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XRX - Q4 2013 Xerox Corporation Earnings Conference Call

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OVERVIEW:

XRX reported 4Q13 GAAP EPS of $0.25. Expects 1Q14 EPS to be $0.23-0.25.

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PRESENTATION

Operator

Good morning, and welcome to the Xerox Corporation fourth-quarter 2013 earnings release conference call hosted by Ursula Burns, Chairman of the Board and Chief Executive Officer. She is joined by Kathy Mikells, Executive Vice President and Chief Financial Officer.

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

After the presentation there will be a question-and-answer session. (Operator Instructions). During this conference call Xerox executives will make comments that contain forward-looking statements which by their nature address matters that are in the future and are uncertain. Actual future financial results may be materially different than those expressed herein. At this time I would like to turn the meeting over to Ms. Burns. Ms. Burns, you may begin.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Good morning and thanks for joining the call. Today we are reporting our fourth-quarter earnings that are largely in line with the expectations that we communicated last quarter. We manage the anticipated impact of headwinds in a handful of businesses while we continue to build in areas of strength and future profits. Let's begin with a review of the strategy.

Our shift to a services led company requires us to constantly enhance our offering and deliver unique Xerox solutions to our customers. They partner with us because we help them take the complexities out of their business processes. For example, we're simplifying services in government healthcare with Enterprise, our system for Medicaid. And we are creating smart parking solutions like Merge, a real-time analytics-based technology that addresses urban parking challenges.

Our managed print services have been awarded highest honors for global market leadership by industry analyst firms, a distinction that validates the strength of our document outsourcing business. In our services business we are continuing with the implementation of the five plank strategy that we reviewed at the November investor conference, which includes improving our cost structure while supporting investments in areas where we see opportunity and differentiated benefits for our customers.

We're maintaining our leadership in document technology and effectively managing this profitable business with strong cash characteristics. With a robust portfolio we are capturing market share with new products like ConnectKey, we are transforming the graphic communications business with new workflow and digital automation services, and we're growing our channels operations to expand our reach to small and medium businesses. And across both segments, services and technology, we have a keen focus on profitability.

Delivering on these strategies will enable consistent earnings expansion and strong cash flow, which we are committed to deploy in a balanced way that will enhance shareholder value.

Here is a closer look at Q4 results. We reported adjusted EPS of $0.29 and GAAP EPS of $0.25, with the difference being the amortization of intangible assets. Total revenues were down with services flat as the student loan runoff continues and we saw no benefit from acquisitions in our revenues. Services operating margins was lower than we planned and, although they were driven by known issues, this is an area where we need to make more structural progress; it's a constant focus for us.

Services signings were up 20% for the year. BPO and ITO renewal rates were at 92% and above our target range of 85% to 90% -- both positive results that position us well for 2014. In document technology revenues stabilized with positive results in global imaging and graphic communications while (inaudible) weaknesses in developing markets in Europe.

Segment margins remained strong and above our target range reflecting strong cost management and expense management. In total operating margin was down 130 basis points year-over-year. A decline in margin was anticipated given known headwinds, but nonetheless emphasizes why we are undertaking our margin improvement strategy and our continued need for disciplined focus on operational excellence.

Cash flow from operations came at the high-end of the full-year range and we ended the year with $700 million of share repurchases. As we look to 2014 I'm pleased with the strategy that we have got in place to expand earnings. I'm confident that we have all that it takes to move our business forward and deliver value to our shareholders.

With that let me turn it over to Kathy. Then I will wrap up and we will open up the call for questions.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Thanks, Ursula, and good morning, everyone. Much of Q4 played out as we expected with the exception of services margin where we have more work to do. We hit our EPS and cash flow guidance and got a bit more done on share repurchases. We feel good about the continued positive trends and leading indicators, our strong cash flow and the progress we are making implementing our services initiative to accelerate growth and improve margin in 2014.

Let's start with a look at overall earnings. Revenue was down 3% or 4% at constant currency with services flat year-over-year or down 1% at constant currency and document technology down 6%. For the full year services was up 3% and document technology was down 6%. Document technology declines were roughly in line with the full year and services revenue growth decelerated as we faced a number of known headwinds that we guided to last quarter.

Gross margin of 30.7% declined 130 basis points year-over-year driven by continued pressure on services margins from start up of healthcare platform projects, student loan runoff as well as from volume decline, with higher pension settlement costs impacting primarily document technology.

Our ongoing productivity initiatives drove improvements in RD&E and SAG in line with the decline in revenue. This resulted in operating margin of 9.3%, down 130 basis points year-over-year, consistent with the decline in gross margin. Adjusted other net was $96 million, down $74 million year over year. There's a couple of drivers here.

Within OID there is a gain of $29 million associated with the sale of a portion of our Wilsonville, Oregon assets and product development resources. This was a win-win arrangement that enabled us to right size our resources and further strengthen our 17-year relationship with 3D Systems.

Notably, we retain our intellectual property as well as capabilities in ink and print head development. The gain enabled us to do a greater level of restructuring in the quarter with restructuring of $56 million coming in about $20 million higher than what we originally guided to and $35 million lower year over year.

Our adjusted tax rate of 24.5% was in line with our guidance and modestly higher year-over-year. Adjusted EPS of $0.29 was down $0.01 from 2012 and in the middle of our guidance range of $0.28 to $0.30.

So in summary, we were pleased to deliver our EPS guidance but need to make more progress to fully overcome near-term headwinds and deliver sustainable earnings expansion. With that I will move to the services segment slide to review in more detail the drivers there.

Services revenue growth was flat with document outsourcing up 4%, ITO up 2% and BPO down 3%. Growth rates have decelerated and are playing out as we expected with document outsourcing showing stable mid single-digit growth and ITO growth tapering consistent with the slowdown in signings.

BPO growth has temporarily gone negative reflecting no inorganic contribution, the toughest compare for student loans, as well as lower volumes than anticipated in customer care. We expect Q1 to show modest improvement in growth driven by BPO as compares improve, signings continue to ramp and we begin to see some inorganic contribution.

Signings in Q4 were once again positive with new business signings up 5%. Total contract value for all signings was flat due to less renewal opportunity in the quarter compared to the prior year. BPO total contract value was up 20% in the quarter with strong growth in healthcare payer, healthcare provider, finance and accounting as well as in Europe. For the year BPO also had strong signings with new business up 9%.

Document outsourcing overall signings were weaker in Q4 due to less renewal opportunity, but new business signings were up 1% and for the year were up 23%.

ITO had lower signings as we continue to see trends towards smaller contract sizes and our focus remains executing on previous large deals and improving our margin. Renewal rate was also positive at 92% in Q4 and full year, which was 7 points higher than the full year 2012. Our new business signings combined with our strong renewal rate yielded total contract value growth of 21% for the year, so leading indicators are strong coming into 2014.

Shifting to profitability, segment margin was 9.6% in Q4, down 160 basis points year over year and a little lower than the roughly 10% we were targeting. The year-over-year drivers were largely anticipated, reflecting the effect of student loan runoff which peaked this quarter and cost us 60 basis points on margin and 1.5 points on revenue; the continued pressure from our new government healthcare Medicaid platform and healthcare exchanges; and volume pressure in wireless customer care.

That said, margin was a little lower than expected as a result of technology customer care volumes ramping up slower than forecasted and healthcare platform expenses coming in above our original forecast as we have had to put even more resources towards improving our operational performance there. At the same time we are in the early stage of implementing our five plank strategy in services that we had outlined at our November investor conference. We expect benefits from these actions to build throughout 2014, improving trends in revenue growth and margin.

Turning to Q1 guidance, we expect a modest improvement in services revenue growth to approximately 1%. Our margin will be seasonally lower and we expect it to be at about the same level as the prior year margin of 9.3%. For the full year we continue to expect at least a 50 basis point margin improvement with the greatest improvement coming in the second half of the year as near-term margin pressure dissipates and the impact of our margin improvement actions accelerate.

I will now turn to document technology. Revenue in document technology was down 6% at both actual and constant currency for both the fourth quarter and the full year. Equipment sales revenue was down 4% year over year in Q4 as relative strength in the US in mid-range and high-end was more than offset by weakness in developing markets. Supplies revenue also declined in Q4 and was down 9% with almost half of the decline the result of actions that we took to reduce channel inventories. Additionally, our previous finance receivable transactions negatively impact annuity revenue growth.

High-end continued to perform well and had positive equipment revenue growth in the quarter as color growth more than offset the mono decline. We are gaining share in the segment and expect that positive momentum to continue.

Midrange had another solid install activity quarter. We have seen strong activity growth for the ConnectKey class of products since launching it last year and we continue to receive very positive customer and industry feedback.

Finally, entry revenue was weak driven by the continued weakness in developing markets as well as the impact of channel inventory reduction. Overall document technology margin was quite strong at 11.7% and, although down 60 basis points year-over-year, reflected the ongoing benefits from cost and efficiency savings and a currency benefit from the weak yen.

The two drivers of the margin decline were lower gains from finance receivable sales and higher pension settlement expense. On an absolute basis this quarter's finance receivable transaction resulted in a $15 million gain contributing 60 basis points to technology segment margin. However, the gain was $6 million lower year over year.

Higher pension settlement activity resulted in $36 million in higher expense for the Company, the majority of which is in document technology. So overall in line performance for document technology for the quarter. Looking to Q1, we expect document technology to have revenue down mid single-digits and margins up year over year. With that let turn to cash flow.

Cash flow from operations was at the high end of guidance with close to $1 billion generated in Q4 and $2.4 billion for the year. Free cash flow was $1.9 billion for the year with CapEx of $427 million. Our cash flow results include a net benefit from finance receivable sales of approximately $130 million in Q4 and $300 million for the year, resulting in underlying cash flow from operations of $2.1 billion for the year which compares to underline cash flow of $2 billion in 2012.

The $100 million year-over-year improvement was mainly due to lower pension funding as working capital was roughly flat for the year. It should be noted that working capital timing was purposefully smoothed out in 2013 and thus we had less of a benefit in Q4 then prior years.

Looking to 2014, we are maintaining our operating cash flow guidance of [$1.8 billion to $2.0 billion] (corrected by Company after call). This reflects our expectation of no finance receivable sales with underlying cash flow of $2.2 billion to $2.4 billion. The drivers of underlying improvement include services EBITDA growth as well as working capital gains. Consistent with our normal seasonality, we expect Q1 operating cash flow to be the lowest of the year with sources roughly offsetting uses.

Moving down the cash flow statement, investing cash flows were a $53 million use in the quarter. We spent $111 million on CapEx and had proceeds of $33 million from the 3D Systems transaction and $50 million from the Europe paper deal. We had no acquisitions in the fourth quarter and spent $155 million on acquisitions for the year. As previously communicated, acquisition spend was tracking below our full-year plan of $300 million to $500 million.

In December we announced the Invoco acquisition, which expands our European customer care presence. But it just closed last week so it will be in our Q1 results. Cash from financing was a use of $100 million and included the issuance of $500 million in senior notes, $71 million in common dividends and $524 million in share Repurchase, which puts the full year repurchases total at approximately $700 million and resulted in a $36 million net reduction in shares for the year.

Moving to the next slide, I will walk through our capital structure and capital allocation plan for 2014. We ended the year with $8 billion in debt which is $500 million higher than our September ending balance driven by our early December $500 million senior note offering. Given attractive rates the offering was $200 million higher than originally planned which will pre-fund a portion of the roughly $1.1 billion senior note that comes to maturity in May of this year.

Applying 7 to 1 leverage on financing assets our allocated financing debt is $4.4 billion, leaving core debt of $3.6 billion. Our financing debt continued to decline driven by the finance receivable transaction and lower originations.

Our capital allocation plan is as follows. On debt, in light of the $200 million pre-funding we expect to refinance about $900 million of the $1.1 billion in debt that comes due in May. On share repurchase we continue to plan to do at least $500 million in 2014 and expect those repurchases to be more evenly spaced through the year.

On acquisitions we expect to spend up to $500 million. With the recent Invoco acquisition we are off to a better start than in 2013 and I feel good about the quality and progression of the deals in our pipeline.

And finally for dividends, we are announcing today a 9% increase in the quarterly dividend to $0.0625 per share. This will result in spend of approximately $300 million which is only modestly higher year over year as share repurchases have served to help self-funded the increase.

Strong 2013 operating cash flow, combined with the lower level of acquisition spend and larger December debt offering, resulted in a year-end cash position in excess of $1.7 billion, providing upside to our capital allocation plan.

So in summary, we enter 2014 on solid footing. Document technology is performing well with stabilized revenue declines, a strong market position and continued good profitability and cash flow. In services we are well underway in implementing our five plank strategy that includes not only cost initiatives but also active portfolio management to drive growth and direct investments towards our higher-margin more differentiated offering. And we feel good about our cash position, cash flow and ability to continue to drive shareholder return through balanced capital allocation.

Looking at Q1, at the consolidated level we expect revenue will still be somewhat pressured and down low single-digits, with document technology down mid single-digits and services growth modestly improving to roughly 1%. And for margin we anticipate it will be seasonally lower with services roughly flat and document technology up year over year. As a result we expect earnings per share of $0.23 to $0.25 for the first quarter, which includes approximately $0.01 for restructuring. With that I will hand it back to you, Ursula.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Thanks, Kathy. our performance in the fourth quarter and for the full year reflected our ability to deliver bottom-line results while we continued working to strengthen our operational delivery capabilities for the long-term. Services signings are growing as we continue to win in the marketplace and strive to differentiate our offering to deliver state-of-the-art platforms and innovative world-class solutions to customers around the world.

Our document technology business is stable, we are gaining market share, we are keeping costs down and we are delivering advanced products in key areas of the printing industry. Both of these contribute to a healthy annuity stream that will benefit our long-term performance.

Throughout 2014 our focus will be on executing our services strategy. This strategy is designed to promote revenue growth and improve margins. We continue to plan for at least 50 basis points of margin improvement in the services segment. We're capitalized on the most advantaged segments of the document technology business to maintain our leadership position in the industry. And we'll continue to deliver healthy cash flow driven by the dynamics of our attractive recurring revenue business model.

With this in mind we are reaffirming our 2014 guidance and we announced today a $0.02 increase in our annual dividend rate to $0.25 a share. I am confident that we have the right strategy, the competitive strength, the dedicated workforce and the disciplined focus on execution to build on our progress. Thank you. And now I'll turn it over to Jim.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, Ursula. Also let me point out that we have several supplemental slides at the end of our deck. They provide more financial details to support today's presentation and complement our prepared remarks. For Q&A I ask participants to limit yourself to one follow-up question so we can get to everyone. At the end of our Q&A session I will turn it back to Ursula for closing comments. Operator, please open the line for questions now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jim Suva, Citi.

Jim Suva - *Citigroup - Analyst*

Congratulations to you and your team there on Xerox, it seems like the services are really turning around. A quick question though on the services. It sounds like that you had to invest a little bit more for the healthcare. If indeed that is correct if you can confirm. And I assume it was probably just you wanted to make sure it pulled off without any bumps. And that being said, can you let us know going forward, it sounds like the 50 basis points improvement is still indeed intact.

As we look forward to 2014 in the services areas, are there any more roll offs or headwinds? I know student loan I think it's going to impact by about 25 basis points. But anything else like more renewals, more large contracts, more -- anything that could impact pricing or do you pretty much have a pretty firm grasp on what is going on with the services as 2014 rolls out?

Ursula Burns - *Xerox Corporation - Chairman & CEO*

I will start with the healthcare investments and then I will turn it over to Kathy to answer the rest. Healthcare, you are correct. We actually made a conscious, necessary decision to invest more in particularly in the rollout of a health exchange platform in a state that we are heavily involved in. That is one investment.

We had already expected, which we actually communicated last quarter, to invest a little bit more. But we actually went even beyond that to assure that we respond to any needs that the clients in the state had. We will continue to do that. I think it will be less necessary as we go forward, if you know what I mean -- we are at a level that I don't think we have to go very much above.

But this is an area that for quarter four we made sure that we didn't step -- we didn't fall any further behind and that we actually served the client on the ground very well. Kathy will talk about the 50 basis points in additional headwinds.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

And so, Jim, at this point I think we have our headwinds very well understood and recognized. And if you look at where we had guided to a quarter ago in talking about what impacts we thought we were going to see, I think we were roughly in line there with the only additional pressure that we saw really, as Ursula just mentioned and as you mentioned, looking to put more resources behind standing up successfully those healthcare platform implementations that we had.

If I look at the progression for improving 50 basis points in 2014, as we talked about on our investor conference, it is naturally backend loaded as you look at the known pressures and how those known pressures will dissipate during the course of the year. So a good example of that is, I've mentioned that as a result of the implementation of our new Enterprise MMIS platform we are drawing amortization now. We will lap that beginning in the second quarter and so that year-over-year impact and pressure will start to dissipate.

With respect to student loans, which caused 60 basis points of the pressure in the quarter and 1.5 points of pressure on revenue, when we get to the fourth quarter of next year we actually lap the government piece of that business just going away. And in terms of that margin pressure you are absolutely correct, it lightens up year over year and, again, that is a little bit more back half end loaded which is why you are going to see the progression of our margin improvement throughout the year.

And I would say similarly in terms of the pressure that we are seeing on revenue, we feel great about forward indicators and our ramp basically bringing BPO revenue growth coming back kind of beginning toward the end of the first quarter and then building into the year. So that gives you a little bit on the puts and takes for what we think the progression is going to look like.

Jim Suva - *Citigroup - Analyst*

Great, thanks. And as a follow-up for this year any both size or quantity of renewals coming up we should be aware of like more than last year or any potential, hey, in Q3 we have a lot more than normal or five megadeals coming up for renewal? Anything we should just be aware of -- conscious of for 2014?

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Yes, the only thing that I would flag is we had a really strong first quarter of 2013 in terms of total signings. I think the number is $3.7 billion. And so we have a tough compare in the first quarter. But there is really nothing else going on in that.

I spoke to a little bit in my prepared remarks the overall kind of composition in terms of mix. One of the things that we talked about at our investor conference was really a focus on improving mix, both taking resources and making sure that we are adequately putting resources where we have high-margin business, we are trying to accelerate growth, data analytics, obviously being a component of that continued innovation.

But as you look at kind of the mix of new business and as you look at the overall mix of signing, it is skewing towards places where we do have high margins. And so, that, again, over the course of the year is going to help us to actually mix up.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, James.

Jim Suva - *Citigroup - Analyst*

Thanks and congratulations to you and your team.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Operator please the next question please.

Operator

Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

My first question is on restructuring. I mean you took over $100 million worth of restructuring charges this year or I guess in 2013, you are planning on taking I think at least that amount in 2014 probably.

Can you give us an idea of exactly where those dollars are focused, how we are seeing the benefit even if not necessarily in margins because of other things that are going on within the business? But if you could just sort of give us an idea what you sort of focused on in 2013 and how you are going to shift the dollars or focus in 2014 so we get an idea of what support level might be behind some of the margin improvement.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Sure, I'll speak to the fourth quarter in terms of the restructuring we did in the fourth quarter. A fair amount of that was targeted towards the US, targeted towards back office. And then we are starting to see more restructuring within services and expect that as we progress into 2014 in part associated with looking to shift a greater percentage of our total labor base towards low-cost countries.

On the technology side of the business restructuring is really normal course, it is what we have to continue to do in responding to the overall pressure of that business to ensure that we are maintaining strong margins. And so, I feel really good about what we see coming in on the bottom-line as a result of that restructuring and that is a good portion of the total dollars that we spend because restructuring is more expensive on the technology side of the business than it is on the services side of the business.

But we will continue to see that and when we talked about it at the investor conference we said that we expect to have at least as much restructuring in 2014 as 2013. And obviously we have guided to $0.01 of restructuring, expect it right now in the first quarter. We did a little bit more restructuring in the fourth quarter. We started out with guidance of $0.02, ended up doing $0.03. But that is going to continue and we feel good about the savings that that drives.

Shannon Cross - *Cross Research - Analyst*

Okay, great. And then, Ursula, maybe if you can talk a bit about what is going on within both technology and DO in terms of underlying trends. It sounds like US is relatively stable but emerging markets are weakening, your low end printers were under pressure but you had strength in color. So if you can just frame sort of what you are doing for your customers, what specifically is going on, why annuity was down 6%, anything you can provide there would be helpful.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Yes, let me give you a -- thanks, Shannon. Let me give you a kind of run around the world on some of the technology standpoint and then by line of business, and then I'll give you a wrap-up on our services. What we are seeing in the US in enterprise account is a little bit of uptick, a little bit of uptick primarily focused around our document outsourcing offering.

If you look at the signings there, we are seeing those signings, US signings, increase. And I think that is a little bit of a bright spot for us. We still have to stand them all up, implement them, et cetera. And in small and medium-size businesses in the US we are seeing a pickup, and that is primarily because of our partner print services as well. And also because we have an unbelievable channel there, a channel that is doing extremely well and taking share. That is our Global Imaging business.

So US pretty much par for the course fairly normal and working very well in technology and fairly well in services. Europe, you may see a twinkle of light in certainly areas, is but it is pretty much the same business. We haven't seen a significant change in the European marketplace up or down throughout 2013. And our outlook for 2014 is pretty much the same.

We are going to increase our focus on operationalizing some of the cost reductions that we have there. Some of the restructuring that we have is focused on that area. Counting on the fact that we are not going to have a big upturn in the economy, we are just going to continue to drive through efficiency so we can keep our profitability in that portion of the market strong.

Developing economies is the place that we saw -- primarily Russia and Eastern Europe are the places that we saw a significant change in trend quarter 3 to quarter 4 significantly, a change in trend quarter 3 to quarter 4. Some of that was driven by us. We literally, as we talked about in the third quarter, changed and tried to drive down our channel inventory actually to protect ourselves to make sure that we actually don't leave a lot of things stranded in the channel.

We moved down our channel inventory, which dampened our revenue. But also we saw just market weakness in Russia and Eastern Europe. It's a big market for us, a very profitable market for us, we are still very successful there. But just the general over market activity is lower there.

In services we are seeing strength in signings in Europe, which is a good leading indicator for us. We started to sign more in Europe, signings are up about -- over 20% in Europe which is really good, we have a good base. We put in place some activities a year ago -- a little bit more than a year ago and it is starting to come to fruition. The rest of the globe is pretty much normal from a services standpoint.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks. Thanks, Shannon.

Shannon Cross - *Cross Research - Analyst*

Okay, thank you.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Next question, please.

Operator

Ben Reitzes, Barclays.

Ben Reitzes - *Barclays Capital - Analyst*

I want to ask about what some of the positives could be to margins during the year. Is there an incremental benefit you are going to see on the cost side from the yen? And can we also just talk a little bit about, on the services side, a little bit more of the timing when like student loan reverses and then what quarters that could be a year-over-year benefit and whatnot?

We talked about some of the hits I think in detail in the beginning of the year. And if we could talk about the positives as we flow-through that would be helpful in both divisions. Thanks.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

And so, overall in terms of just positive impacts on margin, one of the things I talked about at the November investor conference was an expectation that we were actually going to get some relief on the pension side of the house.

So I mentioned that pension settlement expenses were up $36 million in the fourth quarter and a big part of that cause was we printed the discount rate that is used to determine people's pension benefits in August and there was sort of a -- I'll call it a blip of an upturn in August. And so that caused people rightfully who are trying to I would say optimize their economics to choose to take their pension at the lower discount rate in December.

And so, we had a lot more activity in terms of people coming into what I call the cash register to cash out their pension towards the end of the year. So we continue to expect we are going to get margin uplift in terms of just overall lower pension expense next year. We also expect that we will get some benefit in terms of yen flowing through to gross margin in the technology business.

It is going to be I would say not quite to the same degree as we got this year. In total this year we got about a $60 million benefit. We expect that next year is probably going to be roughly $40 million. So those are some upsides. And then as you just talk about other activity that is going to assist us in margin, the slowing of ITO growth relative to BPO growth over the course of the year helps us to naturally mix up -- the signings that we are now ramping up and implementing are more heavily weighted towards higher-margin businesses.

So if I went back to the bubble chart that I talked about at the November investor conference, those bubbles that are the naturally higher margin businesses starting to pick up a higher growth rate as a result of positive signings activity. So those are some of the puts and takes.

Ben Reitzes - *Barclays Capital - Analyst*

Great. On the buyback side too, is that more front end loaded? Maybe you said that, I am sorry if I missed it.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Yes, I said today and I certainly said at the investor conference, we have an expectation to do share repurchases throughout the year, right. If you look at our activity in 2013, we did a little bit in the third quarter and then we did a whole lot in the fourth quarter and that isn't exactly what we would like to see.

So we are already repurchasing shares this year. To date -- as we sit here today we've done about $45 million worth of share repurchases. But what you should see is more of a steady progression over the course of the year.

Ben Reitzes - *Barclays Capital - Analyst*

All right, thanks a lot.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thank you. Next question, please.

Operator

Keith Bachman, Bank of Montreal.

Keith Bachman - *BMO Capital Markets - Analyst*

Hi, I have two questions. The first is on a theme we have brought up before and it is labeled consistency in services. It doesn't seem like it has changed much in that your Analyst Day was on November 12 and you talk about 10% operating margins there and they came in at 9.6%.

And then I don't think any investors thought during the quarter, certainly from leaving that meeting or anytime during the quarter, that services revenue growth would be down 1% in constant currency for the quarter. So my question is, what is Xerox doing to improve the consistency particularly of the services when it is 45 days left in the quarter, I think investors would generally say that they're disappointed with the performance of services relative to message communicated at the investor event.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

So a couple of things. I would start with we said that we thought we would get to roughly 10% margin for the quarter; at Investor Day I said I thought full year would be anywhere between 9.8% and 10% for the full year, we are obviously at the low end of that. And we actually guided to services overall revenue being about flat for the quarter. And so it was flat on an actual basis.

So we are a little bit off I would say. I wouldn't say that we are a lot off. And overall in terms of the trajectory as we go forward, there is a lot that we are changing to improve the overall trajectory of services. But there are a number of things that are one time, right, and that, I'd say, on a long-term basis systemic to the business.

So when you look at the revenue pressure that we are currently facing, student loan and the reduction in wireless coming largely from a single customer account that was very large is a temporary transitional issue. Similarly M&A, which last year in the fourth quarter gave us 2 points of revenue and this quarter gave us nothing, and starting to now see that activity pick up this year is again a transitory issue.

If we look at what we are doing in terms of executing our five plank services strategy, I would say our forward indicators look good in terms of improving our mix in business, kind of clearly part of that strategy. M&A is off to a better start. We've got a very keen granular focus and higher level of engagement in terms of really managing the KPIs around the strategy execution. We are continuing right now to put more resources behind areas of growth.

A great example would be WDS, which we have talked about, does analytics in our customer care telecom space, investing more there, more heavily in R&D in order to build additional platforms so that we can go into additional verticals. So I would say we are doing a whole lot in terms of really actively managing the strategic execution to ensure that we get the improving trajectory that we talked about in 2014.

Keith Bachman - *BMO Capital Markets - Analyst*

Okay, well that relates to my follow up, Kathy. And at Analyst Day you had talked about growth in 2014 of zero to 2% consolidated. And I just want to revisit on your conviction around those numbers. But as part of that I was hoping you could talk a little bit about how we should be thinking about M&A contributing to that number. And specifically if you could talk about how much the deal that you already completed will help in the March quarter. Thank you.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

So the deal that we completed, I will give you what we spent on the deal and that will help you to roughly size it, it was a $60 million deal. With regard to the overall trajectory of M&A, we are starting from zero, right, we obviously expect a positive contribution and we expect that to ramp over the course of the year. We have a fair amount of conviction about not continuing to under spend in M&A with a focus and discipline around ensuring that we do high quality good deals that are going to drive good returns for our shareholders.

So we feel good about that and making sure that we are focused strategically. And that we're looking at deals where we are going to have synergies to help us be more competitive on price pressure. Our pipeline continues to be pretty robust as well, kind of up mid to high single-digits. And so, we feel good about the leading indicators in services.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, Keith. Operator, if we could have the next question, please.

Operator

George Tong, Piper Jaffray.

George Tong - *Piper Jaffray - Analyst*

So we saw some fairly healthy metrics in the services segment over the past 12 months around signings and retention rates and in pipeline growth, particularly in the BPO segment. So looking out in 2014, what areas are you targeting in terms of penetrating growth opportunities and how should those metrics translate into services revenue performance?

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

And so, if you look at services revenue performance and the fact that we were on an actual basis on top-line flat for this quarter, guiding to about 1% growth. In the first quarter we are expecting to see a positive progression from there as we continue to ramp up the positive signing numbers that you referenced as well as start to pick up on M&A activity with one deal already over the finish line right now.

And as I mentioned earlier, the composition of the new business that we have been booking, and if you look at the composition of total signings, it is really skewing more towards higher-margin businesses which should start to give us some tailwind as opposed to headwind in terms of overall margin. So payer provider overall retail, federal government, US transportation -- these are all businesses that are already at very good margins. And the fact that those growth rates should increase relative to other businesses like ITO, as an example, really should help us in overall margins.

One of the things that I mentioned at Investor Day is two-thirds of our BPO portfolio is already at a 10% or above margin. So by continuing to look to accelerate growth of the higher-margin businesses we should really start to give ourselves a little bit more help during the course of the year.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

And we were not at the 10% margin, George. Government healthcare is an area that we are not -- we are making progress, but we are really focused, as I said in responding to the first question, on making sure that we get this right and we do not, like I said, put any additional risk or pressure on any states. But as we do that we are stabilizing more and more.

And so, throughout 2014 this significant investment that we are making -- that we made in 2013 and at the tail end of 2012 should start to pay off with more accretive performance -- accretive results to the Company. I am very confident of that. We have a lot of energy around it. And it is not totally visible to -- the details are not totally visible to the investors, but there is a lot of energy behind this to make sure that we get it right and that we don't, like I said, risk our customers.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

And the one other thing I would just add on government healthcare is we stood up a lot of things in 2013, right, so we implemented a new MMIS platform in New Hampshire, we implemented one in Alaska. We obviously had the lead on the Nevada health insurance exchange and we supported a handful of other health insurance exchanges in other states.

So that is a lot of things to stand up in government healthcare in a given year. And as I look forward to 2014, we have one MMIS customer that we are standing up, but on a relative basis year over year it is nothing in comparison to everything that we had to stand up this year.

George Tong - *Piper Jaffray - Analyst*

That is very helpful. And as a follow up question -- do evolving costs to stand up healthcare contracts alter the individual components of your bridge to get to 50 basis points of margin expansion? And if you can also give us an update on how Project Compete is tracking according to plan?

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

And so, it really doesn't I would say overall alter the bridge that I talked about at Investor Day. I would say with regard to the progression on government healthcare I had already taken into consideration I talked about the amortization of the platform which has a big expense and the fact that we will lap that year over year. Sorry, the second part of your question, George?

George Tong - *Piper Jaffray - Analyst*

Project Compete.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Yes, so Project Compete is well underway. I mentioned a little bit earlier that we are very engaged in ensuring that we are driving kind of KPIs down to the lowest level in the business. A great example of that would be Ursula and I were on a call with I'll call it 25-ish folks across the services organization earlier this week, really walking through their KPIs across all of the metrics we are tracking on strategic execution.

Obviously Project Compete is one piece of how we intend to get labor costs as a percent of revenue down. That is about Project Compete, it is also about just getting more efficient and more effective, implementing technology and automation tools across our customer care centers and the like to just drive overall productivity. So we feel good about the overall program and are very engaged to ensure that we are well executing there.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, George.

George Tong - *Piper Jaffray - Analyst*

Thanks very much.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Next question, please.

Operator

Kulbinder Garcha, Credit Suisse.

Kulbinder Garcha - *Credit Suisse - Analyst*

The question I have -- well, both question actually on services. The first one is if you guys are spending so much on M&A the organic growth rate in services this year is very close to zero. Is that roughly right or will it actually grow? And what is the kind of long-term revenue growth rate we should think about in that business since you have gone through this transition period?

And then on the margin from Q1 to Q4 let's say as we go through this year on services. I just want to understand that Q1 will be the trough it sounds like and then the ramp is a combination of the run off in (inaudible) some of the cost initiatives and just standard leverage. There is nothing else that has to happen for you to let's say do an 11% or slightly above that margin in the fourth quarter in services. Is that the rate way of thinking of it?

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Yes, it is. So I will start with the second part of your question. That is all it is is a ramp over the course of the year, that is exactly how you should think about it. Obviously with the guidance of our margin in 1Q being roughly the same year over year, it suggests that we have got to get to reasonably above 10 for the remainder of the year.

But my expectation in terms of the year-over-year ramp is that it is going to start out slower in terms of year-over-year gains and obviously it is going to be second half of the year loaded. If I then flip back to your first question, which started with all of the spent on M&A, I will kind of start there and say it isn't as if we have had a lot of spent on M&A and we certainly didn't guide to a different overall target number really than we have been trying to execute to previously.

So historically M&A has given the Company 2 to 3 points in revenue growth. We are not expecting that we are going to get a wildly different answer in terms of overall growth from M&A. We are just looking to get M&A activity back up to where it has been historically.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, Kulbinder. If we could have the next question, please.

Operator

Ananda Baruah, Brean Capital.

Ananda Baruah - *Brean Capital Markets - Analyst*

Congrats on a solid quarter. And I guess two from me. The first one would be can you give us a sense of how we should expect BPO revenue to ramp I guess through this year and into 2015 and kind of what the components and the timing of those components are? Even if the components are the removal of headwinds like student loan runoff, kind of government and commercial as we go into 2015?

And should we expect or is it your expectation that BPO get back to mid single-digits in 2015? Or I guess more specifically entering 2015? And then I have a quick follow-up.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Sure. Overall I will start with the last part of the question. BPO will get up to mid single-digits, but that is not where it is going to start at the beginning of the year. Obviously if you look at where we ended 4Q overall in terms of services, right, when BPO being down year over year and first quarter BPO may be down kind of marginally still but kind of quickly then ramping up to be positive.

So some of the factors in terms of how we lap some of the pressures that we are currently facing, right, in the fourth quarter the student loan pressure on revenue, 1.5 points, that is the worst quarter we are going to see. Overall the way that progresses in 2014 is it gets much lighter when we hit the fourth quarter because that is when we hit the compare in terms of the federal government piece of the overall student loan business going away.

Right now in the fourth quarter the wireless volume pressures that we talked about in customer care caused about a point decline in the fourth quarter on revenue. That will dissipate over the course of the year. So when we get to the back half of the year that pressure basically falls away. And then M&A, which year over year was a 2 point decline on revenue, no contribution versus of the prior quarter of about 2 points of revenue, we would expect that will ramp over the course of the year.

Ananda Baruah - *Brean Capital Markets - Analyst*

Got it, that is helpful. And then I guess I -- this is my follow-up. But as we get into 2015 are we -- what are the headwinds that remain in 2015 of the (technical difficulty)?

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

So the only headwind of the things that we talked about that we would expect in 2015 is student loan is two pieces. And I just talked about the government piece, which when we get to the fourth quarter of 2014 we totally lap that business going away. The overall student loan portfolio will continue in slow decline.

So we will still have a negative impact when we get to 2015, but it is not going to be anything near the numbers that we have been talking about. So we are calling attention to it obviously because it is having a big impact right now. By the time we get to 2015, yes, there will be an impact but it is nothing near what we are talking about now.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

In addition, as I (inaudible) 2015 a lot of the contracts that we signed in 2013 and 2014 will have ramped. We are taking that benefit today, just the early portions of it, particularly our technology, customer care business actually doing very, very well. That is going to ramp. And by the time we get to 2014 it will be at the ramp stage, sorry.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

And we are obviously focused talking about BPO or BPO/ITO. With respect to document outsourcing, document outsourcing new business signings were up 23% this year as well and strategically we are incredibly strongly positioned there. We had talked about previously the fact that Gartner has put us in the, quote unquote, magic quadrant. We have got a new leader. We are just well-positioned there. So that also well assists us in the services segment.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, Ananda. If we could have the next question, please.

Operator

Mark Moskowitz, JPMorgan

Mark Moskowitz - *JPMorgan - Analyst*

Is Lynn Blodgett on the call right now?

Ursula Burns - *Xerox Corporation - Chairman & CEO*

No, he is not. Lynn is dealing with a personal medical situation. We expect him back on the next call.

Mark Moskowitz - *JPMorgan - Analyst*

Okay, good, I will hope the best for his recovery there. The reason I asked, I just think it has been pretty point-blank here today about how important services is. I was just hoping we could ask a few questions of him. But we will wait to another day on that.

But maybe I can just talk a little about the services M&A ambitions here because it was definitely absent last year and that was always kind of one of the hallmarks at ACS in terms of the M&A funnel or activity. What has changed now where you are feeling a little more confident where you can move forward with acquisitions?

Does it have to do with just getting the cost structure in order or the balance sheet in order? Or do you guys have to assemble a new team under Kathy's leadership around M&A and integration and all that stuff? Just kind of curious what is changing now where you are feeling a little more confident about making M&A.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

I will have Kathy respond to the actual operational piece and how she does it. Let me just make sure that I make clear what did change in M&A from a strategic standpoint when we acquired ACS. we are significantly more pointed about what we want to acquire. Margin accretive, global expanding innovation-based acquisitions are what we are after.

That selection funnel obviously makes it harder than before we had that funnel. So I think based on history of ACS and what we know about the margin progression and growth progression of this business, that funnel is that right funnel. Kathy will talk about the pipeline that we have, in M&A it is better. But let me give it over to her now.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Yes, so I'd start with we have one deal over the finish line (technical difficulty) that I spoke about. We spent $60 million, that is already a level that is higher than what we did last year because, while we did three deals, they were all quite small.

When I first joined the Company I would have told you that the pipeline was light. And as you know M&A just kind of ebbs and flows. Our pipeline has built over that period of time, it has matured, we obviously have one deal that is over the finish line. We have actually added resources into the M&A group.

And then I would say the other thing we are doing is working really closely with the businesses in trying to generate what I call non-brokered deals. And so, looking for our pipeline to also have a number of deals that we have been through the business kind of courting over a period of time to just improve our success rate.

Mark Moskowitz - *JPMorgan - Analyst*

Okay, thank you there. And then just a follow-up if I could. Can you help us, Kathy, understand for 2014 in terms of EPS guidance, how much is predicated on the increasing off shoring of labor within the services business? Is that a big part of EPS in terms of a support or a backstop or is that more for 2015?

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Certainly over the course of a year we expect overall looking at our labor cost as a percent of revenue to give us a fair amount of help in EPS. A piece of that is clearly moving our footprint more towards low-cost centers. But another piece of that is just getting more productive and more efficient.

And we do that both by literally shifting work into low-cost countries and also through attrition just hiring up in low-cost countries and trying to shift that without necessarily incurring restructuring charges. So for sure it is meaningful, but it is not the only piece that we are focused on in terms of getting our labor cost down.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, Mark. If we could have a last question, please, operator.

Operator

Bill Shope, Goldman Sachs.

Bill Shope - *Goldman Sachs - Analyst*

I have two questions actually on the technology segment. Could you give a bit more color on developing markets comments you made earlier? I mean given the volatility we are seeing in some of these regions can you comment on whether or not we should think about this adding any material risk to the stabilization process we have seen in the tech segment as we progress through 2014?

Ursula Burns - *Xerox Corporation - Chairman & CEO*

I would say not material and not continuous. We have a long history in developing economies in general, that history shows us that it does come and go. The good news is that we have a big base of business in many different areas around the developing economies, you know them all.

This quarter or in the second half of this year this has been pressured and Russia and Eastern Europe, our fundamentals are good there and we are not moving share, we are participating in a fairly normal (inaudible). As the economies start to improve we expect or the regulation starts to improve or whatever drives the changes in Russia and Eastern Europe starts to improve we will participate as we normally do, which is in a leadership way.

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

And the only other thing I would say is BMO developing markets as a percent of total tech revenue is not really high, call it between 12% and 13%. And we have a quite good history of managing profitability there when we see revenue decline.

Bill Shope - *Goldman Sachs - Analyst*

Okay, great. And then my last question would be, a bit more clarity on the supplies inventory situation. Was that -- I'm not sure if I misunderstood this, was that primarily because of the BMO weakness or was that a broader based inventory correction? And then I guess off of that, are you comfortable that you are fairly done with that process now?

Kathy Mikells - *Xerox Corporation - Corp. EVP & CFO*

Yes, so we are comfortable, we are fairly done with that process. I mean we were working towards it and the third quarter and so in the fourth quarter we had a bigger impact. It shows up and DMO and also in indirect channel so that is where the inventory change take place and then DMO just overall was a little bit softer.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

This is something that we initiated and it is -- I think it is a good business practice for us to be on given the volatility that we see in general and in the world. And so, we just wanted to make sure that we didn't have a lot hung out through our partners. And so, we made the decision to pull those back and definitely did impact the SMB segment and DMO, but I think is a good business decision to make.

Bill Shope - *Goldman Sachs - Analyst*

Okay, great, thank you.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, Bill. That's all the time we have for questions today. Thanks for your interest. And, Ursula, anything more to wrap up?

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Yes, let me just wrap up with two points, thanks for joining us today, it's always good to hear from you. I said this earlier but I think it is worth repeating. We are focused on delivering on the synergies that we have outlined which enable consistent earning expansion and really strong cash flow -- cash that we are committed to deploying in a balanced way and enhances shareholder value.

Jim Lesko - *Xerox Corporation - Corp. VP & VP of IR*

Thanks, Ursula. That concludes our call today. And if you have any further questions please contact me or any of our investor relations team. Thanks very much.

Operator

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