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Xerox Holdings Corp. (XRX)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by, and welcome to Xerox Holdings Corporation's Third Quarter Earnings Conference Call. At this time, all participants are in listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] As a reminder, today's program is being recorded.

And now, I'd like to introduce your host for today's program, Mr. David Beckel, Vice President of Investor Relations. Please go ahead, sir.

David Beckel

Vice President & Head-Investor Relations, Xerox Holdings Corp.

Good morning, everyone. I'm David Beckel, Vice President and Head of Investor Relations at Xerox Holdings Corporation. Welcome to the Xerox Holdings Corporation's third quarter 2024 earnings release conference call hosted by Steve Bandrowczak, Chief Executive Officer. He's joined by John Bruno, President and Chief Operating Officer; and Xavier Heiss, Executive Vice President and Chief Financial Officer.

At the request of Xerox Holdings Corporation, today's conference call is being recorded. Other recording and/or rebroadcasting of this call are prohibited without the expressed permission of Xerox. During this call, Xerox executives will refer to slides that are available on the web at www.xerox.com/investor, and will make comments that contain forward-looking statements which, by their nature, address matters that are in the future and uncertain. Actual future financial results may be materially different than those expressed herein.

At this time, I'd like to turn the meeting over to Mr. Bandrowczak.

Steven John Bandrowczak

Chief Executive Officer & Director, Xerox Holdings Corp.

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Good morning, and thank you for joining our Q3 2024 earnings call. The benefits of Reinvention are driving improved financial results, albeit at a slower pace than expected. Positive proof points from the quarter include a second consecutive period of moderating revenue declines, year-over-year improvements in adjusted operating income and income margin, and more than 100% free cash flow conversion from adjusted operating income. Further, the pending acquisition of ITsavvy is expected to improve our mix of revenue from complementary, value-add businesses with higher underlining rates of revenue growth.

Summarizing results for the quarter, revenue of $1.5 billion decreased 7.5% in actual currency and 7.3% in constant currency. Excluding the impact of year-over-year fluctuations in backlog and reductions in non-strategic revenue associated with the Reinvention, core business revenue declined low-single digits, and at a pace consistent with the prior quarter.

Adjusted EPS was $0.25, $0.21 lower year-over-year, due primarily to the one-time sale of non-core business assets in the prior year quarter. Free cash flow was $107 million, $5 million lower year-over-year, and adjusted operating margin of 5.2% was higher year-over-year by 110 basis points, reflecting the benefits of organizational simplification.

The Reinvention of Xerox is difficult, but necessary. Reinvention is a multiyear journey to sustainably streamline operations while positioning the company to benefit from favorable long-term trends within print, digital and IT services. Progress has been steady and confirmatory of our original thesis, but the financial proof points of the strategy's success are not unfolding in a linear fashion. This quarter, print equipment sales fell below expectations due to delays in global launch of two new products and lower-than-expected improvements in sales force productivity.

Tactical challenges associated with the timing of Hurricane Helene and increase in competitive activity in certain markets also contributed to the shortfall. We have analyzed the factors that contributed to the product launch delays and are confident those factors will be resolved as we recalibrate global product launch plans. And despite lower productivity improvement than expected in Q3, we are confident ongoing sales efficiency and effectiveness programs will drive productivity sustainably higher in 2025 and beyond.

Shortfalls in equipment sales mask the breadth of Reinvention progress made to-date, much of which is expected to reveal itself in our annuity revenue streams and a sustaining lower cost base over time. In quarter three, we made progress along each of our strategic priorities, in furtherance of our long-term Reinvention goals.

Starting with the stronger core. A key tenet of Reinvention is closer alignment between our organization and the economic buyers of our products and services. We realized early in our Reinvention that a refined sales coverage model and investment in client perception and sales force productivity were required to more efficiently and effectively serve clients' needs in a rapidly evolving print and workplace services landscape.

The realignment of our sales organization has not been as smooth as we would like, but we are seeing encouraging signs that a leaner, more focused sales team can deliver improved client outcomes and more efficiently than in the past. While sales productivity fell short of our expectation in Q3, it has improved year-to-date through a greater end market focus and a reduction in administrative burden. We expect the cumulative effect of productivity actions taken to-date, future scale efficiencies, including additional capacity in our dedicated virtual sales center, and other initiatives designed to foster incremental client interactions, will drive sales productivity higher than Q3 levels in Q4 and into 2025.

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Net Promoter Score, a key barometer of client perception, has improved 11 points this year in the Americas, through increased client engagement and integrated sales and marketing outreach. The increase reflects improved client satisfaction and a brand consideration, which we expect will drive an increase in purchase intent from clients that understand and appreciate our position in the market as a leading provider of print, digital and IT workflow efficiency solutions.

We see evidence of the strength of our value proposition with clients most prominently in our services metrics. In the last 12 months, our revenue retention rate for large client renewals remained above 100%, meaning, on average, clients are buying more print and digital solutions from us when renewing long-term service contracts.

Our portfolio of digital and managed IT services continues to resonate strongly with clients. In Q3, digital services new business signings were up double digits, with renewal rates above plan, and digital and managed IT services revenue also grew double digits, reflecting sustained signings growth in the current and prior periods. And the pending acquisition of ITsavvy is expected to drive growth as we leverage an improved, expanded portfolio of IT services to grow penetration with existing clients.

Moving to cost improvements. Operating expense decreased more than $50 million year-over-year in Q3 and $125 million year-to-date, reflecting the benefits of strategic actions taken in the prior year, current year reductions in head count associated with the structural reorganization of our business, and ongoing operating efficiencies, driven by our Global Business Service (sic) [Services] organization.

Certain Reinvention actions taken this year have resulted in reduction of revenue. For example, the transition from direct to indirect distribution in certain markets, as is the case with geographic simplification; or measures taken to simplify our offerings, as was the case with our decision to exit the manufacturing of certain production equipment.

Our intent with these actions is to reduce the level of operating expense that previously supported those activities by a greater amount than the associated reductions in gross profit. While still early, we are beginning to see this thesis play out in our financial results. At a total company level, adjusted operating income improved this quarter despite a reduction in revenue. We expect this trend to continue in quarter four.

In future years, we expect our pipeline of more than $400 million of gross cost savings that have either been actioned, but not yet realized in results, or have been identified for future implementation to support operating income growth.

Finally, balanced capital allocation. This quarter, we generated more than $100 million of free cash flow, including the benefits of reduction in finance receivables, marking the fourth consecutive quarter of more than 100% free cash flow conversion from adjusted operating income. We continue to make progress sourcing finance receivable funding agreements outside the US, including a recently signed agreement to sell future finance receivable originations in Canada to De Lage Landen Financial Services Canada Inc.

Balance sheet health improved again this quarter, as we reduced our debt balance quarter-over-quarter. The pending acquisition of ITsavvy will be funded in part with debt, but is expected to be leverage-neutral in a little more than a year and deliver a return on capital well in excess of our weighted average cost of capital.

I will now hand the call over to John Bruno.

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John G. Bruno

Chief Operating Officer, President & Director, Xerox Holdings Corp.

As Steve noted, this quarter equipment sales fell short of expectations for two main reasons. We had higher expectations of global product launches that were impacted by poor product transition planning and execution. Through our postmortem, we are taking deliberate steps to optimize price and marketing programs by specific go-to-market areas to ensure improved demand, to supply chain readiness that will complement market-specific launches.

We also had higher expectations of our sales productivity initiatives in Q3, given the improvement we realized in Q2 after the Q1 organizational changes. We were essentially flat quarter-on-quarter on activity basis, and that was not sufficient to offset the reductions in sales head count. We have analyzed these points of friction from lead generation, quote to order and order to install. We've aligned process improvement teams and we are course correcting these areas of underperformance. We are seeing the positive impact of that work, albeit more slowly than originally forecasted.

While productivity stalled in Q3, we do expect these operational process improvements to drive sales productivity higher in Q4 and into 2025. We make no excuses for our underperformance in equipment sales, and these operational misses overshadow broader strategic improvements elsewhere. On balance, I'd like to highlight other strategic areas of Reinvention where we are seeing the forecasted results of our efforts.

Starting with geographic simplification. This quarter, we transitioned two additional countries, Hungary and Bulgaria, from a direct to an indirect distribution model. We also signed an agreement to sell our paper business in EMEA to a leading global paper supplier, Antalis. These transactions and others expected in quarter four allow us to provide partners in EMEA with the products and services clients demand most, and with greater operating efficiency.

Moving to offering simplification. With the recent launches of our A4 300 series and refreshes of our A3 Altalink and Primelink products, we are streamlining our offerings in the office and light production categories.

For example, the updated 300 series printers share a common engine with our 400 series, reducing spare parts SKUs by 20%. Software enhancements included with the updated Altalink products eliminate the need for physical installation kits and simplify the installation process. And our new Primelink machines offer a wider range of engine speeds, features and capabilities, improving competitiveness and marketability. The consolidated configurations and enhanced capabilities of these respective products make them more competitive, and improve order and inventory management as well as marketing efficiency.

Additionally, we continue to refine our production print equipment portfolio. We've engaged with leading print engine manufacturers to broaden our production print ecosystem. And this quarter, we announced our planned collaboration with Taktiful Software to integrate their digital embellishment technology for our clients.

We anticipate revealing more partnerships within the production print segment in the coming year as we invest in a platform featuring services-led and software-enabled products. For example, our pipeline includes cloud hosted versions of FreeFlow Core to include an AI framework for workflow automation, application expansions into adjacencies like packaging and labels, as well as SaaS-based offerings.

And finally, operating model simplification. Our Global Business Service (sic) [Services] organization, or GBS, is performing as intended and finding ways to leverage a simpler operating model to drive long-term, enterprise-

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wide efficiencies. A key driver of long-term Reinvention savings will be the optimization of our technology and support infrastructure.

Last quarter, we signed agreements with multiple technology partners to transform our operations with a technology-led process improvements. And building on that announcement, this quarter GBS restructured an agreement with a key business process outsourcing partner, creating a mutually beneficial incentive structure to save costs through operating efficiencies. This new service structure is expected to yield a double-digit improvement in contracted rates and will serve as a blueprint for driving sustainable organizational savings.

Collectively, these savings are expected to drive more than $700 million of cumulative gross Reinvention savings over the next few years, putting us on a path to achieve double-digit adjusted operating income margins over the course of our Reinvention. We will continue to exercise balanced execution in the implementation of these initiatives to minimize operational disruption.

And finally, revenue mix. Beyond cost reduction, an equally important tenet of our Reinvention is an improved revenue mix that enables better client outcomes. To that end, two weeks ago, we announced the acquisition of ITsavvy. The acquisition of ITsavvy expands our portfolio of IT service offerings and our addressable market coverage.

With ITsavvy, we acquire an accomplished management team with a demonstrated ability to deliver positive results through its suite of lifecycle, deployment and managed services across key IT infrastructure pillars of cloud hosting, network and security, collaboration and the hybrid workplace. We expect to leverage this platform and improved scale to drive increased penetration of IT services across a client base who increasingly look to Xerox to provide these types of solutions.

The acquisition will be funded with cash on hand and a combination of seller notes. We expect to quickly realize more than $15 million of cost synergies as we consolidate IT service operations and adopt ITsavvy's operating platform.

Along with revenue synergies from expanded client penetration, we expect an enhanced IT services offering. This will improve client satisfaction and stability in our core print business, as clients are able to realize more value from a services partner that can be a one-stop shop for their most critical print and IT infrastructure needs. The acquisition is expected to be immediately accretive to earnings per share and free cash flow, and we look forward to welcoming the ITsavvy team to Xerox at the end of this year.

I'll now hand the call over to Xavier.

Xavier Heiss

Chief Financial Officer & Executive Vice President, Xerox Holdings Corp.

Thank you, John, and good morning, everyone. In Q3, total revenue declined 7.5% in actual currency and 7.3% in constant currency on a year-over-year basis. As Steve described, equipment revenue this quarter fell short of expectations. However, the trajectory of post-sale revenue improved, as expected, reflecting growth in digital and managed IT services.

Turning to profitability. Gross margin was flat year-over-year as higher freight costs, unfavorable equipment mix and lower print volumes were offset by the beneficial impact of Reinvention savings and favorable currency effects.

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Adjusted operating margin of 5.2% was 110 basis points higher year-over-year, due principally to Reinvention-related cost reductions and lower incentive compensation expense, partially offset by the effect of lower revenue and gross profit. Total operating expenses in Q3 declined $53 million year-over-year, or more than 10%, reflecting head count and other non-labor expense reductions associated with recent Reinvention action.

Adjusted other expenses net were $55 million higher year-over-year due to an increase in non-finance interest expense, reflecting higher interest rate and a lower portion of debt allocated to our financing business. The increase also reflects a gain on the sales of non-core business assets recorded in the prior year. Adjusted tax rate of 27.7% compared to 7.2% in the same quarter last year. The increase in rate reflects non-recurring tax benefit associated with uncertain tax position and the establishment of a valuation allowance against the current year deferred tax asset.

Adjusted EPS of $0.25 was $0.21 lower than the prior year, as the benefits of higher adjusted operating income and a lower share count were more than offset by higher non-financing interest expense, a higher tax rate and the prior year gain on sales of non-core business assets. GAAP loss per share of $9.71 included an after-tax non-cash goodwill impairment charge of approximately $1 billion, or $8.16 per share, and a charge to tax expense related to the establishment of a valuation allowance of $161 million, or $1.29.

Regarding the goodwill impairment, it was determined, following a sustained period in which our market value fell below book value, that the fair value of our Print and Other segment has fallen below carrying value. The valuation allowance was established against deferred tax assets that are not expected to be realized in certain international jurisdictions.

Let me now review revenue and cash flow in more detail. Starting with revenue. Q3 equipment sales of $339 million declined around 12% in actual and constant currency. The effect of backlog fluctuations in the current and prior year and Reinvention actions accounted for around 400 basis points of the decline. The remainder of the decline mainly reflects the delayed global launch of two new products, lower than expected improvement in sales force productivity, delays in the timing of installation associated with Hurricane Helene, unfavorable mix and the large production equipment sales in the prior year.

Total equipment activity increased 17% year-over-year due largely to entry level equipment. Entry revenue declined despite higher installation, due to an increase in the mix of low-end black and white multi-function printer. Mid-range installation were slightly lower year-over-year, but revenue declined faster than installations due to unfavorable A3 product family mix. High-end revenue decline reflect the ongoing evolution of our production print portfolio and offering rationalization action taken this year.

Post-sale revenue of $1.2 billion declined mainly 6% in actual and constant currency, a roughly 200 basis point sequential improvement. Excluding a reduction of non-strategic, lower margin paper and IT endpoint device placement and the effect of other Reinvention actions, Post-sales revenue declined 2% in actual currency, reflecting lower activity, partially offset by double-digit growth in digital and managed IT services revenue, as well as higher services pricing.

Consistent with past quarter, I will provide additional commentary to help clarify underlying trends in our core businesses, which exclude the effect of backlog fluctuations and Reinvention actions. For Q3, lower sales of non-strategic paper, IT endpoint device and decline in finance revenue, reflecting the change in our finance receivable strategy, contributed around 200 basis point to the decline.

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Other strategic action taken to simplify our business and improve profitability, including geographic and offering simplification, contributed around 200 basis point to the decline. Finally, the effect of equipment backlog fluctuations in the current and prior year quarters contributed less than 100 basis points to the year-over-year decline in total revenue. When these impacts are removed, total revenue declined low-single digits in actual currency, consistent with the prior quarter.

Let's now review cash flow. Free cash flow was $107 million, lower by $5 million year-over-year. Operating cash flow was $116 million, $8 million lower than the prior year quarter, due to lower contribution from working capital and higher pensions payment, partially offset by higher adjusted operating income and cash from finance receivables.

Investing activities were a use of cash of $7 million compared to a source of cash of $25 million in the prior year, largely reflecting a prior year sales of non-core business assets. Financing activity consumed $74 million this quarter, reflecting $42 million of net debt repayment and dividend of $36 million.

Turning to segments. In Q3, XFS revenue was down around 10% year-over-year due to lower finance income and other fee revenue associated with a decline in our finance receivable balance, partially offset by higher commission from the sale of finance receivable assets, in line with our forward flow strategy.

XFS' finance receivable balance declined roughly 3% sequentially and 23% year-over-year in actual currency, mainly due to XFS' change in strategy to return its focus to captive-only financing solution. Q3 XFS segment profit increased by $9 million, as a reduction in bad debt expense and lower operating expenses more than offset reductions in gross profit associated with lower revenue. Print and Other revenue fell roughly 7% and segment profit increased by around 5% for the reasons previously mentioned.

Focusing on capital structure. We ended Q3 with $590 million of cash, cash equivalents and restricted cash. Around $2 billion of the remaining $3.3 billion of outstanding debt support our finance assets, with the remaining debt of $1.3 billion attributable to the non-financing business.

I now provide an update on Reinvention savings. For 2024, we expect to realize close to $200 million of incremental gross cost savings. Since the prior quarter, we have operationalized an additional $20 million of savings, much of which will be realized in 2025. We maintain a pipeline of more than $400 million of gross cost savings that are expected to be realized by 2026, with around $125 million related to actions already implemented or expected to be implemented in the near term.

Finally, I will address guidance for the remainder of the year and comment on expectation for 2025. All 2024 commentary excludes the effect of the pending acquisition of ITsavvy. For revenue, we now expect a decline of around 10% in constant currency versus a decline of 5% to 6% in constant currency, previously. Around 75 basis points of the decrease in guidance is attributable to incremental effects associated with intentional reduction in non-strategic revenue. The remainder of the decline reflect the delayed launch of two new products and lower-than-expected sales force productivity improvement.

Full year revenue guidance now include around 625 basis points of effects from non-recurring headwinds associated with backlog fluctuation in the prior year and current year, reduction in non-strategic revenue and other Reinvention actions. For the year, the roughly 4% of expected year-over-year decline in core business revenue indicates a mid-single-digit decline in normalized equipment sales and a low- to mid-single-digit decline in normalized post-sales revenue.

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We expect a return to revenue growth in 2025, supported by the inclusion of revenue associated with the pending acquisition of ITsavvy, new product launches, improved sales productivity, and growth in digital and IT services. Inorganic revenue benefit from ITsavvy are expected to more than offset reduction in revenue associated with ongoing Reinvention actions, as the impact of strategic reduction in revenue are expected to be lower in 2025 than they were in 2024.

For full year adjusted operating income margin, we now expect a margin of around 5% versus our prior outlook of at least 6.5%, reflecting the effects of gross profit decline associated with the reduction in our equipment revenue outlook and, to a lesser extent, delays in the implementation of certain cost reduction initiative to 2025.

Due to lower-than-expected revenue in 2024, we no longer expect to grow adjusted operating income $300 million above 2023 level by 2026. However, we continue to expect growth in adjusted operating income and a return to double-digit adjusted operating income margin over the course of our Reinvention.

In 2025, we expect growth in adjusted operating income and margin, supported by a return to revenue growth and the benefit of additional gross cost savings associated with cost reduction action implemented in 2024 or expected to be implemented in 2025. Finally, full year free cash flow guidance was reduced from at least $550 million to a range of $450 million to $500 million, reflecting the previously noted reduction in adjusted operating income guidance.

In summary, 2024 has presented unexpected challenges. However, in Q3, we grew adjusted operating income and margin year-over-year despite a reduction in revenue, a trend we expect to continue as we implement further Reinvention actions aimed at simplifying our organization and driving closer alignment to the economic buyers of our products and services.

We'll now open the line for Q&A.

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QUESTION AND ANSWER SECTION

Operator: Certainly. And our first question for today comes from the line of Ananda Baruah from Loop Capital. Your question, please.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Yeah. Hey guys. Good morning and thanks for taking the question. I guess two, if I could, on the product – the first is on the product delay and on the sales productivity dynamics that you guys talked to. And you did give a lot of good context around it. I guess, the question is, if you mentioned I missed it, like specifically on the product delay, what was it that you guys saw as occurring? And I guess, sort of in that context, what did you learn that can sort of have sort of these dynamics not pop up again?

And then, I guess, also on the sales productivity, any greater specificity around what actually occurred that surprised you guys, that sort of led to the diminished sales productivity? And then, I have a quick follow-up as well. Thanks.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

Hey, Ananda. Steve. Thank you for the question. And I'll turn it over to John in a minute for some specifics. But I just want to remind you, look, the Reinvention is a multiyear journey. And inside that multiyear journey, the ultimate strategy is to get to sustainable revenue growth and get to double-digit operating income. As part of that, we've made some progress in each of the areas, you think about what we're trying to do in our revenue mix. ITsavvy gives us a great platform for seeing IT services growth over the next couple years. We also saw good impact of operating expense reduction quarter-over-quarter and year-over-year.

My point is that inside of Reinvention, we have multiple work streams, some of which will exceed, some of which will be set back, but we will ultimately get to our end goal. Specifically to the product launch and to revenue in terms of productivity, we made very large organizational changes at the end of Q1, very specifically realigned almost 6,500 new jobs in terms of new alignment. And we had a very large reduction in our workforce, which is basically the premise of what caused the reduction. We saw a quarter-over-quarter productivity improvement from Q1 to Q2 and from Q2 to Q3.

John, other color you want to give.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

Sure. Ananda, let me go – start with the product transition issue first. It's a forecasting issue more than anything else. When we look at carried inventory of predecessor products, the timing of the release of new products and the forecasting of that mix, there's a lot of intricacies between the demand to supply signaling. We had higher expectations that we were going to flush through the older product and then the timing of the release of the new product, not only to our direct business, but also into the channels.

As that start to get subsequently through the quarter, we would have a decision to make, and the decision clearly what we don't want to do is leave a lot of working capital and inventory behind, we want to sell through and make

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those transitions. That is a skill and something that we typically do as a company better than we perform, and a lot of that is attributed to the points that Steve has made.

We just did not have a really good sense of the timing of each of those issues, and it left us with a little bit of time towards the end of the quarter to actually make the effective change. At the start of the quarter, we were more bullish that in the last six weeks, we would have a higher ramp than we actually received. And so, that really comes down to the transition period between the demand to supply signaling.

And then I think Steve addressed the issue on sales force productivity. Coming out of – we look at it from a quota-bearing sales head count perspective, and we were down double digits in the number of sellers year-on-year coming into the year, and we've settled that down with new territory assignments, new remapping, new account coverage, and all of that. And as all of these things come in, that really also comes down to the forecasting and the timing and the knowledge of your clients.

And a lot of that we saw, which was a more aggressive view of where we thought equipment sales revenue would be at the start of the quarter. And then as the quarter continued to progress, we were taking a lot more of our upside and replacing it with some of the forecast at the beginning of the year, which is a good thing on balance. But when you're as close to the pin as we are, you just need a few misses here and there, and it's the difference between tens of millions of dollars and nothing more on that when you really come down to it on a quarterly basis.

So, really, what gives me the confidence is, is when I look at that, we did not have a good Q1, as you know; Q2, we had a much better productivity basis from an activity level. When I looked at Q3, I had expectations that Q3 was going to build off of Q2, and it was essentially flat over Q2. And so, we dissected the programs necessarily to what caused that flatness. We certainly didn't go down. But it kind of gives me confidence that we stabilized. So now, it's all about the incremental activities and we're doing it around the sales force demand generation and all the forecasting accuracy that gives us the confidence that we're moving forward.

Xavier Heiss
Chief Financial Officer & Executive Vice President, Xerox Holdings Corp.
A

Yeah. Ananda, I also would like – yeah.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Yeah, yeah, please.

Xavier Heiss
Chief Financial Officer & Executive Vice President, Xerox Holdings Corp.
A

Yeah. Ananda, I also would like to...

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

Yeah, we're all jumping on this one.

Xavier Heiss
Chief Financial Officer & Executive Vice President, Xerox Holdings Corp.
A

Yeah. Sorry, Ananda. Just also to reinforce one point. So, you know that our revenue is made of ESA which is roughly 25% of the total revenue. 75% is coming from post-sales. So when you look at during this year, the ESA

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revenue trajectory from a growth point of view, quarter-over-quarter, sequential growth there, the trajectory has improved. And despite the challenges that John and Steve have articulated in Q3, it was still an improvement versus what we have seen in Q1 and Q2.

On the post-sales revenue, we're also pleased to see that the post-sales revenue stream related to – despite and related to all the Reinvention activities that we are driving, is improving quarter-over-quarter. So, the key message behind this is the Reinvention play is at play currently. And we are delivering, specifically on the post-sales line, the nature of the equipment revenue is that it could be cyclical. And here, we have an example and we face it during quarters.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

That's all super-useful context and I really appreciate it. So, just quick follow-up to that, and then I'll cede the floor. Any sense of sort of macro or the general market demand backdrop was a bit softer and if that was also a contributor to the sort of, John, the flattening Q-over-Q and sort of efficiency progression – sales efficiency...

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

No.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

...progression?

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

Yeah, Ananda, I would say minimal.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Okay. Got it.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

I would say minimal.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

About the same.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

Mostly just execution issues.

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John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

About the same. I'd love to blame the macro. It's about the same.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Got it. Thanks, guys.

Operator: Thank you. And our next question comes from the line of Erik Woodring from Morgan Stanley. Your question, please.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC
Q

Great. Thanks so much for taking my question this morning. I have two, if I may. Maybe just to start, Steve. If we step back, you guys are doing a lot, right? You're exiting businesses. You're changing the delivery model in several regions. You're reducing head count. You're launching new products. You're acquiring new businesses. And then, this is all happening at the same time while your end markets do face demand headwinds. And that's tough and I credit you for taking all these actions.

But as I think about kind of your preliminary comments on 2025, you're setting an expectation for revenue growth, operating income growth and margin expansion. And I'm just wondering why you think that is the right expectation to set today, given everything that's happened in the background and, obviously, given some of the challenges that you've run into this year, which some – you could theoretically face next year as you continue to go through this Reinvention.

So just maybe the question is, amidst all of these changes and moving pieces, what gives you the confidence to say we can get back to growth and margin expansion next year? And then, I have a follow-up please.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.
A

So, thanks for the question. [indiscernible] (00:38:08) a couple of things. First of all, it's the management team that's done it over and over through the history of our careers. We've got pattern recognition that the things that we've put in place, we can see the future. Things you can't see internally that we see, around the program execution, around the signs of what we're building and how we're executing.

So overall, if you think about the Reinvention, very similar to Own It, by the way, where we had 10, 11 work streams, you see 7 or 8. They're going to exceed three or four. They're going to under-exceed expectations, but overall you deliver the end results. And so, what we're seeing is the strategical things that we're doing.

Go back to what we did with our free cash flow, what we did with PARC, all these things are very specific to set up the strategic long-term revenue growth and get us to the operating income that we desire. So, as we look at each of the work streams, we're seeing it on the expense line, the cost coming out, you see it definitively. You see on the acquisition, working that in the background to be able to acquire ITsavvy. You see what we're doing in terms of dramatically changing our sales coverage and what's that doing in terms of building new pipeline, building new customers.

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And so, I'm confident that what we're doing is working. It's not linear and it's not straight. That's the challenge with trying to do this, taking a three-year program and then looking at it in an isolated quarter. But I can see the long-term returns over the next couple of years and what we're trying to do, the evidence and the things that we're trying to do. And more importantly, the pattern recognition of everything we've done across our careers that says we're on the right track.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Super. Thank you, Steve. And then, maybe just as a quick follow-up or just point of clarification. So, you guys have adjusted EBITDA margins close to 9%. I believe that just with the disclosures that you provided on ITsavvy, EBITDA margins are around 7%. So, you guys talked about this asset being – excuse me, accretive immediately.

Can you just help us understand some of the math that you're getting to that accretion in terms of the revenue synergies? I know you alluded to some cost synergies, but if you could just kind of, in totality, help us understand the assumptions around this being accretive, that would be super helpful. Thank you.

Xavier Heiss
Chief Financial Officer & Executive Vice President, Xerox Holdings Corp.

A

Yeah, Erik, I will give you some insight on the ITsavvy, the size of the acquisition, the revenue, and also the expected synergy here. So if you remember in the press release, we mentioned – and we mentioned it in the earnings call as well here, this is a company which is around $440 million, $450 million revenue LTM and around $30 million EBITDA as they are currently here.

We're expecting to deliver around $15 million of synergy here. So when you include [ph] the sales and (00:40:51) you will see what type of EBITDA they can bring and the EBITDA margin versus the revenue, which would be above like 9% here. So, it will become accretive immediately versus our current number.

They are also – from a pure free cash flow point of view, they will be accretive to us there, and obviously EPS will follow directly here. So, the point I want to flag there from a gross margin point of view, so business model is different, less gross margin, but also less OpEx. So, at the end of the day, EBITDA is the metrics to look at. Bottom line, this is what we will see, and it will drive an improvement in our financial that we will capture immediately. So, starting as soon as this transaction is closed, which we are expecting to happen quite soon.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

And Xavier, maybe just one final point of clarification. As we incorporate ITsavvy into the model, is that – I assume, flows through services, maintenance, and rentals line, just as we think about our model? I just want to make sure we're kind of incorporating that correctly. Thanks.

Xavier Heiss
Chief Financial Officer & Executive Vice President, Xerox Holdings Corp.

A

Yeah, we will distribute it in the same way we do it today. So, there is an element of hardware, which is going into a different line, but the bulk of the revenue here. David and the team – the IR team can help you with this one, on how we will do the pro forma, but it is very similar to the way we will do it. As you know it as well, next year we are planning to have [indiscernible] (00:42:10) segment reporting. And this is an important point because, at the end of the day, ITsavvy is just a proof point that our Reinvention strategy is at play.

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With ITsavvy, this IT or digital services here for the total company will become 15%. So, we will move – we'll jump by 5%. Currently, this is 10%. We'll have an additional 5%. And you remember, the trajectory that we have guided for is that during the Reinvention program, we want to achieve 20% of revenue, which are not print related. And this is literally the first step in this direction, significant step here.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Awesome. Thank you so much.

Operator: Thank you. [Operator Instructions] As it appears that we don't have any further questions in the queue at this time, I'd like to hand the program back to Steve Bandrowczak for any further remarks.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

Thank you. Recapping today's call, equipment sales fell short of our expectation this quarter and for the year, but we are confident we have identified and addressed the factors that contributed to these shortfalls. We expected an improved equipment revenue trajectory and the pending acquisition of ITsavvy to drive a return to revenue growth in 2025.

This quarter reminds us no single performance indicator or quarterly results defines our Reinvention. Consistent progress and operating efficiencies, client perception, services signings, and expected sales force productivity gains gives us confidence we are on the path to enabling long-term profitable growth through Reinvention.

Thank you very much for attending this call.

Operator: Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.

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