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XRX - Q1 2013 Xerox Corporation Earnings Conference Call

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OVERVIEW:

XRX reported 1Q13 total revenue of \$5.4b, and adjusted EPS of \$0.27. Expects full-year 2013 total revenue to come in at low end of flat to 2% range, and adjusted EPS to be \$1.09-1.15. 2Q13 adjusted EPS is expected to be \$0.23-0.25.

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PRESENTATION

Operator

Good morning and welcome to the Xerox Corporation first quarter 2013 earnings release conference call hosted by Ursula Burns, Chairman of the Board and Chief Executive 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 us today. During the first quarter we delivered results in our Services business that aligned with our growth strategy and our expectations. However, we fell short in our Document Technology business which put pressure on our overall results.

We will talk today about the consistent trends that we see in our business, with Services becoming a larger part of our total revenue now at 55%, and fueling our annuity base which is now 86% of total revenue. And we will discuss the consistent trends that we are seeing in the marketplace which require faster implementation of business model changes.

We remain focused on earnings expansion and generating strong cash flow. And we remain committed to our full-year expectations on both.

Here is a closer look at Q1 results. We reported adjusted EPS of $0.27. This includes a $0.02 benefit from the reduction of a litigation reserve. As a result, earnings were above our guidance.

In Services we delivered 4% revenue growth along with a stable segment margin and a 64% increase in the TCB of signings to $3.7 billion. Again, the results in our Services business were as expected for the first quarter, with signings come in better than expectations and margins slightly lower. We are making steady progress on managing the cost base to improve the profitability of the Services business as we continue to ramp for more growth.

In Document Technology revenue was down 9% and segment margin declined 1.7 points. Q1 performance was weaker than expected due to timing issues with our reason ConnectKey launch of midrange products as well as continued tough market conditions.

I will provide more detail in a moment, but want to assure you that we understand the issues and are taking immediate actions to address them, including plans to reinvest our earnings upside in Q1 to accelerate restructuring activities in Q2.

During Q1 we used $87 million in operating cash. That is in line with normal seasonality and reflects a temporary increase in inventory. On the next slide we will take a closer look at the income statement.

Total revenue of $5.4 billion was down 3%, reflecting growth in Services and weaker than expected revenue in Document Technology. Based on our product backlog and steady growth in Services, I am confident topline results will improve throughout the year.

During Q1 lower revenue put pressure on margin. As a result operating margin of 7.4% was down 1.1 points from last year. Here is what contributed to the margin decline in the quarter.

First, as with any major product launch we made investment -- incremental SAG investments in Q1 to support the ConnectKey announcement. We invested in sales training, channel outreach and marketing. We planned for the initial revenue benefit from the launch to offset the incremental costs.

But the revenue ramp got off to a slower start and total Q1 Document Technology revenue declined more than our expectations. So the revenue shortfall resulted in SAG at a higher percent of revenue. Some of this will self-correct as revenue picks up both for ConnectKey and in our production color business. But, as I mentioned, we will implement a higher level of cost actions in Q2.

Second, Services is a larger part of our total revenue. As a result, margin is impacted by higher growth in lower margin businesses such as IT outsourcing and transactional BPO.

In Q1 our adjusted Other was $12 million. That is down $67 million due to the litigation reserve reduction and lower restructuring.

Equity income of $47 million grew $7 million, driven by profit growth at Fuji Xerox. And the adjusted tax rate was 22%. This includes a benefit from the Taxpayer Relief Act.

Adjusted EPS of $0.27 was $0.04 higher than 2012.

I remain confident that we will deliver solid earnings growth in 2013, benefiting from our cost actions, share repurchase, portfolio expansion and services growth.

On slide 6 we review our Services segment. The 4% revenue increase in Services reflects steady growth in BPO, which was up 3%; ITO, which was up 13%; and document outsourcing, up 1%.

And here is a closer look at each of these areas. Business process outsourcing represents more than 60% of our total Services revenue. We are benefiting from strong growth in transactional processing and state government services. This was partially offset by volume declines in other areas.

We are quite pleased with the organic growth in BPO and had less contribution from acquisitions in this space. Keep in mind that in Q1 of last year BPO increased 13%, giving us a tough year-over-year compare.

I am also pleased with a solid performance in IT outsourcing. It is the benefit of megadeals that we signed in 2011. In document outsourcing growth was lower in the quarter, a slower start to the year than we expected.

But signings for new managed print services and renewals were quite strong, and will flow through to improve revenue later in the year.

As a matter of fact, total signings were a good story across the board. They were up 64% year-over-year. Renewals were particularly strong as well this quarter. The renewal potential and the high success rate is reflected in our 89% win rate.

New business annual recurring revenue was up 8% year-over-year. The pipeline is up 5%, a steady growth even with strong signings.

Segment margins of 9.3% were flat. We offset negative mix and pricing with cost reductions.

In the quarter 2 we have a tough compare from last year's 10.6% margin, but we'll continue to press for efficiency while never compromising on client satisfaction. So we expect Q2 segment margin around 10%, reflecting strength in BPO and ITO, and a lower margin from document outsourcing. And for the full year we continue to expect to be in the 10% to 12% range with modest year-over-year improvement.

So, Services in summary -- revenue metrics trending well and margin holding ground, delivering solid performance as expected.

So turn to slide 7 for a review of our Document Technology business. In Document Technology, we expected a revenue decline of mid-single digits. During Q1 revenue came in lower at a 9% decline, driven by a 12% decline in equipment sales.

In reviewing the results, here is where we saw the shortfall on revenue, which created pressure on segment margin. And here is why we're confident that the results will improve going forward.

First, lower than expected performance from Europe and some spot weakness in developing markets resulted in lower post-sale revenue. We continue to have our eyes wide open to the macro trends. That is why we are scaling investments in higher growth areas, not only in outsourcing services, but also in color printing and expanding distribution to small and midsize businesses.

Install rates are good indicators of our progress in these areas -- A4 Color MFDs up 16% and high-end color up 44%. Second, in February we announced ConnectKey. It is a software system embedded in 16 new Xerox multifunction printers, some of which began shipping in Q1 and many that are shipping now in Q2.

This is a significant launch for our midrange business. As I said, the install ramp started a bit later than expected. It has since ticked up, and we now have a healthy backlog that will serve us well during the year.

For the balance of 2013, here is what will contribute to revenue improvements. A full launch of ConnectKey, new high-end color systems including advanced iGen presses and the addition of Impika inkjet printers, and expanded coverage of SMB through our global imaging distributors and through additional indirect channel partners.

These are all profitable growth drivers to help offset uncertainty related to macro conditions. Again, focusing on the cost base continues to be a priority.

We are making progress in taking cost out of a legacy infrastructure, but we need to accelerate this progress, especially in Europe. Considering our expectations for improving equipment revenue and the competitive price environment, Q2 segment margin will be somewhat lower year-over-year but sequential improvements from Q1.

Slide 8 is a look at cash flow in the quarter. Cash from operations in Q1 is in line with seasonality. The $87 million use of cash is a bit weaker than in 2012, but that is largely due to a temporary increase in inventory.

Accounts Receivable was less of a cash use in the quarter due to lower reliance on factoring in Q4. In line with our expectations, financial receivables was less of a source of cash.

Also, as anticipated, cash contributions toward global pension plan was lower year-over-year by $34 million, and this reflects our expected full-year decline of $150 million.

Moving down to investing, we spent $107 million on CapEx and $58 million on dividends. And as we announced in February, our quarterly dividend will increase by 35% effective with dividends payable in April.

Cash from financing was a much smaller source of cash. And last year we went to market in Q1 to pre-fund a May note. This year we have a smaller note coming due in May of $400 million.

We plan to retire this note in line with our debt reduction guidance. And as a result, debt of $8.5 billion was lower year-over-year by $1.1 billion and flat to year-end. And $4.9 billion of our debt is associated with our financing business.

We did a nominal amount of share repurchase in Q1, driven by our cash flow timing. We continue to plan on repurchasing at least $400 million in shares this year, weighted towards the second half in line with cash flow. And we continue to expect $2.1 billion to $2.4 billion in cash, with no change to capital allocation plans.

So let us turn to slide 9 for a wrap up, and then we will take your questions.

So, in summary, I call our performance mixed in the quarter. Again, I am pleased with Services and we are seeing improving trends, especially in reducing the cost base, delivering stable segment margin and growing signings. These results are strategically important to the transformation of our Company.

But I am disappointed in the slow start to the year in the Document Technology business. I also believe that we understand the issues in our control and that we are taking the right actions to make progress from here.

Our product innovation brings differentiated value. We are investing in areas of growth like in Services, high-end color and in SMB distribution, and we are divesting in lower growth, non-core areas like our North American paper business.

Our pricing is competitive, and we continue to take cost actions to maximize profit. Across our entire business, we will continue to rationalize our portfolio and restructure our cost base to create a leaner and more flexible business model. And for the full year, we expect total revenue to come in at the low end of our flat to 2% range. Our full-year guidance for earnings, for cash flow and capital allocations remains unchanged.

For the second quarter we expect adjusted EPS of $0.23 to $0.25. Again, we plan to increase restructuring activities in Q2. Approximately $0.02 of restructuring is comprehended in our second quarter guidance.

Expected first-half results will keep us on track to meet our full-year guidance of adjusted EPS of $1.09 to $1.15. With improving margins, cost controls, and steady growth, we will consistently expand earnings and generate strong cash. We will continue take a balanced approach our capital allocation, which creates value for our shareholders.

That is a good place for me to end. Before we open it up to questions, let me and turn it over to Jim Lesko, head of investor relations. Jim.

Jim Lesko - *Xerox Corporation - VP of IR*

Thanks, Ursula. Joining Ursula today is Lynn Blodgett, head of Xerox Services, and Armando Zagalo de Lima, head of our Document Technology Business.

Also let me point that we have several supplemental slides at the end of our deck. They provide more financial detail to support today's presentation and complement our prepared remarks. For the Q&A I asked participants to limit yourself to one question and one follow-on 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). Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

This is a question for Ursula and Lynn. I am not sure who wants to take it. But looking at the Services business, you had anticipated some improvement and it was obviously flat year-over-year. You are accelerating restructuring throughout the business, I believe.

So how do we think about what is going on underlying in the Services business? And how do we think about the growth that you have, in terms of signings, if that might impact your ability to see substantial or some improvement in margin as we go through the year? If you guys could take that and better frame what you are seeing in Services right now.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Thank you, Shannon. I will take it and maybe turn it over to Lynn in a little while if I don't get to all of the points. First of all, we are very pleased with the performance of Services in the first quarter.

Our signings -- our revenue growth at 4% was as expected, without a big contribution from inorganic -- from acquisitions. Margins were essentially in-line with what we expected. We expected a little bit of improvement, maybe 10 basis points or so, but we came in strong. In our signings, renewal rate, new business rate were all very, very, very strong.

The predictions that we have for second quarter, the outlook that we have for second quarter is continued expansion and margin on a sequential basis. We have a tough compared in quarter 2, so it will be down a little year-over-year in quarter 2. Sequential expansion and then throughout the year, continued expansion. We expect to end the year in the 10% to 12% range, up a little bit on a year-over-year basis.

So I think that if you look at the underlying of our business, the cost actions that we are taking, the management focus that we have on good mix of business and new business and to look for continued acquisitions, you should be fairly confident in how we will -- how the Services business will play out in 2013.

Lynn Blodgett - *Xerox Corporation - President, Xerox Services*

The other thing, Shannon, I think is that in our cost of restructuring that we talked about last quarter, and we saw the flow-through of that, it was north of $30 million. We did have the run-off of our -- we started to see the run-off of our student loan business which is very high margin. It is a very mature contract, and so that had an impact.

But our cost restructuring of the fourth quarter offset the discounts that we have expected and the run-off.

The other thing that we are doing to -- that gives us confidence about the ongoing margins and our ability to grow them is that we have -- our restructuring and our basic shift of our cost model is -- we are just getting underway with that. We did some things in the fourth quarter.

We have a program now called Project Compete that is our effort to move work, more work, to low-cost domestic locations and to low-cost offshore locations. And that is underway and is going to run through -- right now clear through 2014 and probably beyond that.

So we still have an awful lot of high-cost labor in our model, and we are working to reduce that. And I think that is probably the main thing that gives me the confidence that we can increase margins.

Shannon Cross - *Cross Research - Analyst*

Great, and then my second question is just, Ursula, can you talk a bit about what you're seeing from an economic standpoint, both perhaps in the enterprise as well as SMB and geographically? Because we have heard from, obviously, several companies so far and it is clearly not a robust market environment out there, but I'm curious as to what you're seeing in your verticals and just whatever you can provide to us. Thank you.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Macro and fiscal uncertainty definitely continued in Q1 and we saw that in our Document Technology business primarily. From a geographic perspective, Europe remains weak. And in the first quarter it had some shocks that weakened it even further.

And we did see a slowdown, a bit of a slowdown, in some developing market economies. We are hoping that doesn't stay for a long time. But our business model is fairly resilient in the developing markets, which is good. We have a very flexible cost base there, so we can actually adjust our infrastructure cost to whatever revenue comes in.

US remains stable, but weak. We have not seen a pickup in the US. Sequestration didn't hurt as a whole lot, didn't help us. It made decision-making -- it continued to keep decision-making slow.

So what I would say is overall we have a status quo -- weak environment around the globe. Whenever there's a little bit of a shock, we see a little bit of a shock in people's outlooks, but nothing too significantly worse than we saw in the fourth quarter.

Jim Lesko - *Xerox Corporation - VP of IR*

Thanks, Shannon. Next question please.

Operator

Ben Reitzes, Barclays.

Ben Reitzes - *Barclays Capital - Analyst*

Wanted to ask about Technology. One of the -- I wanted to hash out again -- you probably get a profit benefit that is either coming, or you saw little bit. But then it also -- the last time this happened, I don't know, 12, 13 years ago where the yen weakened quite a bit, Canon cut price quite a bit and took a lot of share. I was wondering if that has started, and what you think the pricing environment will be throughout the year, given the week yen.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

So let me start with the yen and the impact on our business and I'll going to pricing a little bit. So the yen weakening overall is a positive for us. But, as you know, we actually have two hedges there. One, we have currency sharing with Fuji Xerox and the second is that we hedge -- we hedge the yen on a forward basis.

We were fairly aggressive in hedging in the fourth quarter, in the second half of 2012, as we saw the yen continuing to weak. So we don't benefit as much from the yen weakening immediately as other -- as the yen -- as you would expect from the yen, because we do have these two mechanisms to help offset those major moves.

The benefit in the first half was less than -- was kind of nominal. It will be more in the second half. It will be probably total around $50 million in the year back-end loaded for us if yen stays where it was at the end of the year. As it weakens further, obviously, more benefit; we will continue to hedge and currency share. So --.

As far as pricing goes, we have seen a little bit of a move up in pricing aggressiveness. So we generally are -- and have been over time in this 5% to 10% range. This is primarily in Document Technology, obviously, and primarily on equipment, because the post-sale contracts are locked in for longer periods of time. And we are seeing activity at the higher end of this 5% to 10% range.

And we are being aggressive. Especially as we launch ConnectKey, which gives us a set of offers that allows us to be aggressive in the marketplace, a new set of offerings, we are matching price as we have to, to win back share that we lost when we didn't have the products in the second half of 2012. So, pricing at the higher end of the 5% to 10% range and we are being aggressive to make sure that we stay competitive.

Ben Reitzes - *Barclays Capital - Analyst*

Okay, and then could you just elaborate a little more on the government, in particular? What -- in the last question you mentioned some of it, but what is the latest in terms of government as a percent of sales, and the difference that you're seeing in Services in particular between state and local and federal and how it impacts your business? And, in particular, if you could touch on whether you expect things to get better this quarter in that vertical, maybe if -- somehow?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, so, we are not heavily exposed to the federal government. We have a small portion of our revenue, 5% or so, in federal government; more heavily concentrated in state government, 15%, 20% in state government. What we have seen -- and so I am speaking about state government here, not too much about federal government, because it is kind of de minimis for us, as I said.

State government, we are seeing some good news, particularly in health care. We have a strong position, as you know, in MMIS around the United States. And California is our big contract. New Hampshire just went live. We are doing well there.

Decision-making -- so healthcare is a big segment for us. We do well there. And our profitability is improving in that segment, actually very, very well. So I am bullish about healthcare -- government healthcare services.

What we are seeing, though, is that any new decisions -- any decision in the government takes a little bit longer. A lot more discussions, a lot more engagement, lot more senior level engagement with state officials. And by us, so myself, Lynn, our CFO, are engaged in these kinds of discussions with state officials.

The good news is that they do eventually come, and we win our fair share. So, slow reaction time, slow to making progress, but our concentration is good and we are -- our major concentration is in healthcare. We also have a transportation business that is clearly government-based as well, and we do well there.

So I don't know if Lynn wants to say anything else.

Lynn Blodgett - *Xerox Corporation - President, Xerox Services*

I just -- I was going to add the comment about transportation, that we saw good signings. And we manage it separately, but as Ursula said, it is part of our -- most of them are government entities. So we saw good signings there, and just agree with what Ursula said (multiple speakers).

Ben Reitzes - *Barclays Capital - Analyst*

Thanks a lot.

Jim Lesko - *Xerox Corporation - VP of IR*

Next question, please.

Operator

Ananda Baruah, Brean Capital.

Ananda Baruah - *Brean Capital - Analyst*

Thanks for taking the question; two if I could. Did I hear correctly that the Technology operating margins are expected to be in the 10% to 10.5% range for the June quarter? I just wanted to get a clarification on that.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, you heard that correctly. We -- (multiple speakers).

Ananda Baruah - *Brean Capital - Analyst*

Sorry, go ahead, Ursula. I apologize.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

No, no, you heard that correctly. As you know last year for the full-year, operating margins were north of 11% and we -- which is above the range that we have, and we guided to somewhere around 10% to 11% margins for the second quarter -- operating margins for the second quarter. So expansion over the first quarter, pretty significant; below last year and in line with what we would expect.

Ananda Baruah - *Brean Capital - Analyst*

Got it, so it sounds like overall operating margins are expected to be right back on track once we get to the second -- during the June quarter. So you should be back on track there.

And then I guess my follow-up is -- were you guys -- the strength in signings for the March quarter -- I mean for the March quarter, how is that relative to your expectations? And what is best for us to think about with regards to how a timing of those signings converting into revenue? And does it change your -- I guess your revenue run rate in any particular way?

Lynn Blodgett - *Xerox Corporation - President, Xerox Services*

I think that, first of all, part of the good news of not having a lot of megadeals is that smaller deals are easier to ramp. And so we expect to see impact from the signings, probably a little quicker than if we -- we have said many times if we sign a big Medicaid deal, that they take a long time to ramp. And these deals are typically -- that we have signed in the last quarter -- are a little bit smaller.

So we do expect to see the flow through on that. It is going to be -- still take some time. So that is why we are predicting that our revenue growth will pick up more in the second half than in the second quarter.

Ananda Baruah - *Brean Capital - Analyst*

And just --.

Jim Lesko - *Xerox Corporation - VP of IR*

Thanks Ananda. If we can have our next question please.

Operator

Keith Bachman, BMO Capital Markets.

Keith Bachman - *BMO Capital Markets - Analyst*

I have two also. The first is on Services and the second is on Technology. The first on Services, I would like for you to address if I could, Ursula.

I think your characterization of the Services performance was generous. The signings were great, particularly in BPO, but the margins and revenue -- continuous string of disappointments. It wasn't communicated to investors that margins would be flat in the first quarter. Margins would improve. And yet, once again, they came in flattish even with the help of the restructuring.

You are guiding to margins of, I think, 10% in the June quarter. That is down in a year-over-year basis, but a tough comp. Your guidance for the year is 10% to 12%, but I think at the low end, as I think how you would characterize it.

What are the consequences for continuing to having a year of -- if, in fact, the margins fall short on Services, what are the consequences of another year of disappointment on margins?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

So, Keith, we expect that we will have margin improvement throughout the year, will fall in the 10% to 12% range and have margin improvement on a year-over-year basis in 2013.

I -- my characterization was just a characterization. I don't know generous or not. I think that we came in where we expected in revenue. We came in ahead of where we expected in signings. In renewal rate and in mix of business, we were fairly solid.

As far as margins for the quarter, what we ended up producing, which was flat on a year-over-year basis, was slightly lower than we expected. Driven primarily by the fact that we actually had a great signings and had some compensation payouts that we had to make for those great signings.

But I think that if you look at the business on a go forward basis with the signings, with the new business rate that we have, with the renewal rate that we have, et cetera, et cetera that as the year continues we will meet the expectations that we laid out.

We also did a fair amount of restructuring, as Lynn said. That restructuring did come to the bottom line, and allowed us to actually deliver -- to deliver the flat margins. I think that we were fairly well contained in Services in the first quarter, and we will be for the rest of the year as well.

Keith Bachman - *BMO Capital Markets - Analyst*

All right, well, before I ask my second question I just want to stress, Ursula, I think clearing 10% this year in Services margin is incredibly important for the trajectory of the stock. And another year of disappointments (multiple speakers) will be just that.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

We would agree with you on that. We expect to be in the range of 10% to 12%, and that means that we have to clear 10% to be in the range of 10% to 12%. And, Keith, I think you know that we actually manage this and track it. We have a restructuring program, a signings program, a mix of business program. We are trying to acquire in the right areas.

We were a little light on acquisitions this quarter. We expect to pick those up as we go along. We don't acquire willy-nilly. We try to do it in a very disciplined way. And so I think that the business is actually running pretty much in line with the way that I would expect it to run.

Keith Bachman - *BMO Capital Markets - Analyst*

All right. Just a dimension on my second question on technologies, is there a way to think about -- with the product introductions it feels like it shifted, perhaps, some revenues from March to June. Is there any way to think about that in terms of dimensions?

I know you mentioned backlog was up, I just wanted to see if you can provide any color on or quantification on how much backlog, or how much do you think was perhaps shifted from March to June in the Technology segment, because of those product introductions. And should we be thinking about any of that for the June quarter, what might get further shifted to September? Thank you and that is it for my questions.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Thank you, Keith. I don't -- we expect to capture a lot of the miss in the first quarter in the second quarter. But it will continue to flow through in the rest of the year as well.

Our backlog was up around 25%, so -- which is significant in the quarter. And we saw in the second quarter, so, so far in April, we saw installs up and activity up. So that backlog is not just sitting on the books; it is being fulfilled in the quarter. So I think that I am fairly confident that we will -- that we are fulfilling the promise of ConnectKey, which is to move our activity up.

One of the things I want to actually make sure that it is clear, we actually predict this business to be down mid-single-digits -- the Document Technology business.

Keith Bachman - *BMO Capital Markets - Analyst*

Right.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

We are very, very -- eyes are wide open to what is happening in the marketplace, so we are not delusional about the progress here. We are investing is in areas that grow, and we're trying to take our cost out in areas that are not growing and are moving away.

So we are investing in document outsourcing. We are investing in low-end distribution. We are investing in color across the board, and in high-end color in particular.

And as we do that -- ConnectKey is one of the key elements there. We were a little slow off the launch of ConnectKey. Even though we invested in SAG, we invested in marketing, we invested in the areas that we should.

I am fairly confident that quarter 2 -- I am very confident that quarter 2 will deliver back to the mid-single-digit revenue declines and get our ratios better in line, and therefore our operating margin better in line.

One of the key points here as well, if you look at gross margin, our gross margin in Technology was flat, which is harder to move. It turns out it is harder to improve your gross margin than it is to improve your operating margin in Technology, because our operating margin is around investment that we make on an active basis, if you know what I mean.

Keith Bachman - *BMO Capital Markets - Analyst*

Yes, yes, yes.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

We just (multiple speakers). So I am actually feeling pretty good about Document Technology in quarter 2. I was very disappointed in quarter 1. Thank you.

Keith Bachman - *BMO Capital Markets - Analyst*

Right, right. Okay, thank you.

Jim Lesko - *Xerox Corporation - VP of IR*

Next question please.

Operator

Bill Shope, Goldman Sachs.

Bill Shope - *Goldman Sachs - Analyst*

I have a question on the Services segment as well. Last quarter you had mentioned that some renewals slipped into Q1. Can you talk about how that impacted the renewal rate, and how we should, off of that, think about the renewal rate heading into Q2 and for the remainder of the year?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, Lynn will take it.

Lynn Blodgett - *Xerox Corporation - President, Xerox Services*

Great, yes, we had some deals that moved our renewal universe, if you want to think about it that way, in Q1 was quite large. And we had very good success rate. We are up about, I think, about 40 bps in terms of renewal rate quarter-over-quarter.

And that has a dramatic impact. A renewal is as good as a booking, and in some ways better. So we are optimistic that our renewal rate in the second quarter will continue to be within our range, and we think we will actually have very strong renewals this quarter.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

And if you look at the mix of the business, Bill, it is also good for us. We talked about this -- I don't know if we talked about it in signings. But if you look our signings number, this is offer of renewals and into signings, but also in renewals, BPO, very, very strong across the board in just about every metric that we have.

And BPO is -- has better margins than ITO. So BPO for the first quarter and for 2013 should be strong. Document outsourcing was also very, very good. ITO, we are benefiting from 2011 signings turning into revenue today. So, revenue growth is very good.

The mix of business for Services is looking good. It is coming out the way that we planned for it to come out, or we would like for it to come out on a go forward basis. So, good BPO, good signings and document outsourcing which helps us to offset this low document outsourcing revenue, so that is really good. And ITO delivering on all the -- all of the signings that we had from 2011, so looking pretty good.

Bill Shope - *Goldman Sachs - Analyst*

If I could, just one more on Services. Can you comment on -- you had a big signings quarter. Can you comment on the average contract length for the Services deals you had this quarter given that, obviously, last year you had a pretty significant shortening of contract length? And, obviously that has implications down the road for profit. So could you comment on whether that trend has continued and how you are thinking about that as you look at your signings pipeline for this year?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, Lynn will take it.

Lynn Blodgett - *Xerox Corporation - President, Xerox Services*

Yes, as you have guessed, our average contract term was shorter in the first quarter. Last year we were at about four years. This quarter we were closer to three. And that is reflected in the fact that we have a lot of BPO signings; not much in terms of ITO. ITO tend to be longer contracts and deals that were a little bit smaller.

But we have a good renewal rate, and so we are confident in terms of the long-term growth.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

By the way, the shorter contract length contributed to -- if they were longer, the [GCB] would be even higher, which is an interesting thing. And one of the things that Lynn mentioned, he said more contracts. We have 38% more deals signed in this -- giving us that $3.7 billion.

It is actually an amazing thing, and a positive thing in that, as Lynn said, big deals are longer to stand up than shorter deals. And the smaller deals and shorter deals are a little bit easier to stand up. So we should be able to see the revenue flow through these starting in the second half.

Bill Shope - *Goldman Sachs - Analyst*

Okay, great. Thank you.

Jim Lesko - *Xerox Corporation - VP of IR*

Thanks, Bill. Next question please.

Operator

Chris Whitmore, Deutsche Bank.

Chris Whitmore - *Deutsche Bank - Analyst*

Ursula, in your prepared remarks it sounded like you were shading the low end of the expected revenue targets for the year closer to flat versus slight growth. Was the primary change there related to the outlook for the Technology business? And, if so, is it largely the pricing dynamic? Or is it the revenue timing of the midrange refresh?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, so the -- we -- we did say lower end of the range, and it is all from the Document Technology business. And it is a mix of both things that we are seeing. One is we expect that the revenue from the product refresh will come in, will start to come in.

That is not going to be the biggest -- it will contribute a little bit. And the other piece of -- the other contribution is from what we are seeing in Europe, and the slowdown in DMO that is creating a post-sale usage -- lower usage. And that is one that is harder to outrun.

In addition, we are light on acquisitions. And acquisition -- we are going to make acquisitions in second quarter and beyond, but the timing of those acquisitions will make it hard to have the revenue flow through, have a big impact. So three areas -- one is acquisition. Second is a slow start to the Document Technology, but not that much of there, and then page volumes and pricing and that whole mix environment, particularly in Europe and in DMO.

Chris Whitmore - *Deutsche Bank - Analyst*

Yes, I wanted to ask specifically around -- maybe to get some more color around that post-sale line. It was a big bit weaker than I expected. What were the primary drivers there? Is it primarily straight usage? Or are you seeing any kind of changes of pricing around the back end of these deals?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, so the way that -- well, back end of deal pricing, specifically, no. But what we are seeing is a mix of three things coming together that gets to a lower post-sale. One is usage down. What we are selling, the mix is lower.

So, not that the price of any individual device is lower, but people are buying more lower end of things, so mix a little bit lower, which gets you lower page volumes, lower price per page on lower devices. And we are participating in some segments -- back to the second one -- particularly in high-end color, we are participating more in the lower end of high-end color devices.

And so it is a combination of low economic activity in DMO and in Europe, mix and mix driven lower page volumes and mix driven lower price. But we are not seeing a change in the pricing of a deal, if you know what I mean. If you put in the iGen, we are not seeing a change in the pricing of an iGen deal.

Chris Whitmore - *Deutsche Bank - Analyst*

Got it. And so then last one for me just finally on the pricing environment. Does the more competitive pricing environment impact your overall revenue outlook for the year? Or is it relatively small in the scheme of things?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, I think it is relatively small in the scheme of things. Most of it is in Document Technology and most of it is in equipment sale, which is like 10% to 15% of our total revenue. So it is not -- it is something that we have to overcome, but it is not going to be a significant mover at all.

We will be more concerned, or I knew it would be more of an issue if post-sale prices across the board went down, but that is very, very hard to do. Very hard to do.

Chris Whitmore - *Deutsche Bank - Analyst*

Got it. Thanks a lot.

Jim Lesko - *Xerox Corporation - VP of IR*

Next question please.

Operator

Jim Suva, Citigroup.

Jim Suva - *Citigroup - Analyst*

Thank you and congratulations to you and your team there at Xerox. Notably the signings numbers were super impressive, but I also want to take a bigger picture look at this.

And the prior quarter was weaker than expected. So maybe if you can -- Ursula, for a longer-term strategic CEO perspective, help us smooth out a little bit, to say is there a certain run rate that you want these signings to come in at, to continue to grow your business organically? Because I imagine there is some rolling off all the time, some coming on, and how we should look about that.

And then this quarter, was it truly off the charts? Or was some of it pushed or deferred from the December quarter? And then in lieu of that, with sequester, were there some actually that didn't close that may close into the June quarter?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

So signings, one of the things that we learned early on came over when we got into document outsourcing, but even more when we bought it ACS and got BPO and ITO in, signings are lumpy. There is not a predictable nature to signings, particularly as we participate in the full mix of small to large deals, and which we do. So, unfortunately, I can't give you a -- expect X. They are lumpy.

Do not underestimate or dampen too much the signings that we did in the first quarter. They were very, very good even with the move of some deals from quarter four to quarter 1 -- 64% increase is real -- is a real increase. The number of deals, just the number of transactions, was significantly bigger than we would -- than would naturally happen.

So the quarter was a really good quarter in signings. No -- not just because we moved, et cetera.

And, sequestration, we really haven't seen a specific, so we didn't see a specific line item stop or a specific deal stop. What sequestration does is it just puts a damp rag over everything from a time perspective. So that is -- and that is -- but we are kind of used to that now.

We didn't see a deal stop because something got defunded, not at all. But we did see a lot of slowness in decision-making. And we expect good signings again in quarter 2, as Lynn said. So we do not expect, you know, quarter 1 -- quarter 3 -- quarter 4, 1 and 2 to average out to be an okay set of quarters. We expect -- we had reasonable in quarter 4, a little bit light, very, very good in quarter 1; heavy. And we'll have a very good quarter 1 and quarter 2 in signings as well.

Jim Suva - *Citigroup - Analyst*

Great, thank you, and congratulations to you and your team there at Xerox.

Jim Lesko - *Xerox Corporation - VP of IR*

Thanks, Jim. Next question please.

Operator

Kulbinder Garcha, Credit Suisse.

Kulbinder Garcha - *Credit Suisse - Analyst*

I just have a question on restructuring and the cost base as being a lot of mention on things potentially being accelerated. So I just want to frame the question in terms of, for Ursula, I guess, between let's say 2012, or the end of the year and the end of this year on a run rate basis or to 2014, however you want to describe it, can you speak about how much cost you're trying to take out of the business? Can you put a dollar number on that?

And then, also, in the event that the Services margins may not come through or the Technology business doesn't come through, can you speak what the flexibility you have to further become aggressive on the cost base? Give me some examples maybe for where you could actually accelerate savings. Many thanks.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Thank you. So in 2012 we took about $150 million of restructuring charges, primarily in Document Technology. And toward the end of the year, as you know, we did a restructuring in Services. And in the quarter -- and that flowed through to about $50 million to $60 million worth of savings in the first quarter of the year.

And we expect that the savings for the full year to be north of $200 million or $225 million. For 2013, we expect a similar level of restructuring in 2013 to 2012.

What we have done in quarter 2 is accelerate some of that restructuring into the quarter. And that will be primarily, again, in Document Technology. We are going to take a bigger focus on Europe.

Europe is, as you know, difficult. You may not know, but Europe is difficult to restructure in. The paybacks are very long. It is a challenging environment.

But we are going to go after it with full force in quarter 2 and see what we can do in quarter 2 in European restructuring. And the rest of that, a smaller amount of it, will be the continued restructuring and continued movement of labor and Services that Lynn spoke about, so about the same year-over-year of step up in quarter 2.

That step up will allow us to continue to meet the first half of earnings, and assure that we will meet the full year earnings expectations that we laid out. And we are going to focus on Europe and Document Technology.

Kulbinder Garcha - *Credit Suisse - Analyst*

So, if I have got that right, that is $150 million of restructuring probably this year and hopefully like $200 million -- that results, that said, going into 2014, then, on a full-year basis, $200 million in potential savings. Am I understanding that right?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Correct.

Kulbinder Garcha - *Credit Suisse - Analyst*

Okay, okay, thank you.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

You're welcome. I think I answered all of your questions, I think.

Jim Lesko - *Xerox Corporation - VP of IR*

Next question, please.

Operator

Mark Moskowitz, JPMorgan.

Mark Moskowitz - *JPMorgan - Analyst*

The first question, Ursula, is around the Services business. You are entering the fourth year now with the ACS services piece as part of your Company. I am curious if we exclude the document outsourcing, so the 27% or so of Services that is document outsourcing, it would put your ACS related services around 40% of total Company revenue.

Is that how you, Lynn, and Tom think about where you want that mix? Is it over or under where you were targeting, say a few years ago? How should we think about that mix right now?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, it is a great question, actually. We expect a little bit more. We expect a little bit higher mix at this point in BPO and ITO.

And the biggest gap that we have is in acquisitions. And that gap -- the acquisition gap is one that we are working really hard to remedy. But the organic growth in Services is coming in actually this year ahead of where we expected it to be, tail end of 2012 and first quarter. And what we need to do is another point, another point or two from acquisition revenue would be good.

And as far as the document outsourcing business, it is definitely a lumpy business. It comes and it goes. And right now we have a lot of signings that will translate into revenue in the trail end. So I'm actually pretty okay with document outsourcing. And organic growth in Services I am good with as well.

Mark Moskowitz - *JPMorgan - Analyst*

Okay, just as follow-up, so you said where you could have a remedy is more on the acquisition side. Where could those remedies lie? Can you give us a sense of what we could look to over the next 12 to 18 months as far as some of those remedies?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, so here is the priorities that we have now. The thing about acquisition is that you have to find a candidate that you -- which we find a lot of, but we have to actually like the candidate and have a reasonable value match between the seller and the buyer. You know all of this.

Here, the focus area is that we are going to continue on capabilities, particularly in what is called outside big data, but I call it in data analytics or whatever to actually enable more business in our in situ business, lines of business today. That is one area that you'll see.

The second area that you will see is we are going to continue to double down and triple down in healthcare. And some of that is big data, but, also, in ways to mass market -- pass the market in healthcare.

And the third would be international acquisitions across the board in our Services business. Our international operations are growing, but I want them to grow even faster. And what it allows us to do is get revenue, but also get talent that can be sitting internationally as well, which is something that we need to actually accelerate. So it will be in those three areas.

Mark Moskowitz - *JPMorgan - Analyst*

Okay, and my second question is around cash flow. Just curious, just given that you are entering years two and three, or at least the more mature parts of the Services cycle that you signed on a few years ago after you acquired ACS, could we see a situation where later this year maybe your total revenue actually could be flattish to even down, but you can have some accretive benefits from some of the services deals where you could actually see cash flow actually improve more than expected? Are we getting close to that positive inflection point from a cash flow perspective?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, I think that it is some and some. But I don't think you will see the revenue come down based on the signings, right? If you look at the signings and if we operate -- when we operate the contracts as they say, I don't think you will see revenue coming down.

You will see -- you could see strength and cash based on how effectively we bring those contracts and all other contacts that we have to maturity. So you could have some benefit in cash. I don't think that you will see a negative in revenue. Right?

Megadeals have -- the megadeals that we have signed have a cash -- as they mature they have a cash benefit, right? So the most famous megadeal is California, right. And as California is maturing, thank God, and is doing fairly well, I'm not going to say very well, because very well always jinxes me of doing well, and so as that matures, of course, cash becomes easier to get out of the megadeal. But I don't think revenue will be down. I think cash has some opportunity and -- yes.

Jim Lesko - *Xerox Corporation - VP of IR*

Good, thanks, Mark.

Mark Moskowitz - *JPMorgan - Analyst*

Thank you.

Jim Lesko - *Xerox Corporation - VP of IR*

Okay, if we can have our last question, please.

Operator

George Tong, Piper Jaffray.

George Tong - *Piper Jaffray - Analyst*

Good morning and thanks for the helpful commentary. Wanted to get some color on your Services pipeline. Could you tell us where you are seeing the greatest activity, what you are seeing in terms of mix, and whether you're seeing any megadeals potentially come up?

Lynn Blodgett - *Xerox Corporation - President, Xerox Services*

Yes, we are on -- the main areas that we are seeing activity are transportation, healthcare, our financial services, customer care and in our government space. As Ursula said, we are seeing good growth in government healthcare, and we continue to see a good pipeline there.

We are seeing a few more deals that are larger in size, but not as many as we have had historically. That is why I think it is important that we -- we demonstrate that we can execute on these smaller contracts. The number of deals that we do it is up significantly, and so I don't think we should count on a huge influx of megadeals, but we do believe that we will have continued strong signings grow through the year.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

And Armando will speak about document outsourcing.

Armando Zagalo de Lima - *Xerox Corporation - Corporate EVP and President, Xerox Technology*

So megadeals in quarter 1 were 30% of total, which I think helps the quick turnaround to revenue. So we don't have -- we have 70% of our deals that are not megadeals.

Industrywide-wise, I give you a perspective about 2012. So Public Sector was our major industry with 18 megadeals in 2012. Financial services 16. Manufacturing 10. Healthcare 8.

Quarter 1 I was a little bit different. Three deals -- megadeals in education, three in manufacturing and one in healthcare.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

So I think from the two you will see that we have -- we participate in a broad set of industries. And we are seeing the benefit of historic megadeals, but today now more just across the board good activity for many different sized firms, and many different sized engagements. And that is actually very good.

George Tong - *Piper Jaffray - Analyst*

That is very helpful, thank you. And then as a follow-up question, what percentage of your first-quarter signings came from renewals that slipped from 2012? And are there any renewals slipping into the second quarter that could help drive second quarter's bookings growth?

Lynn Blodgett - *Xerox Corporation - President, Xerox Services*

Yes, there is always -- as Ursula said earlier, the bookings tend to be lumpy and there are always things at the end of one quarter that tend to slip to the next. I think that if I had to put a percentage on it, I would put it at about 10%, maybe 15%. And we had deals, a couple of deals, actually, that we expected to close the last day of the quarter that didn't close. And we have signed those already. But that is kind of normal (multiple speakers).

Jim Lesko - *Xerox Corporation - VP of IR*

Thanks, George. Okay, that is 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, thanks, Jim. I would be remiss if I didn't mention that Kathy Mikells will join us on May 2 as our new CFO. She brings to Xerox extensive financial experience and a broad business acumen in both Services and Technology. And Kathy plans to reach out to our investment community almost immediately after she arrives.

We've covered a lot of ground today, so let me bring it up a couple of levels. Our strategy is consistent. Services led growth. Profitable leadership from Document Technology. Cash generating annuity-based business model, consistent earnings expansion, and financial strength to invest in building value for Xerox and building value for you.

It is up to us to execute effectively, and I remain confident that we will.

Jim Lesko - *Xerox Corporation - VP of IR*

Thanks, Ursula. That concludes our call today. If you have any further questions, please feel free to contact me or any member our investor relations team. Thank you.

Operator

This does conclude today's conference call. You may now disconnect.