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EDITED TRANSCRIPT

XRX - Q4 2016 Xerox Corp Earnings Call

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OVERVIEW:

Co. reported 4Q16 revenues from continuing operations of over \$2.7b and GAAP EPS from continuing operations of \$0.17. Expects 2017 constant currency revenue from continuing operations to decline mid-single digit and GAAP EPS from continuing operations to be \$0.44-0.52.



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CORPORATE PARTICIPANTS

Jeff Jacobson *Xerox Corporation - CEO*

Bill Osbourn *Xerox Corporation - EVP, CFO*

Jennifer Horsley *Xerox Corporation - Director IR*

CONFERENCE CALL PARTICIPANTS

Matt Cabral *Goldman Sachs - Analyst*

Kulbinder Garcha *Credit Suisse - Analyst*

Shannon Cross *Cross Research - Analyst*

Paul Coster *JPMorgan - Analyst*

Jim Suva *Citigroup - Analyst*

George Tong *Piper Jaffray & Co. - Analyst*

Mark Moskowitz *Barclays Capital - Analyst*

PRESENTATION

Operator

Good morning and welcome to the Xerox Corporation fourth-quarter 2016 earnings release conference call hosted by Jeff Jacobson, Chief Executive Officer. He is joined by Bill Osbourn, 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 the expressed permission of Xerox. (Operator Instructions).

Xerox's reported results for the fourth quarter and full-year 2016 reflect only the continuing operations of Xerox. The financial results for the BPO business, once the information has been finalized, will be reported in discontinued operations in Xerox's 2016 Form 10-K report and will not be discussed during this call.

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 Mr. Jacobson. Mr. Jacobson, you may begin.

Jeff Jacobson - Xerox Corporation - CEO

Good morning and welcome to Xerox's fourth-quarter 2016 earnings conference call. During today's call, we will provide an update on our financial progress in the fourth quarter, as well as our expectations for 2017.

On January 1, Xerox began a new chapter, building on our heritage of innovation and customer centricity, while evolving to meet the changing dynamics of the market and the workplace. The new Xerox will capitalize on our market leadership positions and innovation capabilities to deliver more value to our customers and drive revenue improvements over time.



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The 35,000-plus members of team Xerox are excited about the opportunities ahead of us. Our customers are welcoming and encouraged by our renewed focus on what we do best, helping them communicate and work more effectively. I feel really good about our business, our strategy, our leadership team, and how we are positioned for the future.

We have a strong, attractive business model. We participate in an \$85 billion market and have leadership positions in key segments. Our business is 75% wholesale based, which provides great stability. We have loyal and long-standing relationships with our current customers and we're adding to our client roster as we cultivate relationships with new customers.

We continue to be relentless on cost and productivity initiatives and we are very good at operating this business. From 2013 through 2015, we delivered \$300 million to \$350 million of productivity each year. With our strategic transformation program, we are driving for more transformative change that will bring even greater productivity and we are on track to deliver an annual average of at least \$500 million of cost savings from 2016 to 2018.

We are disciplined in our approach, and our ability to deliver productivity will mitigate the impact of revenue decline until we change our revenue trajectory. Our productivity efforts are providing a solid financial foundation to support strong cash generation, margin expansion, and the ability to reinvest in the business.

The market we play in has both growing and declining areas. The growth opportunities range from low single digits to double digits and we have a concrete plan to capture these opportunities in our strategic growth areas. These areas include, one, document outsourcing, especially managed print services in the small and medium business, or SMB, market. Our emphasis will be on the M of SMB.

Two, entry products, where pages are moving from single-function A4-sized printers to higher-value A4 multifunction printers, where we are better positioned. And finally, the production cut-sheet color and emerging production inkjet markets, an area where we are historically strong and are making investments in the newer technologies.

To pursue these opportunities, we have realigned our go-to-market model and we are expanding our channels to increase our reach and strengthen our relationships with our customers, and we are building on successful product launches in 2016 to expand our portfolio and taking things to a greater level in 2017 with the largest product launch in the history of Xerox.

Finally, we are a company that continues to focus on delivering attractive shareholder returns. That is at the core of our mission. We know investors and shareholders expect that, and it is also important for employees and customers who want to be associated with a vibrant, successful, and innovative business. We have the strategies to get there. We also have the foundation of an investment-grade credit profile and a strong free cash flow that supports investment in the business, as well as attractive returns to shareholders.

I am confident we are well positioned for success in the coming year, and our accomplishments in 2016 provide examples of our ability to deliver. Let me share with you a few highlights.

As you know, on December 31, 2016, we successfully completed the spinoff of the business process services business, which is now an independent company named Conduent Incorporated. This was a significant undertaking on a very short timeline. The organization was heavily involved in completing the necessary work of separating vendor, partner, and customer contracts; implementing over 160 information technology projects; and managing the transfer of several thousand employees between entities.

My thanks to all of those involved. They worked tirelessly and late at night and many weekends to complete the transaction as planned.

In addition to completing the separation, we also initiated our strategic transformation program. I am very pleased with the progress made during the first year of the program. We exceeded our 2016 target by delivering \$550 million in gross savings. To ensure we stay on track, we have embedded a rigorous process within our operations to identify, implement, and track initiatives. I am personally involved, as is the full executive team. The entire organization is engaged and focused on delivering on their commitments.



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Just as important as the financial impact of the program are the changes we are making to the way we work. We are simplifying, standardizing, and automating processes throughout the Company. Here are a few examples.

In our service delivery operations, we're advancing the use of automation, including marked increases in the usage of automation, supplies replenishment, and remote solve, which enables us to resolve break/fix issues on our products without dispatching a technician to customer locations.

In our sales operations, we're enabling better pricing and sales tools, including a digital "deal scoring" tool to prescribe optimal pricing recommendations. And within our supply chain organization, we have further globalized our operations, from regionally and functionally siloed organizations to a global organization, and we made progress consolidating our warehousing footprint.

As we prepare to launch the new Xerox, we designed and implemented a streamlined operating model, simplifying our go-to-market approach by creating global processes and deploying them at the local or country level, we will take advantage of our global scale, while strengthening our relationships with customers in our local geographies.

We also delayed the organization to expedite decision making. We have pulled teams together to improve the return on our investments. Combining research, development, and engineering resources will accelerate the process of moving from innovation to product; and uniting our business groups and sales support functions will ensure we have the right products delivered through optimal channels using the most efficient processes to drive revenue improvements.

We have put in place a high caliber leadership team that combines seasoned Xerox veterans, such as Herve Tessler, President of International Operations; Chief Commercial Officer Kevin Warren; Chief Delivery Officer Yehia Maaty; and our Chief Technology Officer Steve Hoover, who was formerly the CEO of PARC. With talented external hires, including our CFO, Bill Osbourn; our General Counsel, Sarah McConnell, and our Chief Strategy and Marketing Officer, Farooq Muzaffar; and two others, Mike Feldman, President of North America Operations, and Darrell Ford, our Chief Human Resources Officer, who, like me, joined the Company within the last five years. We are an energized team committed to our strategy and focused on driving strong results.

In 2016, we continued to apply our innovation capabilities to strengthen our portfolio and bring additional value to our customers. In the production area, we added to our high-end portfolio by bringing two new inkjet presses to market, the cut-sheet Brenva HD and the continuous-speed Trivor 2400, laying the groundwork for further expansion into the growing inkjet market.

We were honored to receive two InterTech Technology Awards from the Printing Industries of America for our Versant press and metallic inks. These awards honor the development of technologies which are predicted to have a major impact on the graphic communications and related industries.

For the office, we introduced the ConnectKey-enabled i-Series multifunction printers-MFPs, which are equipped with ready-to-use apps to speed up paper-dependent business processes and make it easier for users to collaborate and work more effectively. Our Xerox App Gallery, an online portal where customers can select and download MFP resident apps adds functionality, enhances convenience, and increases productivity.

Buyers Laboratory recognized the 2016 ConnectKey Technology platform with its Outstanding Achievement in Innovation honors. In document outsourcing, we were pleased that our efforts in managed print services were recognized once again, as we were named the market leader by all of the top industry analysts. In this strategic growth area, we brought automation solutions to market that simplify how our customers work so they can be faster, more efficient, and effective in the services they provide to their clients.

For example, we introduced a workflow automation solution for retail banking that provides bank employees with a consolidated view of all content within a specific account, simplifying the process of onboarding a new client and improving customer satisfaction.

In higher education, we have an automation solution to streamline the admissions process by automating the capture and routing of documents, increasing both the quality and the speed of the process.



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These are just a few examples of the value we are bringing to our customers as we extend the power of our technology into processes that bridge analog and digital workflows.

Finally, I would be remiss if I did not mention all of the work that was done in 2016 to prepare for the largest product launch in our history, which is coming later this year. We will refresh our office portfolio by introducing a new technology platform and building on the successes of the i-Series approach to apps and workflows.

With that, I will move to our fourth-quarter results. The financial results we will review today are those of the continuing operations of the new Xerox.

In the fourth quarter, we delivered adjusted earnings of \$0.25 per share. Revenue of \$2.7 billion was down 7% year over year, or 5% on a constant-currency basis. While post-sale revenue declines were stable at down 3%, equipment revenue was soft, somewhat owing to the timing of product launches, but this is an area of focus to drive better results. This is why pursuit of our strategic growth areas is so important and will be featured in our commentary going forward as we drive to improve our revenue trajectory over time.

Adjusted operating margin was strong at 14%, up 70 basis points from the previous year, driven by our strategic transformation initiatives.

So, very good results that helped offset revenue declines and allowed us to enhance operating margins.

For the full year, our margin was 12.5%, at the top of the range we expected. We delivered seasonally strong cash flow from operations of \$462 million and we ended the year with a cash balance of \$2.2 billion. We plan to use \$1 billion of cash for the repayment of maturing senior notes in the first quarter of 2017. Bill will provide additional color when he walks through our cash flow in more detail.

Overall, our results demonstrated continued progress in our productivity and cost-savings initiatives and our ability to generate strong cash flows as we work to change the trajectory of our revenue.

I will now turn the call over to our CFO, Bill Osbourn. Bill joined Xerox on December 5 from Time Warner Cable, where his 13-year career culminated with him serving as co-CFO. Previously, Bill spent 14 years at PricewaterhouseCoopers. Bill?

Bill Osbourn - Xerox Corporation - EVP, CFO

Thanks, Jeff, for the introduction. I'm glad to be here and excited to join Xerox at this time, when there is such great opportunity before us.

To me, it's simple. We have a strong market position and brand, margin support and investment room from our strategic transformation, along with strategies with reasonable expectations to improve the revenue trajectory over time, which are supported by our announced product launch.

In the same breath, I would say we have got lots of work to do to execute on the plan and build a track record of consistent delivery. I've been extremely pleased to find such a strong finance and accounting team here at Xerox, and which meshes well with my background, which is rooted in public accounting. Together, my team and I are committed to driving continued financial rigor and clarity in reporting.

Before I walk through the Q4 numbers, it is important to mention again that Conduent's financials are not included in our continuing operations results and, as stated earlier, their results will be included in our discontinued operations when we file our 10-K at the end of February. So I do not plan to comment on Conduent results.

So let's get started. Our adjusted results, as a reminder, exclude from an EPS perspective the following -- nonservice retirement-related costs, as these obligations are predominantly legacy in nature and the cost can be significantly impacted by changes in debt and equity markets, so not operational in nature; restructuring and related costs, as these have significant variability and aren't reflective of future operating performance, as they are expected to yield future benefits; and, lastly, amortization of intangibles, as these are non-cash and associated with past acquisition activity.

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Revenue of over \$2.7 billion, as Jeff described, was down 7.2% at actual currency and 5% at constant currency. When we look at equipment and annuity, (which includes contracted outsourcing services, equipment maintenance services, consumable supplies, and financing, amongst other elements), the equipment decline was greater, down 10.1% at constant currency, while annuity post-sale revenues declined 3.2% at constant currency and was consistent with the full-year results.

Equipment is the more transactional revenue stream, and the higher decline reflected two main drivers. First, timing of product launches in the workplace/office product area. As announced at our December analyst day, we will be launching 29 new A3 and A4 products in this product segment predominantly beginning in Q2, so we are starting to see a bit of a slowdown in sales in anticipation of the product launch. Second, high-end equipment revenue was weaker, reflecting a mix down as entry production products drove the unit growth, while higher-end sales were lower, driven by iGen.

From a geographic perspective, Europe was broadly weaker, US was overall stable, and developing markets improved.

Largely offsetting the decline in revenue was the higher margin, as adjusted operating profit was down only \$9 million on a revenue decline of \$212 million. Gross margin improved and spend was lower in both the selling, administration, and general expenses and R&D. Our adjusted operating margin, in which we are including equity income from our 25% interest in Fuji Xerox on the profit side to better align with what we previously referenced as segment margin, was 14% in the quarter, up 70 basis points year over year, with the absolute strength reflecting the normal Q4 seasonality and the year-over-year improvement driven by the cost savings we are seeing from our strategic transformation program.

Offsetting the good news in operating margin was "other expenses net," which was higher year over year by \$25 million as Q4 2015 benefited from gains on the sale of surplus property.

Tax rate in the quarter was 21.1% on an adjusted basis, which was lower by about a point year over year, driven by a higher foreign tax credit benefit in 2016. To round things out, adjusted EPS from continuing operations was \$0.25 for new Xerox, which compares to \$0.27 in the prior year, and GAAP EPS was \$0.17. These are difficult numbers to give context to, as historical Xerox guidance was not on that basis as it included Conduent.

Overall, I would summarize Quarter 4 as mixed, improvement in margins offsetting revenue declines and resulting in continued solid cash flows from operations, as I will discuss shortly.

As we think about new Xerox following the spinoff, I would like to take some time to cover the trends we are seeing in the business, as well as the key metrics that drive the business. Starting with a high-level view of revenue and margin trends, total revenue in 2016 was down 4.3% at constant currency, modestly better than the 4.6% in 2015.

It is fair to say that the declining revenue trends in the business have been generally consistent in recent years. As the leader in this market, we need to improve upon these trends, which is why the separation (and our ability now to direct all of our resources towards the digital printing and document outsourcing business), as well as the strategic transformation program, are such key enablers to helping improve the topline trajectory. It is important to remember that any meaningful improvement in recent trends will take time, as we should start to see some equipment benefit in the second half of 2017, with resulting post-sale benefits in 2018 and beyond.

We are seeing progress on our transformation and productivity initiatives. As shown on the previous slide, adjusted operating margin in Q4 was 14%, and for the year we ended with a 12.5% margin, which was at the high end of the range we gave at the December investor conference.

There is seasonality in the margin, so we expect Q1 will naturally dip down to below our full-year guidance range, especially when we factor in the investments we are making in the launch of our new products, as well as currency, which I will now spend a moment on.

Currency is a variable to both revenue growth and margin. The strong dollar over the past couple of years has pressured revenue, and we expect about 2 points of unfavorable translation currency in 2017, which will impact profit by approximately \$20 million. The strengthening yen (relative to other currencies) has also been an increasing headwind over the past couple of years, given the product and supplies we source from our partner



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Fuji Xerox. We anticipate this headwind will continue into 2017, with approximately 100 basis points (or \$100 million), of additional margin pressure at recent rates and factoring in our hedging and currency risk sharing with Fuji Xerox.

So in total, we are looking at about \$120 million negative pretax profit impact from currency at recent rates.

Turning now to our key performance metrics, the metrics on this slide are a mix of those we have traditionally provided around installs and signings, as well as some new metrics around strategic growth areas and transformation that align to what we discussed at our December investor conference. As we move into 2017, we will evolve our metrics reporting with the objective of providing transparency into the trends in our key business drivers.

As Jeff referenced, our strategic growth areas comprise managed print services and workflow automation (a subset of document outsourcing); A4 multifunction printers and production color; and our areas where the overall market is expanding. We have growth initiatives to go after each of these areas that leverage our managed print services leadership, our high-end strength, as well as the opportunity to further penetrate the SMB market.

For full-year 2016, strategic growth area revenue comprised 38% of total revenue, which was a 2 point increase year over year, and overall strategic growth area revenue was up 2% at constant currency. As a percent of our total revenue, we expect to see an approximate 3 point increase annually as we roll out our growth initiatives.

Turning to installs, as expected, color growth rates were stronger than black and white. Overall, Q4 was softer than the full-year figures and follow the comments I made on equipment revenue. 2016 was a lighter product launch year in work/place office and, as we have highlighted, 2017 is planned to be our largest product launch year in history, with most of our new product available by the end of the first half. So we are looking for improving trends as we move into the second half of 2017 and beyond.

Document outsourcing signings, while at the highest level of the year, were lower than Q4 2015, and for the full year, signings were down 5% on a trailing 12-month basis at constant currency, not as strong a close to the year as we would have liked. Overall, our pipeline is growing, but we were impacted by lower new business signings in 2016, driven in part by increased price discipline, but also by what we believe was insufficient new logo sales coverage (and some A4 product gaps that will be resolved with our upcoming launch).

As communicated at our December investor conference, part of our strategic growth area of focus is managed print services, so we are taking actions and making investments in this area to drive improving signings trends as we move through 2017. Also, note that we don't capture the higher-growth partner print services signings within our figures.

The last progress area I would like to cover is strategic transformation. This is a critical program to drive both expanding margins and enabling investments to improve the revenue trajectory. We gave a fair amount of detail at the investor conference on these areas of focus and initiatives, as well as our three-year targets that accumulate to over \$1.5 billion in gross savings over three years.

You can also see here how the three-year program savings break down by area. In terms of 2016 results, we exceeded our gross savings objective and we are maintaining our objective of \$600 million for 2017. There are headwinds related to the revenue declines, as well as currency, that partially offset these savings, but "net/net" we anticipate continued margin expansion for the full year in 2017, as I will detail in a moment.

We will work to continue to refine our key performance metrics, and I look forward to updating you on our progress throughout the year.

Another critical element to our business model is our cash flow, which I will cover now. Operating cash generation coming from continuing operations in the quarter was \$462 million and resulted in \$1 billion for the year. Free cash flow was \$423 million in Q4 and \$880 million for the year, so a strong results on both measures.

Some of the key drivers of the continuing operations cash flow for the full year are as follows. Pretax income totaled \$568 million. Adding back non-cash items, pretax income was about \$1.3 billion. Other notable sources and uses included restructuring payments of \$118 million, which was



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less than the charge in the P&L, a reflection of the lag between when charges are taken and payments are made. Pension contributions were \$178 million and is an area, like restructuring, which will be higher in 2017, as I will discuss in a moment.

Working capital was a source in the quarter per normal seasonality, but overall a use for the year, driven by Accounts Payables related to both lower level of payables, as well as timing. We see this as an area of improvement opportunity in full-year 2017. And lastly, change in financed assets was a source for the year, reflecting less originations on lower financed equipment sales, as well as the dissipating drag from the finance receivable sales of a few years ago.

Investing cash flows were a use of \$59 million in Q4 and \$146 million for the year, largely reflecting our CapEx spend, which was \$39 million in the quarter and \$138 million for the year.

We are not presenting a cash flows from financing, as they are presented on a combined, continuing, and discontinued operations basis and are not meaningful on a new Xerox basis, as financing activities were primarily related to the Conduent discontinued operations.

Turning to our capital structure, there are a number of dynamics to cover, especially with the spinoff of Conduent. We ended Q4 with \$6.3 billion of debt, which is lower than the \$7.4 billion we reported at the end of Q3, as \$1 billion earmarked for the term loan repayment that came due upon separation has gone to discontinued operations.

Of our \$6.3 billion in debt, \$3.7 billion is allocated to financing debt, calculated by applying a 7-to-1 leverage to our customers' financing assets of \$4.2 billion, (which are comprised of \$3.7 billion of financed receivables and \$475 million of equipment on operating leases). This financing debt is adjusted out in one form or another by rating agencies when calculating our core leverage.

As financed assets have come down over time, we have lowered our total debt to maintain our core leverage within our target range.

The \$2.6 billion remaining after backing out the financing debt is core debt. We show that pro forma core debt will be \$1.6 billion and cash balance will be \$1.4 billion, taking into account our plan to retire \$1 billion of senior notes that are coming due in Quarter 1.

As we communicated at our December investor conference, as a smaller, less diversified company, we will need to carry less core debt. Thus this reduction, as well as further anticipated debt reductions in 2017, are targeted at maintaining our investment-grade credit profile and will give us more financial flexibility in the long run.

I will now take a moment to walk through our guidance for 2017. Beginning with revenue, we are guiding to mid-single digit revenue declines at constant currency. Also, based on recent rates, we anticipate approximately 2 points of currency headwinds during 2017. We anticipate equipment sale revenue trends will improve as we move into the second half of 2017 as we begin to benefit from new product launches and our growth strategies, although, due to the timing of the launches, the revenue the impact of the new products will have a greater impact in 2018 and beyond.

Also contemplated in our guidance are two specific headwinds, one related to the communication and marketing services (or CMS) business that came from business process outsourcing business, where a focus on exiting low-margin contracts is resulting in higher near-term revenue declines, and the second from our OEM business, which, as we highlighted at our investor day, has been declining at higher rates due to less volume from one of our major OEM customers.

CMS in 2016 had about \$225 million in revenues and OEM had about \$350 million in revenues, and we anticipate both will decline about 20%, which equates to over a point of impact to total revenue, which is about 60 BPS higher than the impact on the prior year.

Moving on to operating margin, we are guiding to a range of 12.5% to 13.5% for the full year, an expansion from the 12.5% we reported in 2016, driven by strategic transformation cost savings offsetting ongoing revenue declines and the negative impact from currency that I highlighted earlier.



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Turning to EPS, on a GAAP basis we are guiding to \$0.44 to \$0.52 of full-year earnings, and on an adjusted basis \$0.80 to \$0.88, which compares to \$0.88 in 2016. Revenue declines, currency headwinds, and a higher tax rate are more than offsetting margin expansion and lower interest expense. Just as we expect improving equipment sale trends on the latter half of the year, we also expect improving trends of EPS as revenue declines lessen and cost transformation accelerates.

We are not giving quarterly EPS guidance, as I believe we should be focused on the full-year achievement. With that said, while Q1 has historically represented about 20% of full-year EPS, we expect Q1 2017 results will be somewhat lighter, given currency pressures and timing of our product launch. You should also note that our GAAP guidance assumes approximately \$225 million in full-year restructuring, of which \$125 million is expected to be incurred in Q1.

Finally, turning to cash flow, we had a very strong cash flow in 2016. As we communicated at the investor conference, we anticipate lower cash flow in 2017 and are guiding to a range of \$700 million to \$900 million of operating cash flow from continuing operations. The decline year over year primarily is driven by higher restructuring payments of \$215 million and higher pension contributions of \$350 million, partially offset by improvements in working capital. Note that the year over year, this assumes restructuring payments will increase by \$100 million and pension contributions will increase by about \$175 million.

Before I hand it back to Jeff, I would like to close by walking through our capital allocation plans. From a sources of cash perspective, we will be using both our 2017 operating cash flow, as well as cash on the balance sheet, to fund our cash uses. As noted on the previous slide, we expect operating cash flow from continuing operations in 2017 to be in the range of \$700 million to \$900 million. We will have some carryover separation payments of approximately \$100 million that will come through operating cash flow from discontinued operations.

We also highlighted that we have a pro forma cash balance after paying off the Q1 debt maturities of \$1.4 billion, which is about \$400 million above what we are currently targeting as our 2017 ending cash balance.

Thus, combining our expected operating cash flows with the available cash on the balance sheet, we will have between \$1 billion and \$1.2 billion in cash available for capital allocation, which is planned as follows. We are anticipating and doing an additional \$300 million in debt repayment to bring our leverage in line with our targets. As far as dividends, considering our annualized \$0.25 common dividend and the preferred dividend, we anticipate paying \$280 million in dividends during the year.

We have a fairly light capital business model and plan on spending approximately \$175 million on CapEx, which contemplates some incremental IT investment, and we are currently targeting approximately \$100 million for M&A. Which leaves somewhere between \$145 million and \$345 million to be deployed opportunistically and according to our capital allocation priorities to maintain our investment-grade credit profile by reducing debt and/or pension liabilities, as well as investing in our business to drive higher shareholder returns.

While return of capital is an important priority, given the attractive dividend yield we are intending to pay, we believe the best use of cash for 2017 is either to bolster our credit profile or fund growth and thus do not plan for any share repurchases this year. It is important that we take the opportunity in 2017 to more efficiently structure our balance sheet and manage our business, which will enable greater investment in shareholder returns in the future.

With that, let me hand it back to Jeff to wrap up prior to Q&A.

Jeff Jacobson - Xerox Corporation - CEO

Thank you, Bill.

We are a new Xerox, a company that is building on its long history of improving the way work gets done. We will bring the best of the legacy Xerox and combine it with a focused, streamlined, and simplified organization that more easily adapts to meet the needs of today's markets, while delivering solid returns to our shareholders.



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In 2016, we laid the foundation for the future. The launch of our strategic transformation program will support strong cash generation, margin expansion, and the ability to reinvest in the business. We defined our strategy and have solid plans in place to capture opportunities in our strategic growth areas to change the trajectory of the Company's topline and outperform the market over time.

2017 is all about execution. My team and I are singularly focused on the operational performance of the business to ensure we successfully execute upon our strategy and deliver on our commitments to our customers, our employees, and our shareholders.

We will now open the line for questions. Jennifer?

Jennifer Horsley - Xerox Corporation - Director IR

Thanks, Jeff. Before we get your questions for Jeff and Bill, let me point out that we have a number of supplemental slides at the end of our deck, which provide more financial details to support today's presentation and complement our prepared remarks.

For the Q&A, I would ask participants to limit follow-on and multipart questions so we can get to everyone. At the end of our Q&A session, I will turn it back to Jeff for closing comments. Operator, please open the line for questions now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Matt Cabral, Goldman Sachs.

Matt Cabral - Goldman Sachs - Analyst

So on the equipment revenue, you touched on this a little bit in the prepared remarks, but it looks like the pace of decline accelerated to end the year. So I was wondering if you could just touch upon your view on the health of the industry at large and how much of the slowdown you think was Xerox related, given some of the upcoming product launches, versus more of a market-wide slowdown that we are going through?

And then, related to that, I noticed in the press release that you called out Europe as being particularly weak. Just wondering if you could expand a little bit on what you are seeing there.

Jeff Jacobson - Xerox Corporation - CEO

This is Jeff. Thanks for the question. So as Bill alluded to in his remarks and you mentioned, in terms of versus full year, our North American business was stable. The trends were very stable.

Developing markets actually improved versus that trend, and we did have a worsening in Europe. As a matter of fact, it was probably -- where they were low single digits, it went to above the average in decline, and it was really due to a few things.

The entry mid-sector was lower really due to the advent of the new products we have. If you think about our European business, just a little less than 50% of the European business is our channel business, so they are preparing their supply chain right now for the new products coming in, so that was part of it. Also, if you were to go to last year in Europe, in the high end we had the iGen 5 introduction in the second half of the year. Europe did a really great job with that. If you go back to Q4 of 2015, they had a very tough compare there, so we think it was that.

The market overall has been relatively stable. Certainly in North America, it has been stable, developing markets, as I mentioned, relatively stable. We think in Europe, Brexit, we hear a little bit about did that -- some of the uncertainty there. Could that have been part of the causal?



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But where we think that we're going to see the benefits now, as we start rolling out the new products, and almost all of them will be in our supply chain in the second quarter of the year, which will start benefiting us in the second half of the year, we think we will start seeing stabilization there for sure.

Matt Cabral - *Goldman Sachs - Analyst*

Got it. And then on the cost-transformation program, obviously you are only a year into the plan, but you are already executing above the targets that you have laid out. Could you just talk about the levers that you have to potentially deliver savings beyond the \$1.5 billion plan that is in place through 2018?

And just thinking more philosophically about your approach, if you were to see some upside in your cost-savings targets, how are you viewing the trade-off between using those to accelerate some of the reinvestments that you've talked about versus dropping those through to the bottom line and starting to show some operating leverage in the model?

Bill Osbourn - *Xerox Corporation - EVP, CFO*

Yes, I will hit the cost transformation first and then hand it over to Jeff about thoughts about additional cash available for other investments.

As we said in our prepared comments, we are very pleased with what our results were for 2016, exceeding the \$500 million, achieving \$550 million. We targeted \$600 million. Despite overachieving last year, we still believe we can do \$600 million for this year.

The levers, we described the various areas, but one of the levers is clearly restructuring, and we are purposely timing a significant part of our restructuring, \$125 million of our planned \$225 million for the full year, in the first quarter so we get more of the benefits within the year. So as I said, we are very committed, very pleased by the results, and still believe we can achieve \$600 million in 2017.

Jeff Jacobson - *Xerox Corporation - CEO*

And Matt, just to supplement it, we do have a very diligent process. We guided that we thought we would get \$500 million of gross productivity in 2016. We were very aggressive. We were able to pull some things earlier, which got us to the \$550 million. We are still sticking to the \$600 million.

And in terms of how we are going to use it, one of the things I want to emphasize is we have a very strong return of capital strategy and every free dollar of free cash flow we have fights for the best return on investment. A big part of this strategy we have to remember, as we rolled out at our investor conference, is that these cost-productivity programs, we want to drop some to the bottom line. We want margin expansion.

But it is also all about how do we change the revenue trajectory. We are not pleased with where we were at 3.9% and 4.6% and then, last year, 4.3%. This year, you heard our guidance for the year, but it is all about 2018 and beyond. How do we begin to change that revenue trajectory?

Jennifer Horsley - *Xerox Corporation - Director IR*

Great. Thanks, Matt. Operator, next question.

Operator

Kulbinder Garcha, Credit Suisse.



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Kulbinder Garcha - *Credit Suisse - Analyst*

Thanks for the questions. Just a couple of clarifications. On the revenue decline this year, you are saying mid-single digits, and then the currency impact's about 2 points. And so when I think of that, I think you're guiding for maybe a 7% revenue decline on a reported basis.

Is that what we are thinking about now? And the reason why I mention it is I think previously you said the revenue decline would be comparable in 2017 to what you saw in 2016? So has there been any change in your visibility, your view, on revenues for 2017 over the last couple of months since the analyst meeting? That's my first question.

And then, also linked to that, it sounds like revenue year-over-year declines are worse in the first half and they get better as we get through the end of the year.

And the final question I have is just on cost reduction. You keep saying that you're going to do more than \$1.5 billion long term in this program, in the strategic transformation program. Can you give us -- is there a point at which you will maybe inform us how much more it is going to be, and is it going to be materially more? Is it maybe \$100 million or \$200 million only? So can you can give us some sense in terms of how much more given -- as you go through this, how much more you could potentially save? Many thanks.

Bill Osbourn - *Xerox Corporation - EVP, CFO*

Yes, this is Bill. You were breaking up slightly, but I think we pretty much got your three questions. First of all, regarding the revenue guidance down mid-single digits, as background there is lots of detailed analysis and build-up in coming to that, but when I take a step back and think about it at a high level in giving that guidance, the Company historically hasn't had a track record, a great track record, on meeting its constant-currency revenue guidance.

You also factor in the Q4, we were down 5% on a constant-currency basis, and that in 2017 the expectation is with the new product launches in the second quarter, towards the latter part of the first half of the year, that the improvement, relatively speaking, will be more in the back end of 2017.

So that combined with, and specifically I mentioned in my prepared comments two parts of our business, the OEM business and CMS that have been declining in recent years at a much higher rate than the overall Company as a whole, but even are accelerating year over year, they really at about 60 basis points in additional declines, so that 4.3% you were looking at last year, relatively speaking you are starting at 4.9%.

All those things factor together. Like I said, there is a lot of detailed analysis also that underlies it. It gets you to a mid-single digits as far as revenue guidance at constant currency with improvements in the latter half of the year versus the first half, which I think answers your second question, first half versus second half, and, yes, we would expect better improvements or lesser declines in the second half versus the first half as a result of the new product launch.

As far as the cost reduction (multiple speakers)

Jeff Jacobson - *Xerox Corporation - CEO*

And Kulbinder, if I can, this is Jeff. I just want to supplement Bill also. One thing when you look at our revenue model is, you know as well as anyone, 75% of our revenue is annuity. It has been fairly stable with declines of about 3%. One of the advantages we have of that 75% of annuity, about 62% of it are bundled contracts, which is different from a lot of the industry.

So we have a lot of stability from that standpoint. We certainly don't rest upon it, so the real key for us is changing the trajectory in the equipment sale revenue, because if we can start showing improvements there, getting more machines in the field, burning more pages, that will help the annuity even more, but obviously it will bring down the drag of the equipment sale revenue.

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With regard to the costing, we don't want to give 2018 guidance on cost. What we said at the investor conference, we would be at \$1.5 billion plus. We feel very good that we got to \$550 million. We feel equally as good that we are guiding to \$600 million. It is not in the bank yet. We have to drive it very hard. It is a lot of heavy lifting, but when we achieved that and if we can achieve that, we will be at, let's call it, \$1.150 billion, and then we would be able to update our guidance as we get to 2018.

Jennifer Horsley - Xerox Corporation - Director IR

Thanks, Kulbinder.

Kulbinder Garcha - Credit Suisse - Analyst

Thank you.

Jennifer Horsley - Xerox Corporation - Director IR

Operator, next question.

Operator

Shannon Cross, Cross Research.

Shannon Cross - Cross Research - Analyst

I have two questions. The first is just, Jeff, can you talk a bit about how you're thinking about accelerating growth or improving what is going on within the document outsourcing business? If you can talk about specifics, how, I don't know, maybe some of the weaker signings is carrying forward right now. But, just, there was a mention I think in the script about walking away for some lower profit deals. So are you seeing more pricing pressure in this segment? Just any color you can give would be great. Thanks.

Jeff Jacobson - Xerox Corporation - CEO

Sure, thanks, Shannon. Yes, so the comment about walking away from lower pricing deals was probably more in Europe where there were a couple of very large deals where we just said from a margin standpoint not something as the lead that we really wanted to participate in.

When I look over all of our document outsourcing business, as you know, we are very well positioned here as the industry leader from a market-share standpoint. If you took number two and three, they just about equal our market share. Our pipeline actually is up. So the way I look at it is that our growth was 1% in Q4. It was up 2% for the year. Our signings for the full year were down 5%. The renewals were up double digit. It was the new business signings that were down.

Where we are going to attack that, and let me also add in terms of the new business signings being down, if you think about it, we are really just reporting new business signings in the enterprise. For our Xerox

Partner Print Services, we don't report the signings there. So in the enterprise, it is a \$6 billion managed print services market growing about 2%. We have just a little under a 50% share there.



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So we would expect to see somewhat of a little slowing in new signings there, but to counter that what we are doing is the new product launch will help us a lot, and let me touch on the new products. Why will that help us? We have always been the leader in A3. A4 from a cost standpoint, we perhaps were not as competitive as we could have been or should have been.

From a functionality standpoint, these new products will have a tablet-based user interface. They will be mobile enabled, cloud connected, app centric, with benchmark security, which is so important to the market today, and there will be fleet coherency between A4 and A3.

So we think with those new products, and we are going to hire what we call new logo or new business hunters, who will do nothing but focus on that percentage of the business, the enterprise we don't have. And then if I just factor over to document outsourcing where we have even a better opportunity for growth in the SMB market of managed print services, that's a \$7 billion market growing at 7% and our share is under 10% there.

So, if I just compare and contrast the shares we have in the enterprise versus the SMB, again with a focus on the M, and we start putting the focus there and we are growing -- we did grow at 12%, that's where we are looking for the growth opportunity.

Shannon Cross - Cross Research - Analyst

Okay, thank you. And then if you can talk a little bit about how you think about use of cash, and it was covered in the script to some extent, but I am just curious. As you are sitting six months from now or nine months from now and you have got a pile of cash, how are you thinking about it in terms of internal investment versus acquisition? Are there areas where you think you should be developing things internally and leveraging Xerox PARC versus opportunities to go out and buy? And then, obviously balancing that against share repurchase, which I understand is on the table this year, but then also debt paydown?

You are going to end up with some cash. You clearly will have cash next year, net of the return program you've put in place. So, how do you as the CEO balance these opportunities?

Jeff Jacobson - Xerox Corporation - CEO

Perfect, Shannon, thank you. So, let me address it and then Bill could certainly supplement it.

But we distinctly and purpose -- we are very purposeful for saying the \$145 million to \$345 million. I wanted to keep, and the team wanted to keep, our powder dry right now. I don't think it's any secret when you look at the percentage of cash we generated in this side of the house over the years that in a two-division structure, some of that certainly went over to the services side of the house. And what we did is we had a strategy to manage our business certainly for margin, for cash. We will continue to do that. We will always do it, and we will be prudent and judicious with any investments we make.

But what we are going to look at investments to accelerate the trajectory in the topline, and again, revenue is very hard, as we all know. These things won't come quickly, but we're going to align it to the growth strategy, Shannon. So what can we do in document outsourcing? Is it professional services? What can we do in workflow automation?

In the SMB channel, obviously we have had great success with global imaging. We will continue to do that. We will look at some of the same things in Europe. On the production side, from an inkjet standpoint we know we have some work to do there and we will continue to make investments there.

And as you saw in our recent Brother Dominic commercial about set the page free, the technology today is not just about printing on paper, but what can we do in packaging? What could we do from a technology standpoint? Printing on plastics, printed electronics.

So we are going through that internal debate of what -- perhaps we commercialize ourselves, which will obviously take more time, what could we do with partnerships, or what could we potentially do in M&A, so that's the way we are looking at it.



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Jennifer Horsley - Xerox Corporation - Director IR

Thanks, Shannon. Operator, next question.

Operator

Paul Coster, JPMorgan.

Paul Coster - JPMorgan - Analyst

I will build a little bit on the questions that Shannon just asked. First of all, with the dividend, should we think of it as contingent on the cash flow each year or are you in a position to commit to dividend growth knowing that once pension fund payments are out of the way, you will be in a much more robust position from a free cash flow perspective?

Bill Osbourn - Xerox Corporation - EVP, CFO

Yes, as we said in our prepared comments and as Jeff just went through, we are -- clearly, the return of capital is an important priority, whether from share repurchases and from a dividend perspective, and as we said at the investor conference, over time on an annual basis we would expect to be returning in one form or another greater than 50%.

As far as committing to dividend growth versus share repurchases, right now and the future, we're not going to give guidance on that, but just know that we are committed as a company to returning on an annual basis greater than 50%.

Jeff Jacobson - Xerox Corporation - CEO

And again, as I said before, we do have a strong return of capital strategy, and every dollar fights for the ROI and is compared against the return of capital.

Paul Coster - JPMorgan - Analyst

Got it, okay. And then on the acquisition front, can you just talk to us a little bit about the philosophy, both in sense of accretion, market-share gain, growth trajectory? What criteria are you using, please?

Bill Osbourn - Xerox Corporation - EVP, CFO

A couple of things, just to supplement what Jeff was saying earlier. First of all, our acquisitions will be in areas that we are clearly experienced with that are close to our knitting, areas that we understand.

And one of those areas historically has been in the GIS, or global imaging services, area where we buy multi-branded resellers and essentially convert them over to more of a mono-branded reseller, being Xerox. And historically, we have had very good returns in that. We've paid a multiple in the range of 1 times revenue, and we look to the extent that they are the right opportunities and doing those type of acquisitions in 2017 and beyond not only in the US, but internationally.

And then as far as other types of acquisitions, whether more in the workflow automation, whether software or technology types, we would probably pay a higher multiple just depending upon the specifics of the potential deal.



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Jeff Jacobson - Xerox Corporation - CEO

Yes, and Paul, we are looking for things that will get us into those markets where perhaps we can't address well today. So, if you were to look at just production color, we say it is a \$5 billion market growing at 5%. There is a market that is probably 12, 13 times that that is called commercial offset print and packaging where, if we can have technologies or get into that space, that would help us a great deal.

Jennifer Horsley - Xerox Corporation - Director IR

Thanks, Paul.

Paul Coster - JPMorgan - Analyst

Thank you.

Operator

Jim Suva, Citigroup.

Jim Suva - Citigroup - Analyst

Thank you very much and thanks so much for the details. On your annual EPS guidance, this is your guys' first opportunity to really come out and set a watermark and set your goals and lay it out. Yet I think one would be remiss if they don't realize the political and economic environment the past 30 to 60 days has been probably more uncertain than ever.

So for your guidance, does it incorporate a risk-adjusted weight of all that or is it a stretch EPS goal? Is it conservative? How should we think about that, as it's really you guys are setting up your reputation at risk here? Is it conservative? Is it prudent? Is it a risk? Is it how you see things, because we're just trying to figure out how your Company is guiding versus the old Xerox?

Bill Osbourn - Xerox Corporation - EVP, CFO

Yes, this is Bill. I will start with that question. And as you know, we gave a lot of detail in the prepared remarks and everything, but from a high level what I think about is we came in at \$0.88 on an adjusted EPS for 2016. When you factor in known differences upfront, whether the lower interest expense, the higher effective tax rate, more foreign currency headwinds, you effectively have a net \$0.10 off of that \$0.88 and you are starting at \$0.78.

And then you look through just the various cost-transformation initiatives to help fund potential future growth, and based upon our detailed analyses, we believe that gets us a \$0.02 to an additional \$0.10 upside, which gets you to an \$0.80 to \$0.88. So at a high level, that's the way we think about it. We think it is an appropriate and reasonable guidance range based upon what we know at this time.

With that said, just as I said in the prepared comments about Q1 being 20% typically, but a little bit negative impacted this year by foreign currency and the timing of the product launch, the full-year guidance is also dependent upon a successful product launch, both from a timing perspective and customer demand. But based upon everything we know now and our detailed analyses, we believe it is a reasonable range.

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Jeff Jacobson - Xerox Corporation - CEO

And Jim, our leadership philosophy is if something were to get worse in the external markets, we are just going to do more and just go with the productivity even harder to make up for it. When we started the year, we didn't -- or we looked at the guidance originally months ago, we didn't know we were going to have \$120 million of currency headwinds, and that's why you are seeing the productivity initiatives so high.

Jim Suva - Citigroup - Analyst

Thank you very much for the detail.

Jennifer Horsley - Xerox Corporation - Director IR

Thanks, Jim. Operator, next question.

Operator

George Tong, Piper Jaffray.

George Tong - Piper Jaffray & Co. - Analyst

Going back to the transformation savings program, can you outline what the sources of upside were in your savings of \$550 million in the year compared to your \$500 million target, and how your views on 2017 savings have changed at the increment, acknowledging that you are for now sticking to your original \$600 million savings target?

Jeff Jacobson - Xerox Corporation - CEO

I am sorry. George, we missed the last part. Could you repeat that, please? We just want to make sure we heard you right.

George Tong - Piper Jaffray & Co. - Analyst

Yes, just how your views on your 2017 savings have changed at the increment.

Bill Osbourn - Xerox Corporation - EVP, CFO

It comes from a lot of different factors, but, as I said, one of the big things is that we are clearly -- first of all, last year, the whole program started in the February time frame. We have the benefit of being up and running and it starting as of the beginning, so it will be a full year. But we also purposely are front-ending a lot of our restructuring initiatives and expect to get benefits within the year from a lot of that. So that will have an incremental impact, that alone.

Jeff Jacobson - Xerox Corporation - CEO

And again, when you look at the delayering of the organization, we have gone from about 11 layers down to seven layers. If you look at the things we have been doing in technical service, those things are starting to hit now. Obviously, as we discussed, we have \$225 million in restructuring. We're going to do a lot of that in the first quarter, \$125 million of the \$225 million.



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So as Bill mentioned, we have a head start versus last year. We have got runway. We have got wraparound benefits from 2016 flowing into 2017, and we're hitting it pretty hard.

George Tong - *Piper Jaffray & Co. - Analyst*

Got it, that's helpful. For your upcoming product launch, can you elaborate on your 2017 and 2018 timeline in terms of the cadence of when those products will come out and what the margin mix impact could be, based on your mix of new products and entry mid and the high end?

Jeff Jacobson - *Xerox Corporation - CEO*

Yes, so the vast majority, almost all of them, George, should be in by the -- into our supply chain, I am going to underline into our supply chain, by the end of the first half of the year. Then they obviously will start flowing into our reseller supply chains and to the direct users in the second half of the year, and that's why Bill commented we will see the equipment sale revenue benefits year over year in the second half and the flowthrough of the post-sale in 2018.

From a margin standpoint, as we all know in this industry, A4, obviously, you mix down the entire industry when you sell the A4. You lose money on the hardware. You make money in the post-sale. We have contemplated that mix in terms of the -- what we are doing from a strategic transformation on the cost side to offset that. Additionally, as we are selling more into the SMB markets, we would expect the margins there to be healthier than they would be in the enterprise. So, net net, we should be okay and we have contemplated that in our guidance.

Jennifer Horsley - *Xerox Corporation - Director IR*

Thanks, George. Operator, I think we have time for one last question.

Operator

Mark Moskowitz, Barclays.

Mark Moskowitz - *Barclays Capital - Analyst*

Good morning and I appreciate the details and the crisp messaging today. Two questions, if I could real quickly here. Can you remind us how we should think about the strategic growth initiatives in terms of how they compare to your legacy business from a cash flow perspective? Do you get better cash attach for these new initiatives or you sell more installs?

And then, secondly is more tactical. The conservatism around the first half of the year, I know you're not giving explicit guidance, but your guidance you did provide around the contribution for earnings for the first quarter, is that related to conservatism just post-split? I know it is two different companies, but HP Inc. hit an air pocket when they misread the channel replenishment post their split a year and a half or so ago. Is there any sort of dynamic you're trying to brace for there or is it just more of the aforementioned factors surrounding the high end versus low end and the new product launches? Thank you.

Bill Osbourn - *Xerox Corporation - EVP, CFO*

Yes, I will address the second part of the question regarding conservatism. The comments regarding Q1 and the relative history being about 20% of the total and the headwinds are what we are seeing, is our best estimate right now. I think your question is getting to is there any distractions as a result of the recent split. And really, we are not -- we don't see any. We are not factoring any of that in, really, as far as the first quarter. It is really just what we are seeing as far as our buildup and what sort of headwinds we see.



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Jeff Jacobson - Xerox Corporation - CEO

Yes, and Mark, we don't envision the margins or the cash being any different in our strategic growth areas. If you look at them, it is managed print services and workflow automation where we have been operating the business for a long time, production color where we are a leader, and certainly in the A4 MFPs, those will be going into the channel where we have been working within. As we said, the margins in the SMB business to some extent should be better than they are in the enterprise. So, net net, we should be okay.

Jennifer Horsley - Xerox Corporation - Director IR

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

Jeff Jacobson - Xerox Corporation - CEO

Thanks, Jennifer, and thank you all for your questions.

As I said earlier, we are a new Xerox and we really are excited about the opportunities ahead of us. We have a well-defined strategy to pursue the growth areas of the market, while we continue to advance our strategic transformation program. This combination will provide the headroom we need to enhance margins as we invest for growth to change the trajectory of our revenue. Our team is very focused and we are confident in our ability to meet our commitments. We look forward to updating you on our progress, and I want to thank you all for joining our call today.

Operator

Ladies and gentlemen, thank you for participating in today's conference. That does conclude today's program. You may all disconnect. Everyone, have a great day.

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