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XRX - Q2 2015 Xerox Corp Earnings Call

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OVERVIEW:

XRX reported 2Q15 total revenue of \$4.6b and GAAP EPS from continuing operations of \$0.09. Expects 2015 revenue will be down approx. 2% on constant currency basis and adjusted EPS to be at lower-end of \$0.95-1.01 range. Expects 3Q15 adjusted EPS to be \$0.22-0.24.



CORPORATE PARTICIPANTS

Ursula Burns *Xerox Corporation - Chairman and CEO*

Kathy Mikells *Xerox Corporation - Corporate EVP and CFO*

Leslie Varon *Xerox Corporation - VP of IR*

Bob Zapfel *Xerox Corporation - Corporate EVP and President, Xerox Services*

CONFERENCE CALL PARTICIPANTS

George Tong *Piper Jaffray & Co. - Analyst*

Shannon Cross *Cross Research - Analyst*

Keith Bachman *BMO Capital Markets - Analyst*

Jim Suva *Citigroup - Analyst*

Matt Cabral *Goldman Sachs - Analyst*

Brian Essex *Morgan Stanley - Analyst*

Ananda Baruah *Brean Capital, LLC - Analyst*

Tien-tsin Huang *JPMorgan - Analyst*

Kulbinder Garcha *Credit Suisse - Analyst*

Jamie Friedman *Susquehanna Financial Group/SIG - Analyst*

PRESENTATION

Operator

Good morning and welcome to the Xerox Corporation second-quarter 2015 earnings release conference call hosted by Ursula Burns, Chairman of the Board and Chief Executive Officer. She is joined by Kathy Mikells, Executive Vice President and Chief Financial Officer.

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

(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 and CEO

Good morning, and thanks for joining our call. Today, we reported second quarter results that are largely in line with our guidance. During the call, we will update you on our strategy, provide detail on the second quarter, and share the areas where we are intensifying our focus throughout the balance of the year.

Let's start with our strategy. Our direction has been consistent. We are making progress in some areas, but we know we can and should do better in other areas. While our direction is unchanged, we are making several shifts in the way that we execute against it.



First, we have taken steps to create much greater focus in our services business. We completed the divestiture of our ITO business enabling a clear focus on the BPO and Document Outsourcing businesses. Last Friday, we announced a major change in our government healthcare strategy. We are focused on ensuring the success of the existing Health Enterprise implementations by limiting new pursuits with this platform.

Second, we are modifying our acquisition expectations for the year, setting an achievable spend level given our progress to date.

Third, the services leadership team is in place with our last industry leader appointed in April. Our capabilities are fully staffed and sales resources are in place to market our full portfolio of services.

Collectively, these actions result in a sharpened focus on achieving organic improvement in our Services business.

We've also announced changes to our 2015 capital allocation plans. For the full year, we will increase our share repurchase by \$300 million to \$1.3 billion, and we will return \$300 million to shareholders in dividends, unchanged.

In summary, we have the right business strategy, we are reprioritizing investments and accelerating our restructuring actions in Services to improve revenue and margin. While we have more work to do, we are making decisions and changes that will deliver attractive returns for our investors.

Now let's look at quarter 2. We delivered adjusted earnings per share of \$0.22 -- that's in line with our guidance -- which excludes a previously announced healthcare software impairment charges of \$0.08. Total revenue was \$4.6 billion, which is down 3% in constant currency. We grew Services revenue modestly in constant currency that was driven by strong performance in Document Outsourcing. We delivered on our Services margin guidance.

There are a few highlights in Services that I would like to share. We are seeing indications that our new Services go-to-market model is taking root. Our opportunity pipeline is up sequentially, and we are seeing more cross-selling and better customer engagement. We made some important strides in innovation introducing new levels of robotic information to support our BPO offerings. For example, we recently announced ClearSight Automated Intelligence and ClearSight Case Management. We also introduced managed print services innovations with next generation offerings and workflow automation solutions to reinforce our leadership in the industry.

And for internal productivity, we're driving transformational change in our own capability operations with the Call Center of the Future program.

Now moving on to Document Technology. Revenue was down 7% in constant currency, which is modestly lower than what we had expected. Including DO though, total document related revenues were down 4% in constant currency. That's consistent with the trends that we have seen over the last several quarters.

Document Technology margins were in line with expectations. Here are some highlights on Doc Tech. We retained our number one position in equipment sales revenue market share for the 22nd straight quarter. We were pleased with in-store performance in the quarter as most product segments improved, especially in the high end of our business. The new product introductions during the quarter and the launch of the iGen 5 earlier this month will enable us to continue in our leader position.

Finally, we used our strong operating cash flow, \$349 million in the quarter, to acquire Health Communities Institute and Conestoga Business Solutions. We repurchased shares and supported our dividend program.

Now I'll turn it over to Kathy to go over some details in the quarter. I'll be back later to wrap things up. Kathy?

Kathy Mikells - Xerox Corporation - Corporate EVP and CFO

Thanks, Ursula, and good morning, everyone. Our bottom-line results were within our guidance for the quarter with Services profit in line, Tech profits a little light on modestly softer revenue, which was offset by a bit better non-operating expenses.



I will cover the segments in more detail in a minute but first I will run through total Company results for the second quarter.

Total revenue in the quarter was down 7% at actual currency and 3% at constant currency. Growth in Services was more than offset by declines in Document Technology which accelerated modestly driven by continued weakness in developing markets and higher declines in supply revenue. The negative currency impact of 4 points on our top line was consistent with our expectations and with first-quarter results.

Gross margin of 31.1% was down 100 basis points year over year driven by lower Technology gross margin as well as the greater mix of Services which carries lower margin. RD&E was slightly lower year over year and SAG in absolute dollar terms was down 6% helped by currency. However, as a percent of revenue, SAG was up 30 basis points year over year to 19.7% as productivity benefits were more than offset by investments in Services. As a result, our second quarter operating margin decreased 160 basis points year over year and operating profit declined 22%. About a quarter of the operating profit decline was driven by currency and developing markets with the remainder of the decline coming from the causals that I just discussed.

Moving down the income statement, Adjusted other, net expense was \$26 million lower year over year, driven by lower restructuring costs. Equity income was \$29 million in the quarter down \$4 million year over year, driven by the continued impact of negative translation currency. Our second quarter adjusted tax rate of 25.8% was in the middle of our guidance and about one point lower year over year. Second-quarter adjusted earnings per share was in the middle of our guidance range at \$0.22.

GAAP EPS from continuing operations in the quarter was \$0.09 and includes the \$0.08 impact from the government healthcare software impairment we announced last week which was driven by the strategy change that Ursula already discussed. As this was a very large non-cash charge, we excluded it from our adjusted results to better reflect underlying operating performance.

I'll now move on to discuss our operating performance in Services. Services revenue declined 3% and was up 1% in constant currency, which was consistent with the first quarter and a bit better than our guidance of roughly flat, driven by 4% growth in Document Outsourcing.

Growth in Document Outsourcing reflects continued strong Xerox Partner Print Services growth as well as good equipment revenue growth in Enterprise accounts from recent strong signings. BPO revenue was down 1% reflecting the continued headwind from last year's larger contract losses more than offsetting lower new ramps from softer signings in previous quarters.

We continue to expect BPO growth to improve in the second half as we lap the larger contract losses. We completed two small acquisitions in the first half and M&A remains a variable factor. I'll talk about this more when I cover cash flow and capital allocation.

Total signings in the quarter were up 20% and new business signings were up 9% driven by strong signings in Document Outsourcing as well as the recently signed New York Medicaid processing contract in BPO. We expect our go-to-market investments and moves to industry alignment will yield improved new business signings growth as we progress to the year. Our pipeline continues to build and is up sequentially.

Our renewal rate in the quarter was 82%, which was below our target range of 85% to 90% and reflected in part lower renewal opportunities in the quarter. Year to date renewal rate is 87%.

Turning to margin, segment margin was 7.5% in the quarter which was down 100 basis points year over year and in line with our expectation. As expected, margin was pressured by higher costs related to our Health Enterprise platform implementation. As we acknowledged last quarter, costs are continuing to run high and we have more work to do to turn around financial performance in these accounts.

Additionally, investments in our new Services operating model are not yet being fully offset by enhanced productivity from our operational initiatives, which are still ramping up. Partially offsetting these impacts was continued good margins in Document Outsourcing albeit lower year over year, as expected, and the year-over-year compare benefit related to the charge last year from the lost Nevada HIX business.



So in summary, the quarter was in line for Services. We have made significant changes over the past year to move our Services business forward and will be taking additional restructuring actions to ensure our productivity ramps up faster throughout the second half. I'll discuss this more when we get to guidance.

I'll now turn to Document Technology. Document Technology revenue in the quarter was down 7% at constant currency. As expected, currency had a 5-point negative impact with revenue at actual currency down 12%. As we highlighted last quarter, we don't include developing markets in our constant currency calculation but if we had revenue would have been down 6% at constant currency so overall revenue trends remained fairly stable.

Looking at the details, equipment revenue declines moderated, down 6% at constant currency in the second quarter versus down 8% in the first quarter and 10% in the fourth quarter. The improving trend reflects benefits from recent new product launches, especially within high-end where equipment revenue grew in the quarter.

Offsetting the positive equipment trend were higher declines in supplies revenue driven in part by developing markets which were pressured by softening economies and currency.

From an activity perspective, we saw improvements in growth in midrange, high-end, and higher volume Entry products. So, overall positive growth in installs across our product segment.

Document Technology margin of 12.1% was down year over year but up sequentially and in the middle of our 11% to 13% range for 2015. Year-over-year drivers included the anticipated higher pension expense and negative mix associated with improved equipment sales at lower margins. These were partially offset by a retiree health curtailment gain.

So in closing, revenues were a little lighter than expected but overall a reasonable quarter for Technology with equipment trends and high-end performance seeing positive takeaways.

Turning to cash flow. Cash flow from operations was \$349 million in the quarter, above last year's cash flow of \$325 million. This reflects good overall performance despite weaker profit as working capital was a lower net use versus last year driven by the following factors: accounts receivable was a source of \$56 million in the quarter versus a use last year reflecting lower revenues and flat year-over-year DSO; accounts payable and accrued compensation was a \$75 million lower use this year reflecting timing of supplier payments. This was partially offset by a little higher inventory due to timing of shipments.

Moving down the cash flow statement, investing cash flows were an \$831 million source driven by proceeds of \$930 million from the sale of the ITO business. This was partially offset by \$102 million spent on CapEx and \$20 million on acquisitions.

Cash flow from financing was a \$423 million use, which included \$395 million spent on share repurchases and \$83 million used for preferred and common stock dividends. As well, it reflects an increase in Commercial Paper offset by payments of \$250 million on Senior Notes.

Our cash balance at the end of the quarter was \$1.6 billion, an increase of \$769 million since the end of the first quarter driven by the proceeds received on June 30th from the ITO divestiture. So cash flow is strong and continues to track our expectations.

Now, I'll quickly go over capital structure. We ended the second quarter with \$7.6 billion of debt. Applying 7-to-1 leverage on customer financing assets, our allocated financing debt at the end of the second quarter was \$3.9 billion leaving core debt of \$3.7 billion. We manage our core debt to maintain credit metrics consistent with our investment grade rating. Our capital structure remains fairly stable. If we move to the next slide, I'll review where we are in terms of capital allocation.

Through the first half, we have repurchased \$611 million in shares, spent \$147 million on common stock dividends, and \$48 million on acquisitions. Considering our first half performance and the opportunities we see for the balance of the year, we are adjusting our capital allocation plans.



On acquisitions, we have spent about \$50 million year-to-date. We now expect to spend between \$100 million and \$400 million for the full year. The bar is higher as we focus on organic improvement in Services for the next few quarters. We are working to enhance our proactive business development capabilities and recently hired a new leader for business development and M&A.

On share repurchase, we are increasing our full-year plan by \$300 million to \$1.3 billion. This reflects our view that our shares are attractively priced and a good investment as well as our reduced near-term plans for acquisitions. This leaves approximately \$200 million unallocated that we will deploy opportunistically.

On debt, we retired our last tranche of debt coming due this year, \$250 million in June, and we continue to expect to end the year at a debt balance of roughly \$7.7 billion. And finally on dividends, we continue to expect to spend just over \$300 million.

I'll now turn to a discussion of guidance. First starting with revenue. Document technologies trends are stable as expected improvements in high-end and financing have been offset by ongoing weakness in developing markets from softening economies as well as from currency. As a result, we are planning for Document Technology revenue to be down roughly 6% at constant currency in the second half and for the full year. Additionally, we are spending less on acquisitions than originally planned, dampening back half Services revenue acceleration.

At the total Company level, we now anticipate full-year revenue, at constant currency, will be down approximately 2%, consistent with prior year and down 1 point from what we last communicated. Turning to margin, we expect Services margin will be at the low-end of the 8.5% to 9% range for the year. With our margin at 7.5% for the first half, we need to average about 9.5% in the second half of the year to hit that level. This requires a step function change given the continued higher Health Enterprise implementation costs and margins not yet improving in the business as a whole outside of Health Enterprise.

While our productivity initiatives are beginning to ramp, we need to further accelerate that to drive the second half improvement. In addition to capturing attrition benefit, we are planning a restructuring initiative which combined will reduce headcount by approximately 3,000 people. We expect modest sequential Services margin improvement in the third quarter with the fourth quarter clearly showing the greatest benefit, given the timing of additional workforce actions and accelerating yield from our operating model changes. Seasonality in Document Outsourcing also aids sequential improvement in the fourth quarter.

For Document Technology, we continue to expect margins between 11% to 13% for the full year, in part supported by pension expense coming in lower than originally anticipated.

In the first half, restructuring actions were focused on Technology. In contrast, our second half actions will be focused on Services. As a result, we expect relatively low restructuring costs due to natural attrition and relatively low average severance costs in services.

So in summary, we now expect to be at the lower end of our \$0.95 to \$1.01 adjusted earnings per share range. For the third quarter, we expect adjusted earnings per share between \$0.22 and \$0.24 reflecting normal seasonality and approximately \$0.01 of restructuring.

As I indicated earlier, operating cash flow was strong in the first half and we still expect to be within our \$1.7 billion to \$1.9 billion range despite the lower earnings, reflecting both good working capital performance and lower restructuring costs.

We are committed to taking the needed actions to improve profitability and meet our 2015 earnings and cash flow guidance. And we are confident that we have the right plan in place to deliver that, and create value for our shareholders.

With that, I'll hand it back to you, Ursula.

Ursula Burns - Xerox Corporation - Chairman and CEO

So thanks, Kathy. And for the second quarter, as Kathy said, we largely met expectations. We are committed to delivering our guidance and we are doing everything that we can to over achieve. In Services, we are accelerating cost-reduction actions and reprioritizing investments in the second



half to position the business for stronger financial performance while investing in the parts of the business that are critical to drive productivity and future growth.

In Document Technology, we are focused on leading in the most attractive segments of the market and on delivering strong financial performance. So in short, it's all about focus at Xerox.

In addition to leading in the attractive document [segment] markets, we are focused on making portfolio moves that strengthen our business financially and strategically. We are focused on optimizing our new Service operating model. We are focused on productivity improvements across the business. We are focused on driving revenue and profit growth in every line of business and most importantly we are focused on our people and on our clients. We remain committed to our business strategy and we are bullish about the markets that we serve and the opportunities that lie ahead.

Thank you, and now let me turn it over to Leslie.

Leslie Varon - Xerox Corporation - VP of IR

Thanks, Ursula. Joining Ursula and Kathy today is Bob Zapfel, head of our Services business. Let me point out that we have several supplemental slides at the end of our deck they provide more financial detail support today's presentation and complement our prepared remarks.

For the Q&A, I'd ask participants to limit follow-on and multipart questions so we can get to everyone. At the end of our Q&A session, I'll turn it back to Ursula for closing comments.

Karen, you can please now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) George Tong, Piper Jaffray.

George Tong - Piper Jaffray & Co. - Analyst

First question for Kathy. In your margin performance guidance for Services that's been updated, can you detail what you're assuming for margin performance outside of government healthcare and what investments into government healthcare, you're assuming in the second half?

Kathy Mikells - Xerox Corporation - Corporate EVP and CFO

Sure, if you look at what I discussed in terms of the overall progression in Services margin in the second half, it's very clear that outside of the Health Enterprise accounts what we are expecting is ramping productivity between the third and fourth quarter to basically accelerate our margin improvement over the second half.

The other thing that's really important to recall is that Document Outsourcing is a meaningful part of our Services business and as a percent of our Services business got larger when we divested the ITO business. And that has a natural seasonal pattern in the second half of the year where margins decline in the third quarter and then accelerate sequentially in the fourth quarter. So those are some of the important puts and takes in terms of the acceleration in the back half of the year.



Operator

Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

Thank you very much. I had a couple of Services questions as well. I mean, first can you talk a bit more about details on the restructuring program and specifically what I'm wondering is kind of what has changed in how you're looking at the restructuring from last quarter to this quarter?

Bob Zapfel - *Xerox Corporation - Corporate EVP and President, Xerox Services*

Shannon, it's Bob. So, a couple of things. First, as was mentioned, heavily focused on Services rather than Doc Tech where we get kind of visibly more yield for restructuring dollars spent. And then inside our Services restructuring, a combination of what I would call G&A part of -- now that we've got our arms around managing the set of people and our capabilities organization but a combination of that and then not needing to backfill and being able to take out a higher proportion of our delivery resources as a result of automation investments that we've been making during the year and as a result of really having improved the service level quality where we are confident.

We were trying to be a little bit careful to not go too quickly relative to optimizing our cost base without being sure that we could maintain and continue to increase delivery quality. So this would be the main summary points.

Operator

Our next question comes from -- I'm sorry?

Leslie Varon - *Xerox Corporation - VP of IR*

I was just asking Shannon if she had a follow-up, because she mentioned she had a couple of questions.

Operator

Shannon, your line is open.

Shannon Cross - *Cross Research - Analyst*

Okay, thank you. My only follow-up is just, can you talk a little bit -- you started to retrain and realign the salesforce on the services side. So I'm curious as to what you're seeing in terms of any benefit from that or how that's progressing.

Bob Zapfel - *Xerox Corporation - Corporate EVP and President, Xerox Services*

Yes, we have completed, largely completed the addition of resources in our sales teams and, you know, we've got good sequential pipeline improvement. So besides the fact that as was mentioned before, our signings were strong in the quarter, we've seen our pipeline build out. And we are also seeing, which was part of the design of the new model of going to market by industry, we are seeing a visible increase in the number of opportunities where we are bringing more than one offering to the customer. So that it's leveraging Xerox services broadly rather than an isolated offering by itself. So those would be the primary points.



Leslie Varon - Xerox Corporation - VP of IR

Karen, I think we can move onto the next question.

Operator

Keith Bachman, BMO Capital Markets.

Keith Bachman - BMO Capital Markets - Analyst

Thank you, I had two as well. On the M&A pipeline, I understand completely that you want to focus on kind of righting the ship. But if I think about over the last year and 1.5 years, it seems like Xerox hasn't been able to hit, identify targets associated with M&A in the services area.

And in contrast, it seems like I get an email a week from Accenture about adding deals or completing deals. I'm wondering is this more Xerox threshold, is it the pipeline, is that the supply-demand imbalance?

What has been the challenge associated with adding services revenue through inorganic means and then I have follow-up.

Kathy Mikells - Xerox Corporation - Corporate EVP and CFO

So Keith, I'm going to start with the way we have historically talked about this, we tended to say and up to number. So as an example when we started the year we said M&A up to \$900 million and in fact we knew that was kind of quite a big number for us especially relative to what we had typically been doing in the past. And so, we also said at the same time that we expected we might roll some of that over until next year. You know, I'd note in the recent guidance we just gave, we are giving a range. Because it seems like when we set up to if we didn't hit the top end of that number, people really dinged us for falling short, when M&A is a little difficult the call.

If I go to what we need to do to actually get more done, I'd say the core thing we need to do is improve our hit rate and the changes that we are looking to make is to pivot more of our activity to a proactive approach rather than just looking at deals that are being brokered in the market.

That isn't something that happens overnight. I mentioned that we hired a new leader recently in order to head up that business. And in the meantime, we're also clearly looking to hold the bar a little higher as we focus over the next couple of quarters on really getting our organic improvements and services accelerating.

Ursula Burns - Xerox Corporation - Chairman and CEO

If I can just add something. We are clearly -- part of our model to fill out capabilities and broaden our reach, particularly internationally, we need M&A. So we are not pleased with the fact that we are at the low-end of our performance ranges here. But I also think it's kind of a fortuitous time in the back half of the year to be focused on organic growth. We have all of the infrastructure in place. We've hired the capability leaders. We have the salesforce full. We have the line of business guys all in place. We have a good start to an operating model and focus here is an important thing.

I don't want anyone to believe that we are walking away from M&A that we're not going to do it but based on the reality of where we are, I think we're going to be in this \$100 million to \$400 million range. We're going to spend the last half of the year trying to get that done and then making sure that we have a foundation, a strong foundation; a kind of unshakable foundation in the organic side of the business. So I know it's not where we want to end up but it is where we are.

Keith Bachman - *BMO Capital Markets - Analyst*

Well, I think Ursula, it's certainly the right thing to do is try to focus on the execution. I think totally appropriate.

My follow-up question, though, is on the printing side of the business. It does seem like there are some challenges there, and I was wondering if you could add any color. In particular, the supply side seems a bit weaker than I would have anticipated, and it seems to be a lingering problem. And is that just demand or is there share or is there -- how is the technology business seem to be facing incremental challenges particularly on supplies. Thank you.

Kathy Mikells - *Xerox Corporation - Corporate EVP and CFO*

And so, specifically on supplies, I'm going to first kind of refer back to my commentary when I talked about developing markets and the fact that we don't adjust currency out. So when we look at these numbers and publish these numbers, it has developing markets at actual currency. If you make that adjustment in tech or supplies, it actually moves the number by about 2 points. And that would be the case for the last couple of quarters that currencies in developing markets have really been under pressure.

So I think if you look at it that way, I would say overall supply ebb and flow a little bit but we don't see any kind of monumental shifts going on here. We think the business is pretty stable.

Ursula Burns - *Xerox Corporation - Chairman and CEO*

One other thing to add, Keith, if I can, is that our supplies mix is a little different than what some of our peers or competitors are as well, so a smaller portion of our business. Most of our supplies are bundled in contracts and what we're talking about here are the supplies outside of that. It's a lower portion by a lot of our business. That's one.

And the other thing about supplies is that -- Kathy talked about the currency impact but it is even outside of the currency, DMO is just a basket of uncertainty there. We manage very tightly. We try to get our inventory levels lined up. Everything has to be managed pretty tightly by us there so we don't get too far over our skis.

I think, fundamentally, we don't see massive changes in the marketplace particularly when you look at currency but we do pay a lot of attention to it and also remember that it's a smaller part of our business than some of our competitors.

Keith Bachman - *BMO Capital Markets - Analyst*

All right, fair enough, I will cede the floor. Many thanks.

Operator

Jim Suva, Citigroup.

Jim Suva - *Citigroup - Analyst*

My question is regarding the turnaround of operating services. If I do the math correctly unless I'm mistaken, it looks like calendar Q4 will have operating margins 10% or above. Is my math right and if so can you help us with your confidence and conviction there because it was literally at your Investor Day where Bob -- literally we asked does he [bluff] these numbers? You've been at the company now for nine months and looked at the contracts and kicked the tires and toured. And you said yes and then we had a takedown as this year has progressed in this area. So you can help us understand and do you actually have the visibility to kind of put your name behind it all as it's been a challenging area.



And then my follow-up question is more probably for Kathy on the cash flow side. You know, very (technical difficulty) cash flow held this year despite all the stumblings and challenges that you've actually had this year and the take down of lots of different things from revenues to margins to M&A and all that not coming through. So are there things that are helping out cash flow one time this year whether it's pension or reversals or something like that that we should be aware of that are not sustainable? And the reason why is numbers have perpetually been coming down lower but cash flow has held up. I just wanted to know if that cash flow is still protected as we look forward long-term in the model. Thank you.

Bob Zapfel - Xerox Corporation - Corporate EVP and President, Xerox Services

Jim, it's Bob, I'll start. So first your math is accurate. So for us to deliver the commitments we made we would expect to drive a two-digit number in the fourth quarter. And I guess what I would go back to is we got a broad set of actions that drive that, if you will, hockey stick of improvement. They start with the productivity that we talked about earlier and restructuring and taking costs out of our delivery model and cost base. It also includes a lower level of losses in our health enterprise portfolio. We think we've got sufficient contingencies for the unpredictability that we would see there but that is part of our design model. I talked about the restructuring beyond delivery. We've got continued strong profitability in our document outsourcing business, and it's got a seasonality that's heavier in the second half in terms of profit yield than the first half.

And then we're really committed to driving improved revenue dynamics. So we have been pretty visible all along that we thought that we would be at the lower end of the [2] to [4] revenue range. We've run at [1] for the first half of the year. So mathematically, we'd obviously have to get to [3] in the second half.

We've got headwinds that dissipate relative to Texas and student loans. We've got New York ramping. On the other side of it, we'll have less in the way of inorganic revenue growth. But the combination of factors would get us to improved revenue dynamics in the second half and then that profit increase is part of our model.

So Kathy, do you want to address cash flow or provide more color on --?

Kathy Mikells - Xerox Corporation - Corporate EVP and CFO

I'll go to cash flow. On cash flow, I'd start with as you mentioned, our cash flow has been really strong for the first half of the year and we're very comfortable with where our guidance is.

If you look at some of the charges we've taken this year, especially in health enterprise outside of the recent impairment charge which is obviously non-cash, some of those charges are just spread over the contract period where we are doing the health enterprise implementations. And so while they have some cash impact in the current year, the cash impact is really spread over a multiple-year period.

As we see declines in our technology business, that actually throws off a reduction in working capital, and so we get a natural benefit there as well as actually just managing our working capital really well. And then finally the lower segment results are in part offset with a little lower restructuring.

So as we look out to the back half based on where we've been tracking year to date this year, we feel very comfortable about where we are at meeting our guidance.

Leslie Varon - Xerox Corporation - VP of IR

Operator, next question.

Operator

Bill Shope, Goldman Sachs.



Matt Cabral - Goldman Sachs - Analyst

Thank you this is Matt Cabral in for Bill. So I wanted to better understand the thought process behind the announcement last week to limit health enterprises at six states you currently have under contract. Was there anything that changed the last quarter to necessitate this change? Are there any additional challenges that you see in ramping those four states that aren't up and running yet that maybe weren't as clear three or six months ago?

And then related to that, just thinking to the longer-term revenue targets that you guys gave for the services business, how much of that was predicated on extending health enterprise into additional states beyond the six that you currently have?

Ursula Burns - Xerox Corporation - Chairman and CEO

So the decision to -- I'm going to have Bob kind of follow-up with the details but I also wanted to start out with the top-level decision. And the decision that we announced last Friday was one that was a fundamental strategic change. And the change was not that we didn't want to be in health enterprise, we just wanted get what we had under way kind of bedded down and tightly focused.

We have big states, New York and California -- New York just starting, and California kind of in the middle of its journey. And what I asked the services team to do is actually focus on those big implementations. The six states that we have, let's make sure that we get those settled down and then will start to pursue the market again in the future if we think it's actually useful.

So I'm going to actually then have Bob get into the details of what we see in the states.

Bob Zapfel - Xerox Corporation - Corporate EVP and President, Xerox Services

Yes, I would just add as Ursula shared, I mean we're really trying to focus on success in those existing clients, and we've got the big states reference left to really deliver on. Long term to grow -- the best way to grow is to have every customer completely satisfied. So we felt like our delivery capacity -- you know, you've got to remember New York really was just won at this point in the last conference call. And as we looked at how much capacity we had, the work to do in California and New York, Montana kind of across the remaining portfolio. We felt that we would be better served to center our resources there.

There aren't that many new bids that come up. It's not something where all 50 states are rebidding every year. We have -- these have a long shelf life so we felt that it would be better both short-term and long-term to deliver world-class service and platforms with these accounts and then reassess after that's done whether we would pursue more opportunities in the marketplace.

Ursula Burns - Xerox Corporation - Chairman and CEO

And long-term revenue dynamics, we do understand that we will have some back-end pressure. Back end meaning out year pressure but, as Bob said, the big thing here is that getting these six states done, we found historically that additional business comes if you operate really well. The quicker we can get them done and the quicker we can get them aligned, I think that we can actually balance the revenue in the out years that would be pressured if we didn't actually pursue. So I don't think that we're going to have significant issues in the out years due to this decision.

Bob Zapfel - Xerox Corporation - Corporate EVP and President, Xerox Services

And we'll have just to reinforce, we'll have visible growth here next year as we ramp New York. So this portfolio of accounts is not going to be a low growth business for us in the short-term but it is a longer-term question that we think we can manage.

Matt Cabral - Goldman Sachs - Analyst

Thank you.

Leslie Varon - Xerox Corporation - VP of IR

Karen, next question.

Operator

Brian Essex, Morgan Stanley.

Brian Essex - Morgan Stanley - Analyst

I was wondering if we could start off first of all just revisiting the New York contract and maybe, Bob, you just mentioned ramping in the next year. Obviously, we've known for quite some time that you had this contract and you'd been pre-spending, so to speak. Maybe help me understand or help us understand how you expect the trajectory of ramp for the benefits of that contract to be realized by the Company.

And then this kind of 18-month implementation timeline, when does that clock starts ticking. Are you well ahead of that or how do we think about hitting those goalposts and leveraging your now I guess fundamentally complete software development program and how can gain confidence so you can hit that timeframe?

Bob Zapfel - Xerox Corporation - Corporate EVP and President, Xerox Services

Okay, let me start if I can, Brian, with kind of delivery plan with New York. So there are two major release mileposts. One is at the first quarter of next year and the second is at the fourth quarter of 2016. There's a set of deliverables along the way, and we are on track across those deliverables.

And the reason, not the only reason, but a reason that we are off to a good start, as you referenced, is we invested ahead. So we took the financial hit a little bit in the fourth quarter and in the first quarter from investing ahead. In our initial concept sessions with the state where we confirmed designs have been very collaborative all going well. So at this point we're tracking well and, as you may remember, New York is basically leveraging the platform that we built for New Hampshire which was just certified by CMS back in June. So it's now federally certified as a good platform.

Relative to ramp on the revenues, Kathy, do you want to cover that?

Kathy Mikells - Xerox Corporation - Corporate EVP and CFO

Sure. So we just started the contract in the second quarter and so it's going to be ramping to the rest of the year. We should exit the year with New York just under a point in terms of kind of revenue growth for overall services.

Brian Essex - Morgan Stanley - Analyst

Okay, great. And then maybe if I could follow up the obligatory question on the Florida toll road contract. Any update there terms of progression of what you might expect in terms of a timeline?



Ursula Burns - Xerox Corporation - Chairman and CEO

Yes, I'm going to take this one. We don't have an update of what we would expect and the only reason why is that we're out of predicting this. We have won the bid and we've won the bid again. So we (technical difficulty) we've won the bid; it's not a question. But we now have an additional protest that is going to go through its cycle and when it's done, we'll get the business. We're not going to predict when that protest is going to be done because every time we seem to say something it delays it. So we're just going to stand pat.

Bob Zapfel - Xerox Corporation - Corporate EVP and President, Xerox Services

But we do think this is the last remaining potential protestee, so hopefully this is the last part of the cycle.

Brian Essex - Morgan Stanley - Analyst

Okay, very helpful.

Leslie Varon - Xerox Corporation - VP of IR

Thanks, Brian. Karen, next question.

Operator

Ananda Baruah, Brean Capital.

Ananda Baruah - Brean Capital, LLC - Analyst

Thanks for taking the question. I have two, if I could as well. I guess the first is, seems to be a revenue component to the second half guide-down with BMO and there seems to be services margin component as well, maybe to guide down the second half of the year is a couple of pennies.

So the question is kind of tail should we expect these to have, these two dynamics to have as we think about going into 2016? And to the extent that they do extend into 2016, can you make it up anywhere and, if not, should we when we start to think about 2016 -- I realize you're not going to give guidance. But if there's sort of like a \$0.02 tail, \$0.02 impact of these things in the second half of the year, should we think about their having some kind of impact as we move into the next year? And then I have a follow-up. Thanks.

Kathy Mikells - Xerox Corporation - Corporate EVP and CFO

So the overall dynamics that we're seeing really in tech are stable. And we had been expecting to see tech improve a little bit as a result of our execution in areas of growth. So while we're seeing good execution in a place like high-end, it's being offset by developing markets not stabilizing but continuing to be a little bit soft, both from soft economies in developing markets and from currency, and I mentioned the fact that we don't adjust out developing markets for constant currency basis. And so that kind of heightened the decline for us little bit.

On services, really the only change there is the fact that we are a little light on M&A and so that will make us a tad bit lighter in terms of just trying to accelerate growth in the back half. But it's important to understand the same way that the services segment margin kind of ramps over the course of the back half, we have a very similar dynamic going on in revenue in large part because we're going to start to lap some big contract losses.



So you'll recall the loss of the Texas Medicaid contract. If we look at first half over our second half, that's worth about 2 points to us. So between that and New York we have quite good, I'd say, organic revenue growth dynamics kind of naturally from half to half and throughout the second half of the year.

Ursula Burns - *Xerox Corporation - Chairman and CEO*

And Ananda, I would just say I know that we are guiding to the lower end of our range but I want to make sure that we understand that we are still in the range and we're going to try to do everything we can to overachieve that. But it's important -- we're trying to hold ourselves to the commitment to the range that we have in both services margin and in total EPS.

Ananda Baruah - *Brean Capital, LLC - Analyst*

And hopefully the new restructuring actions and the new wins that you have in services can actually sort of scale up into the cost structure and help the revenue and the margins there as well. So those are both good tick-ups.

And then I guess as my follow-up, just touching base on M&A again as it was touched on earlier in the Q&A, this is maybe the third year where you've been a little bit on the softer side of the target. My question is at what point do you guys start to get a little wary of what kind of longer-term top-line impact would be to the model? And then are you guys thinking of it in that context yet?

Kathy Mikells - *Xerox Corporation - Corporate EVP and CFO*

So I think the things that we're doing to I'd say change our approach in execution in M&A are what we need to do to actually get this engine kind of moving for us more consistently. And that's really pivoting from being opportunistic largely a pipeline of kind of brokers deals to an M&A and business development activity that's led by our strategic planning, and that strategic planning really yielding a team focus on where we have gaps in our portfolio and a proactive M&A activity where we proactively build our pipeline.

That, I'd say, shift in overall approach, not a shift in strategy for what we're trying to accomplish to M&A, but shift in the execution approach should help us to improve our hit rate. And if I had to kind of point to one soft underbelly in M&A, it's that with a large part of our pipeline coming through broker deals, our hit rate is not as high as we would desire it to be. So we are taking actions in order to change our overall approach so that we can be both very focused right and improve our hit rate.

Leslie Varon - *Xerox Corporation - VP of IR*

Thank you, Karen, next question.

Operator

Tien-tsin Huang, JPMorgan.

Tien-tsin Huang - *JPMorgan - Analyst*

I'll ask a derivative M&A question. I'm curious if all of this healthcare consolidation, especially on the healthcare payer space, does that have any impact to Xerox in your overall health care business?



Bob Zapfel - Xerox Corporation - Corporate EVP and President, Xerox Services

You know we're fortunate that we are providers to all of the players that are participating in the consolidation dynamics, and kind of my business experience is if you got the acquiree as the client, that's not a good place to be. When you have both the acquirer and the acquiree, you're better positioned. So I would expect -- and we don't do the exact same work with each side, if you will, and some of the big visibly announced planned mergers. So I think for us, there's always the chance that you're going to get -- you are going to be part of the synergy savings play and help those lead customers achieve their synergy savings.

We think we are well-positioned to participate in that because we will on both sides of the visible transactions. We have very strong client reference ability and we tend to see the clients wanting to consolidate and leverage providers where they would be more likely to even use us more broadly.

Tien-tsin Huang - JPMorgan - Analyst

Got it. Makes sense, Bob.

Leslie Varon - Xerox Corporation - VP of IR

Thanks. Karen -- certainly, one more question.

Tien-tsin Huang - JPMorgan - Analyst

I'm sorry, just a quick one. Just on the signing side -- thanks for letting me sneak one more in. Just on the services signings front. I caught the Florida comment, obviously New York coming in. I'm curious, any other larger deals that could be building up in the pipeline because thematically it sounds like bigger deals are coming back for this sector including within BPO. I'm curious if you're seeing that as well. Thank you. I'll drop off.

Bob Zapfel - Xerox Corporation - Corporate EVP and President, Xerox Services

We're not really seeing an increase in what I would call the big multi- or hundred-million dollar plus deals. But what we are seeing is we are seeing visible improvement in our pipeline including the progression. So not just the how many deals to be have to pursue but where are they in the sales stage that we need to then leverage to drive improved signings in the second half of the year. That's our plan.

Leslie Varon - Xerox Corporation - VP of IR

Thank you, next question, Karen.

Operator

Kulbinder Garcha, Credit Suisse.

Kulbinder Garcha - Credit Suisse - Analyst

Hi, most of my questions have been asked and maybe I missed some of these things but can you --?

Leslie Varon - Xerox Corporation - VP of IR

Can you speak up a little bit, Kulbinder.



Kulbinder Garcha - *Credit Suisse - Analyst*

Sorry, most of my questions have been asked. I just wanted to ask have you given a number for the restructuring amount this year and what's the normal level of restructuring going forward for the Company and then also what tax rate should we be assuming? Thanks.

Kathy Mikells - *Xerox Corporation - Corporate EVP and CFO*

So I think in going to repeat the questions just because I'm not positive that I heard you. Was your first question just asking about the level of restructuring generally?

Kulbinder Garcha - *Credit Suisse - Analyst*

Correct.

Kathy Mikells - *Xerox Corporation - Corporate EVP and CFO*

So we have tended to do, I'll call it, about \$0.02 a quarter or between \$0.01 and \$0.02 a quarter that ebbs and flows in different quarters as we look at and assess our business. We specifically guided to doing about \$0.01 in the third quarter, and we'll assess the fourth quarter as we get closer but we do have an expectation that in the back half of the year generally our restructuring is going to be a little bit lighter.

And I think your second question was overall kind of tax rate. We haven't changed our tax rate guidance. We expect to be between 25% and 27%.

Leslie Varon - *Xerox Corporation - VP of IR*

Thank you. I think we have time for one last question.

Operator

Thank you. Our final question for today comes from the line of Jamie Friedman from Susquehanna.

Jamie Friedman - *Susquehanna Financial Group/SIG - Analyst*

Thanks for sneaking me in, Leslie. There's a reference in the press release that's sort of deep down there but with regard to the New Hampshire contract and it states in there that Medicaid -- I'll just paraphrase -- that Medicaid certified you retroactively to the April 2013 implementation date. I guess, more generally, I was just -- what the status of New Hampshire is? I understand it's launched and live but what does that certification mean? And is there any financial implications to the fact that it's retroactive?

Bob Zapfel - *Xerox Corporation - Corporate EVP and President, Xerox Services*

There really aren't financial implications to the retroactivity but the certification that -- the certification really means for the other states that as they look at and work with us (technical difficulty) that platform not just that were selling with its features but that the feds and CMS agree that that's designed to meet the federal targets. It's a very good thing.

Ursula Burns - Xerox Corporation - Chairman and CEO

It's a very good thing. Very good thing.

Jamie Friedman - Susquehanna Financial Group/SIG - Analyst

That sounds like a positive, thank you.

Leslie Varon - Xerox Corporation - VP of IR

Great, thanks, Jamie. So that's all the time we have for questions today. Ursula, wrap up?

Ursula Burns - Xerox Corporation - Chairman and CEO

So as I said earlier, the second quarter was in line but we expect more and we're working to deliver more. We are making choices that increase our short-term performance while retaining the ability to achieve our long-term goals. We are focused on delivering better results and improving the performance of our business. And I thank you all for joining us on the call.

Leslie Varon - Xerox Corporation - VP of IR

Thanks, Ursula, that concludes our call today. If you have any further questions, please contact me or any member of our investor relations team.

Operator

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

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