these financial instruments is impracticable. We refer to the effect of these conservative practices as "match funding" customer financing assets. This practice effectively eliminates the risk of a major decline in interest margins during a period of rising interest rates. Conversely, this practice effectively eliminates the opportunity to materially increase margins when interest rates are declining.

Pay fixed-rate and receive variable-rate swaps are typically used in place of more expensive fixed-rate debt. Additionally, pay variable-rate and receive fixed-rate swaps are used from time to time to transform longer-term fixed-rate debt into variable rate obligations. The transactions performed within each of these categories enable more cost-effective management of interest rate exposures. The potential risk attendant to this strategy is the non-performance of the swap counterparty. We address this risk by arranging swaps with a diverse group of strong-credit counterparties, regularly monitoring their credit ratings and determining the replacement cost, if any, of existing transactions.

Our currency and interest rate hedging are typically unaffected by changes in market conditions as forward contracts, options and swaps are normally held to maturity consistent with our objective to lock in currency rates and interest rate spreads on the underlying transactions.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

The information set forth under the caption "Risk Management" on pages 28-29 of this Quarterly Report on Form 10-Q is hereby incorporated by reference in answer to this Item.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth under Note 8 contained in the "Notes to Consolidated Financial Statements" on pages 11-12 of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this item.

Item 2. Changes in Securities

During the quarter ended March 31, 1999, Registrant issued the following securities in transactions which were not registered under the Securities Act of 1933, as amended (the Act):

- (a) Securities Sold: on January 1, 1999, Registrant issued 1746 shares of Common stock, par value \$1 per share.
- (b) No underwriters participated. The shares were issued to each of the non-employee Directors of Registrant: B.R. Inman, A.A. Johnson, V.E. Jordan, Jr., Y. Kobayashi, H. Kopper, R.S. Larsen, J.D. Macomber, G.J. Mitchell, N.J. Nicholas, Jr., J.E. Pepper, P. F. Russo, M.R. Seger and T.C. Theobald.
- (c) The shares were issued at a deemed purchase price of \$59.00 per share (aggregate price \$102,625), based upon the market value on the date of issuance, in payment of the quarterly Directors' fees pursuant to Registrant's Restricted Stock Plan for Directors.
- (d) Exemption from registration under the Act was claimed based upon Section 4(2) as a sale by an issuer not involving a public offering.

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibit 3(a)(1) Restated Certificate of Incorporation of Registrant filed by the Department of State of the State of New York on October 29, 1996. Incorporated by reference to Exhibit 3(a)(1) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1996.

Exhibit 3 (b) By-Laws of Registrant, as amended through April 6, 1999 (in electronic form only).

Exhibit 11 Computation of Net Income per Common Share.

Exhibit 12 Computation of Ratio of Earnings to Fixed Charges.

Exhibit 27 Financial Data Schedule (in electronic form only).

- (b) Current reports on Form 8-K dated December 18, 1998, January 25, 1999 and March 26, 1999 reporting Item 5 "Other Events" was filed during the quarter for which this Quarterly Report is filed.

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.

XEROX CORPORATION
(Registrant)

Date: May 14, 1999

By Philip D. Fishbach
Vice President and Controller
(Principal Accounting Officer)

Exhibit 11

Xerox Corporation

Computation of Net Income Per Common Share
(Dollars in millions, except per-share data; shares in thousands)

	Three months ended March 31,	
	1999	1998
I. Basic Net Income Per Common Share		
Income from continuing operations	\$ 343	\$ 301
Accrued dividends on ESOP preferred stock, net	(10)	(11)
Adjusted income from continuing operations	333	290
Discontinued operations	-	(190)
Adjusted net income	\$ 333	\$ 100
Average common shares outstanding during the period	658,472	653,740
Common shares issuable with respect to exchangeable shares	2,402	3,388
Adjusted average shares outstanding for the period	660,874	657,128
Basic earnings per share:		
Continuing operations	\$ 0.50	\$ 0.44
Discontinued operations	-	(0.29)
Basic earnings per share	\$ 0.50	\$ 0.15
II. Diluted Net Income Per Common Share		
Income from continuing operations	\$ 343	\$ 301
ESOP expense adjustment, net of tax	3	1
Interest on convertible debt, net of tax	3	1
Adjusted income from continuing operations	349	303
Discontinued operations	-	(190)
Adjusted net income	\$ 349	\$ 113
Average common shares outstanding during the period	658,472	653,740
Stock options, incentive and exchangeable shares	10,749	12,058
Convertible debt	13,190	5,288
ESOP preferred stock	52,531	53,978
Adjusted average shares outstanding for the period	734,942	725,064
Diluted earnings per share:		
Continuing operations	\$ 0.48	\$ 0.42
Discontinued operations	-	(0.26)
Diluted earnings per share	\$ 0.48	\$ 0.16

Exhibit 12

Xerox Corporation
Computation of Ratio of Earnings to Fixed Charges

(In millions)	Three months ended			Year ended			
	March 31,		1998*	December 31,			
	1999	1998		1997	1996	1995	1994
Fixed charges:							
Interest expense	\$ 206	\$ 177	\$ 748	\$ 617	\$ 592	\$ 603	\$ 520
Rental expense	35	28	145	140	140	142	170
Total fixed charges before capitalized interest and preferred stock dividends of subsidiaries							
	241	205	893	757	732	745	690
Preferred stock dividends of subsidiaries							
	14	14	55	50	-	-	-
Capitalized interest							
	-	-	-	-	-	-	2
Total fixed charges	\$ 255	\$ 219	\$ 948	\$ 807	\$ 732	\$ 745	\$ 692
Earnings available for fixed charges:							
Earnings**	\$ 504	\$ 459	\$ 837	\$2,268	\$2,067	\$1,980	\$1,602
Less undistributed income in minority owned companies							
	(10)	(9)	(27)	(84)	(84)	(90)	(54)
Add fixed charges before capitalized interest and preferred stock dividends of subsidiaries							
	241	205	893	757	732	745	690
Total earnings available for fixed charges	\$ 735	\$ 655	\$1,703	\$2,941	\$2,715	\$2,635	\$2,238
Ratio of earnings to fixed charges (1)(2)	2.88	2.99	1.80	3.64	3.71	3.54	3.23

(1) The ratio of earnings to fixed charges has been computed based on the Company's continuing operations by dividing total earnings available for fixed charges, excluding capitalized interest and preferred stock dividends of subsidiaries, by total fixed charges. Fixed charges consist of interest, including capitalized interest and preferred stock dividends of subsidiaries, and one-third of rent expense as representative of the interest portion of rentals. Debt has been assigned to discontinued operations based on historical levels assigned to the businesses when they were continuing operations, adjusted for subsequent paydowns. Discontinued operations consist of the Company's Insurance, Other Financial Services, and Third Party Financing and Real Estate businesses.

(2) The Company's ratio of earnings to fixed charges includes the effect of the Company's finance subsidiaries, which primarily finance Xerox equipment. Financing businesses are more highly leveraged and, therefore, tend to operate at lower earnings to fixed charges ratio levels than do non-financial businesses.

* Excluding the effects of the charges recorded in connection with the 1998 restructuring plan, the ratio of earnings to fixed charges would be 3.55.

** Sum of "Income before Income Taxes, Equity Income and Minorities' Interests" and "Equity in Net Income of Unconsolidated Affiliates."

BY-LAWS

of

XEROX CORPORATION

April 6, 1999

ARTICLE I

MEETINGS OF STOCKHOLDERS

SECTION 1. Annual Meetings: A meeting of shareholders entitled to vote shall be held for the election of Directors and the transaction of other business in May of each year on any day (except a Saturday, Sunday, or holiday) in that month as determined by the Board of Directors.

SECTION 2. Special Meetings: Special Meetings of the shareholders may be called at any time by the Chairman of the Board, the President or the Board of Directors.

SECTION 3. Place of Meetings: Meetings of shareholders shall be held at the principal office of the Company or at such other place, within or without the State of New York, as may be fixed by the Board of Directors.

SECTION 4. Notice of Meetings:

(a) Notice of each meeting of shareholders shall be in writing and shall state the place, date and hour of the meeting. Notice of a Special Meeting shall state the purpose or purposes for which it is being called and shall also indicate that it is being issued by or at the direction of the person or persons calling the meeting. If, at any meeting, action is proposed to be taken which would, if taken, entitle shareholders, full-paying the requirements of Section 623 of the Business Corporation Law to receive payment for their shares, the notice of such meeting shall include a statement of that purpose and to that effect.

(b) A copy of the notice of any meeting shall be given, personally or by mail, not less than ten nor more than sixty days before the date of the meeting, to each shareholder entitled to vote at such meeting. If mailed, such notice is given when deposited in the United States mail, with postage thereon prepaid, directed to the shareholder at his address as it appears on the record of shareholders, or, if he shall have filed with the Secretary a written request that notices to him be mailed to some other address, then directed to him at such other address.

(c) Notice of meeting need not be given to any shareholder who submits a signed waiver of notice, in person or by proxy, whether before or after the meeting. The attendance of any shareholder at a meeting, in person or by proxy, without protesting prior to the conclusion of the meeting the lack of notice of such meeting, shall constitute a waiver of notice by him.

SECTION 5. Quorum and Adjourned Meetings:

(a) At any Annual or Special Meeting the holders of a majority of the votes of shares entitled to vote thereat, present in person or by proxy, shall constitute a quorum for the transaction of any business, provided that when a specified item of business is required to be voted on by a class or series, voting as a class, the holders of a majority of the votes of shares of such class or series shall constitute a quorum for the transaction of such specified item of business. When a quorum is once present to organize a meeting, it is not broken by the subsequent withdrawal of any shareholders.

(b) Despite the absence of a quorum, the shareholders present may adjourn the meeting to another time and place, and it shall not be necessary to give any notice of the adjourned meeting if the time and place to which the meeting is adjourned are announced at the meeting at which the adjournment is taken. At the adjourned meeting any business may be transacted that might have been transacted on the original date of the meeting. If after the adjournment, however, the Board of Directors fixes a new record date for the adjourned meeting, a notice of the adjourned meeting shall be given to each shareholder on the new record date entitled to notice under Section 4 of this Article I of the By-Laws.

SECTION 6. Nominations and Business at Meetings

At any annual meeting of shareholders, only persons who are nominated or business which is proposed in accordance with the procedures set forth in this Section 6 shall be eligible for election as Directors or considered for action by shareholders. Nominations of persons for election to the Board of Directors of the Company may be made or business proposed at a meeting of shareholders (i) by or at the direction of the Board of Directors or (ii) by any shareholder of the Company entitled to vote at the meeting who complies with the notice and other procedures set forth in this Section 6. Such nominations or business proposals, other than those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the Secretary of the Company and such business proposals must, under applicable law, be a proper matter for shareholder action. To be timely, a shareholder's notice shall be delivered to or mailed and received at the principal executive offices of the Company not less than 120 days nor more than 150 days in advance of the date which is the anniversary of the date the Company's proxy statement was released to security holders in connection with the previous year's annual meeting or if the date of the applicable annual meeting has been changed by more than 30 days from the date contemplated at the time of the previous year's proxy statement, not less than 90 days before the date of the applicable annual meeting.

Such shareholder's notice shall set forth (a) as to each person whom such shareholder proposes to nominate for election or reelection as a Director, all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (including such person's writ-ten consent to being named in the proxy statement as a nominee and to serving as a Director if elected); (b) as to any other business that the shareholder proposes to bring before the meeting, a brief description of the business desired to be brought before the annual meeting, the reasons for conducting such business at the annual meeting and any material interest in such business of such person on whose behalf such proposal is made; and (c) as to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made, (i) the name and address of such shareholder, as they appear on the Company's books and (ii) the class and number of shares of the Company which are beneficially owned by such shareholder. No person shall be eligible for election as a Director of the Company and no business shall be conducted at the annual meeting of shareholders unless nominated or proposed in accordance with the procedures set forth in this Section 6. The Chairman of the meeting may, if the facts warrant, determine and declare to the meeting that a nomination or proposal was not made in accordance with the provisions of this Section 6 and, if he should so determine, he shall so declare to the meeting and the defective nomination or proposal shall be disregarded.

SECTION 7. Organization: At every meeting of the shareholders, the Chairman of the Board, or in his absence, the President, or in his absence, a Vice Chairman, or in the absence of such officers, an Executive Vice President designated by the Chairman of the Board, or in the absence of such officers, a person selected by the meeting, shall act as chairman of the meeting. The Secretary or, in his absence, an Assistant Secretary shall act as secretary of the meeting, and in the absence of both the Secretary and an Assistant Secretary, a per-son selected by the meeting shall act as secretary of the meeting.

SECTION 8. Voting:

(a)Whenever any corporate action, other than the election of Directors, is to be taken by vote of the shareholders, it shall, except as otherwise required by law or by the Certificate of Incorporation be authorized by a majority of the votes cast in favor of or against such action at a meeting of shareholders by the holders of shares entitled to vote thereon. An abstention shall not constitute a vote cast.

(b)Directors shall, except as otherwise required by law, be elected by a plurality of the votes cast at a meeting of shareholders by holders of shares entitled to vote in the election. [; provided, however, a nomination shall be accepted, and votes cast for a nominee shall be counted by the inspectors of election, only if the Secretary of the Company has received at least twenty-four hours prior to the meeting a statement over the signature of the nominee that he consents to being a nominee and, if elected, intends to serve as a Director.] *

SECTION 9. Qualification of Voters:

(a)Every shareholder of record of Common Stock and Series B Convertible Preferred Stock of the Company shall be entitled at every meeting of such shareholders to one vote for every share of Common Stock and Series B Convertible Preferred Stock, respectively, standing in his name on the record of shareholders.

(b)Shares of stock belonging to the Company and shares held by another domestic or foreign corporation of any type or kind, if a majority of the shares entitled

to vote in the election of directors of such other corporation is held by the Company, shall not be shares entitled to vote or to be counted in determining the total number of out-standing shares.

(c) Shares held by an administrator, executor, guardian, conservator, committee, or other fiduciary, except a trustee, may be voted by him, either in person or by proxy, without transfer of such shares into his name. Shares held by a trustee may be voted by him, either in person or by proxy, only after the shares have been transferred into his name as trustee or into the name of his nominee.

(d) Shares standing in the name of another domestic or foreign corporation of any type or kind may be voted by such officer, agent or proxy as the By-Laws of such corporation may provide, or in the absence of such provision, as the Board of Directors of such corporation may provide.

SECTION 10. Proxies:

(a) Every shareholder entitled to vote at a meeting of shareholders or to express consent or dissent without a meeting may authorize another person or persons to act for him by proxy.

(b) No proxy shall be valid after the expiration of eleven months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the shareholder executing it, except as otherwise provided by law.

(c) The authority of the holder of a proxy to act shall not be revoked by the incompetence or death of the shareholder who executed the proxy unless, before the authority is exercised, written notice of an adjudication of such incompetence or of such death is received by the Secretary or an Assistant Secretary.

(d) Without limiting the manner in which a shareholder may authorize another person or persons to act for him as proxy pursuant to paragraph (a) of this Section, the following shall constitute a valid means by which a shareholder may grant such authority:

(1) A shareholder may execute a writing authorizing another person or persons to act for him as proxy. Execution may be accomplished by the shareholder or the shareholder's authorized officer, director, employee or agent signing such writing or causing his or her signature to be affixed to such writing by any reasonable means including, but not limited to, by facsimile signature.

(2) A shareholder may authorize another person or persons to act for the shareholder as proxy by transmitting or authorizing the transmission of a telegram, cablegram or other means of electronic transmission to the person who will be the holder of the proxy or to a proxy solicitation firm, proxy support service organization or like agent duly authorized by the person who will be the holder of the proxy to receive such transmission, provided that such telegram, cablegram or other means of electronic transmission must either set forth or be submitted with information from which it can be reasonably determined that the telegram, cablegram or other electronic transmission was authorized by the shareholder. If it is determined that such telegrams, cablegrams or other electronic transmissions are valid, the inspectors shall specify the nature of the information upon which they relied.

(e) Any copy, facsimile telecommunication or other reliable reproduction of the writing or transmission created pursuant to paragraph (d) of this Section may be substituted or used in lieu of the original writing or transmission for any and all purposes for which the original writing or transmission could be used, provided that such copy, facsimile, telecommunication or other reproduction shall be a complete reproduction of the entire original writing or transmission.

SECTION 11. Inspectors of Election:

(a) The Board of Directors, in advance of any shareholders' meeting, shall appoint one or more inspectors to act at the meeting or any adjournment thereof. The Board of Directors may designate one or more persons as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate has been appointed, or if such persons are unable to act at a meeting of shareholders, the person presiding at a shareholders' meeting shall appoint one or more inspectors. Each inspector, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector at such meeting with strict impartiality and according to the best of his ability.

(b) The inspectors shall determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall receive votes, ballots or consents, hear and determine all challenges and questions arising in connection with the right to vote, count and tabulate all votes, ballots or consents, determine the result, and do such acts as are proper to conduct the election or vote with fairness to all shareholders. On request of the person presiding at

the meeting or any shareholder entitled to vote thereat, the inspectors shall make a report in writing of any challenge, question or matter determined by them and execute a certificate of any fact found by them. Any report or certificate made by them shall be prima facie evidence of the facts stated and of the vote as certified by them.

SECTION 12. List of Shareholders at Meetings: A list of share-holders as of the record date, certified by the Secretary or by the transfer agent, shall be produced at any meeting of shareholders upon the request thereat or prior thereto of any share-holder. If the right to vote at any meeting is challenged, the inspectors of election, or person presiding thereat shall require such list of shareholders to be produced as evidence of the right of the persons challenged to vote at such meeting, and all persons who appear from such list to be shareholders entitled to vote thereat may vote at such meeting.

ARTICLE II

BOARD OF DIRECTORS

SECTION 1. Power of Board and Qualification of Directors: The business of the Company shall be managed under the direction of the Board of Directors, each of whom shall be at least eighteen years of age.

SECTION 2. Number, Term of Office and Classification:

(a)The Board of Directors shall consist of not less than five nor more than twenty-one members. The number of Directors shall be determined from time to time by resolution of a majority of the entire Board of Directors then in office, provided that no decrease in the number of Directors shall shorten the term of any incumbent Director. At each Annual Meeting of shareholders Directors shall be elected to hold office until the next annual meeting.

(b)If and whenever six full quarter-yearly dividends (whether or not consecutive) payable on the Cumulative Preferred Stock of any series shall be in arrears, in whole or in part, the number of Directors then constituting the Board of Directors shall be increased by two and the holders of the Cumulative Preferred Stock, voting separately as a class, regardless of series, shall be entitled to elect the two additional Directors at any annual meeting of shareholders or special meeting held in place thereof, or at a special meeting of the holders of the Cumulative Preferred Stock called as hereinafter provided. Whenever all arrears in dividends on the Cumulative Preferred Stock then outstanding shall have been paid and dividends thereon for the current quarter-yearly dividend period shall have been paid or declared and set apart for payment, then the right of the holders of the Cumulative Preferred Stock to elect such additional two Directors shall cease (but subject always to the same provisions for the vesting of such voting rights in the case of any similar future arrearages in dividends), and the terms of office of all persons elected as Directors by the holders of the Cumulative Preferred Stock shall forthwith terminate and the number of the Board of Directors shall be reduced accordingly. At any time after such voting power shall have been so vested in the Cumulative Preferred Stock, the Secretary of the Company may, and upon the written request of any holder of the Cumulative Preferred Stock (addressed to the Secretary at the principal office of the Company) shall, call a special meeting of the holders of the Cumulative Preferred Stock for the election of the two Directors to be elected by them as herein provided, such call to be made by notice similar to that provided in the By-Laws for a special meeting of the shareholders or as required by law. If any such special meeting required to be called as above provided shall not be called by the Secretary within twenty days after receipt of any such request, then any holder of Cumulative Preferred Stock may call such meeting, upon the notice above provided, and for that purpose shall have access to the stock books of the Company. The Directors elected at any such special meeting shall hold office until the next annual meeting of the shareholders or special meeting held in place thereof. In case any vacancy shall occur among the Directors elected by the holders of the Cumulative Preferred Stock, a successor shall be elected to serve until the next annual meeting of the shareholders or special meeting held in place thereof by the then remaining Director elected by the holders of the Cumulative Preferred Stock or the successor of such remaining Director.

(c) All Directors shall have equal voting power.

SECTION 3. Organization: At each meeting of the Board of Directors, the Chairman of the Board, or in his absence, the President, or in his absence, a chairman chosen by a majority of the Directors present shall preside. The Secretary shall act as secretary of the Board of Directors. In the event the Secretary shall be absent from any meeting of the Board of Directors, the meeting shall select its secretary.

SECTION 4. Resignations: Any Director of the Company may resign at any time by giving written notice to the Chairman of the Board, the President or to the Secretary of the Company. Such resignation shall take effect at the time

specified therein or, if no time be specified, then on delivery.

SECTION 5. Vacancies: Newly created directorships resulting from an increase in the number of Directors and vacancies occurring in the Board of Directors for any reason except the removal of Directors without cause may be filled by a vote of a majority of the Directors then in office, although less than a quorum exists. A Director elected to fill a vacancy shall hold office until the next annual meeting.

SECTION 6. Place of Meeting: The Board of Directors may hold its meetings at such place or places within or without the State of New York as the Board of Directors may from time to time by resolution determine.

SECTION 7. First Meeting: On the day of each annual election of Directors, the Board of Directors shall meet for the purpose of organization and the transaction of other business. Notice of such meeting need not be given. Such first meeting may be held at any other time which shall be specified in a notice given as hereinafter provided for special meetings of the Board of Directors.

SECTION 8. Regular Meetings: Regular meetings of the Board of Directors may be held at such times as may be fixed from time to time by resolution of the Board of Directors without notice.

SECTION 9. Special Meetings: Special meetings of the Board of Directors shall be held whenever called by the Chairman of the Board, the President, or by any two of the Directors. Oral, telegraphic or written notice shall be given, sent or mailed not less than one day before the meeting and shall state, in addition to the purposes, the date, place and hour of such meeting.

SECTION 10. Waivers of Notice: Notice of a meeting need not be given to any Director who submits a signed waiver of notice whether before or after the meeting, or who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to him.

SECTION 11. Quorum and Manner of Acting:

(a) If the number of Directors is twelve or more, seven Directors shall constitute a quorum for the transaction of business or any specified item of business. If the number of Directors is less than twelve, a majority of the entire Board of Directors shall constitute a quorum.

(b) A majority of the Directors present, whether or not a quorum is present, may adjourn any meeting to another time and place without notice to any Director.

SECTION 12. Written Consents: Any action required or permitted to be taken by the Board of Directors or any committee thereof may be taken without a meeting if all members of the Board or the committee consent in writing to the adoption of a resolution authorizing the action. The resolution and the written consents thereto by the members of the Board or committee shall be filed with the minutes of the proceedings of the Board or committee.

SECTION 13. Participation At Meetings By Telephone: Any one or more members of the Board of Directors or any committee thereof may participate in a meeting of such Board or committee by means of a conference telephone or similar communications equipment allowing all persons participating in the meeting to hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.

SECTION 14. Compensation: The Board of Directors shall have authority to fix the compensation of Directors for services in any capacity.

SECTION 15. Interested Directors:

(a) No contract or other transaction between the Company and one or more of its Directors, or between the Company and any other corporation, firm, association or other entity in which one or more of its Directors are directors or officers, or are financially interested, shall be either void or voidable for this reason alone or by reason alone that such Director or Directors are present at the meeting of the Board of Directors, or of a committee thereof, which approves such contract or transaction, or that his or their votes are counted for such purpose, provided that the parties to the contract or transaction establish affirmatively that it was fair and reasonable as to the Company at the time it was approved by the Board, a committee, or the shareholders.

(b) Any such contract or transaction may not be avoided by the Company for the reasons set forth in (a) if

(1) the material facts as to such Director's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the Board or committee, and the Board or committee approves such contract or transaction by a vote sufficient

for such purpose without counting the vote of such interested Director or, if the votes of the disinterested Directors are insufficient for such purpose, by unanimous vote of the disinterested Directors (although common or interested Directors may be counted in determining the presence of a quorum at a meeting of the Board or of a committee which approves such contract or transactions), or

(2) the material facts as to such Director's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the shareholders entitled to vote thereon, and such contract or transaction is approved by vote of such shareholders.

SECTION 16. Loans to Directors: The Company may not lend money to or guarantee the obligation of a Director of the Company unless the particular loan or guarantee is approved by the shareholders, with the holders of a majority of the shares entitled to vote thereon constituting a quorum, but shares held of record or beneficially by Directors who are benefited by such loan or guarantee shall not be entitled to vote or to be included in the determination of a quorum.

ARTICLE III

EXECUTIVE COMMITTEE

SECTION 1. How Constituted and Powers: There shall be an Executive Committee, consisting of not less than three nor more than nine Directors, including the Chairman of the Board, the Chairman of the Executive Committee and the President, elected by a majority of the entire Board of Directors, who shall serve at the pleasure of the Board. The Executive Committee shall have all the authority of the Board, except it shall have no authority as to the following matters:

(a) The submission to shareholders of any action that needs shareholders' authorization.

(b) The filling of vacancies in the Board or in any committee.

(c) The fixing of compensation of the Directors for serving on the Board or on any committee.

(d) The amendment or repeal of the By-Laws, or the adoption of new By-Laws.

(e) The amendment or repeal of any resolution of the Board which, by its terms, shall not be so amendable or repealable.

(f) The declaration of dividends.

SECTION 2. Meetings: Meetings of the Executive Committee, of which no notice shall be necessary, shall be held on such days and at such place as shall be fixed, either by the Chairman of the Board, the Chairman of the Executive Committee, or by a vote of the majority of the whole Committee.

SECTION 3. Quorum and Manner of Acting: Unless otherwise provided by resolution of the Board of Directors, a majority of the Executive Committee shall constitute a quorum for the transaction of business and the act of a majority of all of the members of the Committee, whether present or not, shall be the act of the Executive Committee. The members of the Executive Committee shall act only as a Committee. The procedure of the Committee and its manner of acting shall be subject at all times to the directions of the Board of Directors.

SECTION 4. Additional Committees: The Board of Directors by resolution adopted by a majority of the entire Board may designate from among its members additional committees, each of which shall consist of one or more Directors and shall have such authority as provided in the resolution designating the committee, except such authority shall not exceed the authority conferred on the Executive Committee by Section 1 of this Article.

SECTION 5. Alternate Members: The Board of Directors may designate one or more eligible Directors as alternate members of the Executive Committee, or of any other committee of the Board, who may replace any absent or disqualified member or members at any meeting of any such committee.

ARTICLE IV

OFFICERS

SECTION 1. Number: The officers of the Company shall be a Chairman of the Board, a President, a Chairman of the Executive Committee, one or more Vice

Chairman of the Board, one or more Vice Presidents, a Treasurer, a Secretary, a Controller, and such other officers as the Board of Directors may in its discretion elect. Any two or more offices may be held by the same person.

SECTION 2. Term of Offices and Qualifications: Those officers whose titles are specifically mentioned in Section 1 of this Article IV shall be chosen by the Board of Directors on the day of the Annual Meeting. Unless a shorter term is provided in the resolution of the Board electing such officer, the term of office of such officer shall extend to and expire at the meeting of the Board held on the day of the next Annual Meeting. The Chairman of the Board, the President, the Chairman of the Executive Committee and the Vice Chairmen shall be chosen from among the Directors.

SECTION 3. Additional Officers: Additional officers other than those whose titles are specifically mentioned in Section 1 of this Article IV shall be elected for such period, have such authority and perform such duties, either in an administrative or sub-ordinate capacity, as the Board of Directors may from time to time determine.

SECTION 4. Removal of Officers: Any officer may be removed by the Board of Directors with or without cause, at any time. Removal of an officer without cause shall be without prejudice to his contract rights, if any, but his election as an officer shall not of itself create contract rights.

SECTION 5. Resignation: Any officer may resign at any time by giving written notice to the Board of Directors, or to the President, or to the Secretary. Any such resignation shall take effect at the time specified therein, or if no time be specified, then upon delivery.

SECTION 6. Vacancies: A vacancy in any office shall be filled by the Board of Directors.

SECTION 7. Chairman of the Board: The Chairman of the Board shall preside at all meetings of the shareholders at which he is present, unless at such meetings the shareholders shall appoint a chairman other than the Chairman of the Board. The Chairman of the Board shall preside at all meetings of the Directors at which he is present. In the absence or inability to act of the President, or if the office of the President be vacant, the Chairman of the Board, subject to the right of the Board from time to time to extend or confine such powers and duties or to assign them to others, shall perform all the duties and may exercise all the powers of the President. The Chairman of the Board shall have such powers and perform such other duties as may be assigned to him by the Board.

SECTION 8. President: The President shall, in the absence of the Chairman of the Board, preside at all meetings of the shareholders, Directors or the Executive Committee at which he is present. The President shall act as the Chief Executive Officer of the Company and it shall be his duty to supervise generally the management of the business of the Company with responsibility direct to the Board and subject to the control of the Board. The President shall have such powers and perform such other duties as may be assigned to him by the Board.

SECTION 9. Chairman of the Executive Committee: The Chairman of the Executive Committee shall have such powers and perform such duties as may be assigned to him by the Board. The Chairman of the Executive Committee shall preside at meetings of the Executive Committee of the Board of Directors.

SECTION 10. The Vice Chairmen: Each Vice Chairman of the Board shall have such power and shall perform such duties as may be assigned to him by the Board of Directors or the President.

SECTION 11. The Vice Presidents: Each Vice President shall have such powers and shall perform such duties as may be assigned to him by the Board of Directors or President.

SECTION 12. The Treasurer: The Treasurer shall, if required by the Board of Directors, give a bond for the faithful discharge of his duties, in such sum and with such sureties as the Board of Directors shall require. He shall have charge and custody of, and be responsible for, all funds and securities of the Company, and deposit all such funds in the name of and to the credit of the Company in such banks, trust companies, or other depositories as shall be selected by the Board of Directors. The Treasurer may sign certificates for stock of the Company authorized by the Board of Directors. He shall also perform all other duties customarily incident to the office of Treasurer and such other duties as from time to time may be assigned to him by the Board of Directors.

SECTION 13. The Controller: The Controller shall keep and maintain the books of account for internal and external reporting purposes. He shall also perform all other duties customarily incident to the office of Controller and such other duties as may be assigned to him from time to time by the Board of Directors.

SECTION 14. The Secretary: It shall be the duty of the Secretary to act as secretary of all meetings of the Board of Directors, and of the shareholders, and to keep the minutes of all such meetings at which he shall so act in a proper book or books to be provided for that purpose; he shall see that all notices required to be given by the Company are duly given and served; he may sign and execute in the name of the Company certificates for the stock of the Company, deeds, mortgages, bonds, contracts or other instruments authorized by the Board of Directors; he shall prepare, or cause to be prepared, for use at meetings of shareholders the list of shareholders as of the record date referred to in Article I, Section 12 of these By-Laws and shall certify, or cause the transfer agent to certify, such list; he shall keep a current list of the Company's Directors and officers and their residence addresses; he shall be custodian of the seal of the Company and shall affix the seal, or cause it to be affixed, to all agreements, documents and other papers requiring the same. The Secretary shall have custody of the Minute Book containing the minutes of all meetings of shareholders, Directors, the Executive Committee, and any other committees which may keep minutes, and of all other contracts and documents which are not in the custody of the Treasurer or the Controller of the Company, or in the custody of some other person authorized by the Board of Directors to have such custody.

SECTION 15. Appointed Officers: The Board of Directors may delegate to any officer or committee the power to appoint and to remove any subordinate officer, agent or employee.

SECTION 16. Assignment and Transfer of Stocks, Bonds, and Other Securities: The Chairman of the Board, the President, the Treasurer, the Secretary, any Assistant Secretary, any Assistant Treasurer, and each of them, shall have power to assign, or to endorse for transfer, under the corporate seal, and to deliver, any stock, bonds, subscription rights, or other securities, or any beneficial interest therein, held or owned by the Company.

ARTICLE V

CONTRACTS, CHECKS, DRAFTS AND BANK ACCOUNTS

SECTION 1. Execution of Contracts: The Board of Directors, except as in these By-Laws otherwise provided, may authorize any officer or officers, agent, or agents, in the name of and on behalf of the Company to enter into any contract or execute and deliver any instrument, and such authority may be general or confined to specific instances; but, unless so authorized by the Board of Directors, or expressly authorized by these By-Laws, no officer, agent or employee shall have any power or authority to bind the Company by any contract or engagement or to pledge its credit or to render it liable pecuniarily in any amount for any purpose.

SECTION 2. Loans: No loans shall be contracted on behalf of the Company, and no negotiable paper shall be issued in its name unless specifically authorized by the Board of Directors.

SECTION 3. Checks, Drafts, etc.: All checks, drafts, and other orders for the payment of money out of the funds of the Company, and all notes or other evidences of indebtedness of the Company, shall be signed on behalf of the Company in such manner as shall from time to time be determined by resolution of the Board of Directors.

SECTION 4. Deposits: All funds of the Company not otherwise employed shall be deposited from time to time to the credit of the Company in such banks, trust companies or other depositories as the Board of Directors may select.

ARTICLE VI

STOCKS AND DIVIDENDS

SECTION 1. Shares of Stock: Shares of stock of the Company shall be represented by certificates except to the extent that the Board of Directors of the Company shall provide by resolution that some or all of any or all classes and series of the Company's shares shall be uncertificated shares, provided that such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the Company. Except as otherwise expressly provided by law, the rights and obligations of holders of uncertificated shares and the rights and obligations of the holders of certificates representing shares of the same class and series shall be identical.

SECTION 2. Certificates For Shares. To the extent that shares of stock of the Company are to be represented by certificates, the certificates therefor shall be in such form as shall be approved by the Board of Directors. The certificates of stock shall be numbered in order of their issue, shall be signed by the Chairman of the Board, the President, a Vice Chairman or a Vice

President, and the Secretary or an Assistant Secretary, or the Treasurer or an Assistant Treasurer. The signature of the officers upon a certificate may be facsimiles if the certificate is countersigned by a transfer agent or registered by a registrar other than the Company itself or its employee. In case any officer who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer before such certificate is issued, it may be issued by the Company with the same effect as if he were an officer at the date of issue.

SECTION 3. Transfer of Stock: Transfers of stock of the Company shall be made only on the books of the Company by the holder thereof, or by his duly authorized attorney, on surrender of the certificate or certificates for stock represented by certificates, properly endorsed, or in the case of shares of stock not represented by certificates, on delivery to the Company of proper transfer instructions. Within a reasonable time after the issuance or transfer of uncertificated stock, the Company shall send to the registered owner thereof a written notice containing the information required to be set forth or stated on certificates pursuant to the Business Corporation Law of the State of New York. Every certificate surrendered to the Company shall be marked "Canceled", with the date of cancellation, and no new certificate shall be issued in exchange therefor until the old certificate has been surrendered and canceled. A person in whose name stock of the Company stands on the books of the Company shall be deemed the owner thereof as regards the Company; provided that, whenever any transfer of stock shall be made for collateral security, and not absolutely, such fact, if known to the Secretary of the Company, or to its transfer agent shall be so expressed in the entry of the transfer. No transfer of stock shall be valid as against the Company, or its share-holders for any purpose, until it shall have been entered in the stock records of the Company as specified in these By-Laws by an entry showing from and to whom transferred.

SECTION 4. Transfer and Registry Agents: The Company may, from time to time, maintain one or more transfer offices or agencies and/or registry offices at such place or places as may be determined from time to time by the Board of Directors; and the Board of Directors may, from time to time, define the duties of such transfer agents and registrars and make such rules and regulations as it may deem expedient, not inconsistent with these By-Laws, concerning the issue, transfer and registration of certificates for stock or uncertificated stock of the Company.

SECTION 5. Lost, Destroyed and Mutilated Certificates: The holder of any certificated stock of the Company shall immediately notify the Company of any loss, destruction or mutilation of the certificate therefor. The Company may issue a new certificate or uncertificated stock in place of the lost or destroyed certificate, but as a condition to such issue, the holder of such certificate must make satisfactory proof of the loss or destruction thereof, and must give to the Company a bond of indemnity in form and amount and with one or more sureties satisfactory to the Treasurer, the Secretary or any Assistant Treasurer or Assistant Secretary. Such bond of indemnity shall also name as obligee each of the transfer agents and registrars for the stock the certificate for which has been lost or destroyed.

SECTION 6. Record Dates for Certain Purposes: The Board of Directors of the Company shall fix a day and hour not more than sixty days preceding the date of any meeting of shareholders, or the date for payment of any cash or stock dividend, or the date for the allotment of any rights of subscription, or the date when any change or conversion or exchange of capital stock shall go into effect, as a record date for the determination of the shareholders entitled to notice of, and to vote at, any such meeting and any adjournment thereof, or entitled to receive payment of any such dividend, or entitled to receive any such allotment of rights of subscription, or entitled to exercise rights in respect of any such change, conversion or exchange of capital stock, and in such case, such shareholders and only such shareholders as shall be shareholders of record on the day and hour so fixed shall be entitled to such notice of, and to vote at, such meeting or any adjournment thereof, or to receive payment of such dividend, or to receive such allotment of rights of subscription, or to exercise rights in connection with such change or conversion or exchange of capital stock, as the case may be, notwithstanding any transfer of any stock on the books of the Company after such day and hour fixed as aforesaid.

SECTION 7. Dividends and Surplus: Subject to the limitations prescribed by law, the Board of Directors (1) may declare dividends on the stock of the Company whenever and in such amounts as, in its opinion, the condition of the affairs of the Company shall render it advisable, (2) may use and apply, in its discretion, any part or all of the surplus of the Company in purchasing or acquiring any of the shares of stock of the Company, and (3) may set aside from time to time out of such surplus or net profits such sum or sums as it in its absolute discretion, may think proper as a reserve fund to meet contingencies or for equalizing dividends, or for the purpose of maintaining or increasing the property or business of the Company, or for any other purpose it may think conducive to the best interest of the Company.

ARTICLE VII

OFFICES AND BOOKS

SECTION 1. Offices: The Company shall maintain an office at such place in the County of Monroe, State of New York, as the Board of Directors may determine. The Board of Directors may from time to time and at any time establish other offices of the Company or branches of its business at whatever place or places seem to it expedient.

SECTION 2. Books and Records:

(a) There shall be kept at one or more offices of the Company (1) correct and complete books and records of account, (2) minutes of the proceedings of the share-holders, Board of Directors and the Executive Committee, (3) a current list of the Directors and officers of the Company and their residence addresses, and (4) a copy of these By-Laws.

(b) The stock records may be kept either at the office of the Company or at the office of its transfer agent or registrar in the State of New York, if any, and shall contain the names and addresses of all shareholders, the number and class of shares held by each and the dates when they respectively became the owners of record thereof.

ARTICLE VIII

GENERAL

SECTION 1. Seal: The corporate seal shall be in the form of a circle and shall bear the full name of the Company and the words and figures "Incorporated 1906, Rochester, N. Y."

SECTION 2. Indemnification of Directors and Officers: Except to the extent expressly prohibited by law, the Company shall indemnify any person, made or threatened to be made, a party in any civil or criminal action or proceeding, including an action or proceeding by or in the right of the Company to procure a judgment in its favor or by or in the right of any other corporation of any type or kind, domestic or foreign, or any partnership, joint venture, trust, employee benefit plan or other enterprise, which any Director or officer of the Company served in any capacity at the request of the Company, by reason of the fact that he, his testator or intestate is or was a Director or officer of the Company or serves or served such other corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, in any capacity, against judgments, fines, penalties, amounts paid in settlement and reasonable expenses, including attorneys' fees, incurred in connection with such action or proceeding, or any appeal therein, provided that no such indemnification shall be required with respect to any settlement unless the Company shall have given its prior approval thereto. Such indemnification shall include the right to be paid advances of any expenses incurred by such person in connection with such action, suit or proceeding, consistent with the provisions of applicable law. In addition to the foregoing, the Company is authorized to extend rights to indemnification and advancement of expenses to such persons by i) resolution of the shareholders, ii) resolution of the Directors or iii) an agreement, to the extent not expressly prohibited by law.

ARTICLE IX

FISCAL YEAR

SECTION 1. Fiscal Year: The fiscal year of the Company shall end on the 31st day of December in each year.

ARTICLE X

AMENDMENTS

SECTION 1. Amendments: By-Laws of the Company may be amended, re-pealed or adopted by a majority of the votes of the shares at the time entitled to vote in the election of any Directors. If, at any meeting of shareholders, action is proposed to be taken to amend, repeal or adopt By-Laws, the notice of such meeting shall include a brief statement or summary of the proposed action. The By-Laws may also be amended, repealed or adopted by the Board of Directors, but any By-Law adopted by the Board may be amended or repealed by shareholders entitled to vote thereon as hereinabove provided. If any By-Law regulating an impending election of Directors is adopted, amended or repealed by the Board of Directors, there shall be set forth in the notice of the next meeting of shareholders for the election of Directors the By-Law so adopted, amended or repealed, together with a concise statement of the changes made.

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM XEROX CORPORATION'S MARCH 31, 1999 FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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	MAR-31-1999	106
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