

21-Apr-2022

Xerox Holdings Corp. (XRX)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Xerox Holdings Corporation First Quarter 2022 Earnings Release Conference Call. After the presentation, there will be a question-and-answer session. [Operator Instructions]

At this time, I would like to turn the meeting over to Mr. David Beckel, Vice President and Head of Investor Relations.

David Beckel

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

Good morning, everyone. I'm David Beckel, Vice President and Head of Investor Relations at Xerox Holdings Corporation. Welcome to the Xerox Holdings Corporation first quarter 2022 earnings release conference call hosted by John Visentin, Vice Chairman and Chief Executive Officer. He is joined by Xavier Heiss, Executive Vice President and Chief Financial Officer.

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

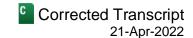
At this time, I'd like to turn the meeting over to Mr. Visentin. Mr. Visentin, you may begin.

John Visentin

Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Good morning, and thank you for joining our Q1 2022 earnings call. I hope everyone is safe and healthy. Before I get to the results, I want to start by acknowledging the humanitarian tragedy taking place in Ukraine. Our thoughts

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are with all those who have been affected. As the situation began to unfold in late February, we took swift and decisive actions to ensure the safety and security of our people. We suspended all but emergency support operations in Ukraine and provided emergency cash grants to the Ukrainian employees through our employee relief fund. Shipments to Russia were halted as soon as the conflict started. We continue to evaluate the situation in this region and will adapt our response, hoping for the restoration of peace as soon as possible.

In total, the percentage of our revenue exposed to the Eurasian region is in low-single digits. The operating environment was once again challenged in Q1 and will remain fluid in Q2. At the beginning of Q1, the Omicron variant resulted in office closures in our largest markets, affecting page volumes in January and February. Supply chains are still disrupted by COVID-related factory closures in parts of Asia. Inflationary pressure is building across our cost base, including cost of goods sold, labor and logistics.

At this point, we continue to expect supply chain conditions to ease beginning in the second half of the year, albeit at a slower pace than originally anticipated. Return to office trends are improving. As the Omicron variant receded, page volumes increased, result in March being one of the highest months of post-sale revenue since the beginning of the pandemic. The continued correlation between in-office work and print activity and strong demand for equipment and consumables confirms that employees are using our equipment and services when they return to the office.

Third-party data points to momentum in increasing office attendance, and we continue to expect a gradual return of workers to the office in Q2, with momentum building in the second half of the year, barring another variant outbreak.

Summarizing results for the quarter, revenue of \$1.67 billion declined 2.5% in actual currency and 0.7% in constant currency. Adjusted EPS was negative \$0.12, \$0.34 lower year-over-year. Free cash flow was \$50 million, compared to \$100 million in Q1 last year. And adjusted operating margin of negative 0.2% was lower year-over-year by 540 basis points.

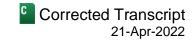
Revenue was in line with our expectations. Equipment revenue declined 17.6%, or 16.1% at constant currency, as expected, with supply chain disruptions limiting our ability to fulfill demand. Total backlog grew 21% sequentially to \$422 million, as demand for our equipment continued to outpace supply. Post-sale revenue grew 1.9% or 3.7% in constant currency, reflecting improvement in print activity. Our IT Services business grew double digits on an organic basis, and we expanded its reach with the acquisition of Powerland, a Canadian IT Services provider.

Operating costs in the quarter were higher than expected, resulting in a small adjusted operating loss and negative earnings per share. Going into the quarter, we knew supply chain constraints and investments in new businesses would weigh on our margins. What was unexpected was the magnitude and intensity of inflationary pressure across our cost base and the growth in supply chain costs. We expect the margin-dilutive effects of supply chain costs and new business investments to subside as constraints ease and our new businesses scale.

The effect of inflationary pressure is more difficult to predict, but we plan to offset most inflation-related cost growth with price adjustments and additional Project Own It savings. Price adjustments are being implemented, but it will take time to realize, given most of our revenue is contractual.

Despite the challenges we face, some of which are new since issuing our 2022 guidance, we are maintaining our revenue and free cash flow targets for the year, subject to our return to office and supply chain assumptions. Xavier will provide more color on guidance.

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We continue to focus on the same four strategic initiatives that guided us over the years: optimize operations, drive revenue, monetize innovation, and focus on cash flow. Project Own It has become institutionalized and ingrained in our culture, driving each employee to pursue operational efficiencies and excellence in everything we do.

To help stabilize our profitability and maintain our free cash flow target amidst inflationary pressures and a challenging operating environment, we plan to increase our targeted savings of \$300 million for 2022 by 50%. These efficiencies will catalyze operating margin improvement as our business recovers from the pandemic and recent supply chain disruptions.

Moving beyond the supply-constrained environment, we are confident in our ability to grow the Print and Services business. Growth will be driven by factors largely within our control, including market share gains and a greater strategic emphasis on secular growth verticals, such as IT and digital services.

For the full year of 2021, we gained approximately 200 basis points of equipment sales market share and achieved the number one share in our markets. These share gains reflect our differentiated go-to-market strategy and broad suite of product and services offerings.

Our services offerings include our leading Managed Print Services business, integrated workflow solutions, and a growing portfolio of IT and digital services. We continue to deliver innovation relevant for our customers, most recently refreshing our low-end A4 desktop cloud-connected models and A3 Entry models, with significant improvement in productivity and enhanced security with McAfee Embedded Security, all of which supports our award-winning Workflow Central platform.

Yesterday, it was announced that our Managed Print Services business was the sole winner of the Buyers Lab 2022-2023 PaceSetter Award in comprehensive MPS program from Keypoint Intelligence. This award reflects the breadth of our MPS offering, as well as our cloud-first development path, pivot to at-home workers and inclusion of dealer channel partners. IT and digital services will become a more significant part of our Print and Services business over time.

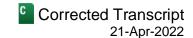
IT Services is a natural adjacency for Xerox, given the expansive direct sales force deployed through XBS, our unit serving small and medium-sized businesses. The SMB IT Services market is attractive as it is growing mid-single digits and competition is highly fragmented, and our IT Services business scales efficiently.

In Q1, IT Services grew more than 20% on an organic basis. And we expanded our geographic reach by acquiring Powerland, a leading IT Services provider in Canada. Our IT Services business is experiencing strong interest in some of the newest offerings, such as: robotic process automation, RPA; data solutions; and managed security.

We launched our commercial RPA business only recently and are already seeing repeat business from customers wanting to add bots to improve operational efficiency. Our bots help customers with invoice processing, order entry, financial reporting and document classification, and the pipeline of use cases continues to expand.

In Q2, we will offer an AI solution that automates data extraction from high volumes of unstructured document for our legal clients. Xerox Digital Services offerings are resonating with new and existing Managed Print Services clients. These offerings help clients navigate their digital documentation transformation by providing intelligent document processing and personalized customer communications. For Capture and Content, which includes

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Digital Mailroom, data extraction and processing services, signings grew 72% in the quarter, with new business signings growing more than 100%.

We continue to invest in FITTLE, CareAR and PARC. In Q1, FITTLE increased its focus on providing financing solutions that extend beyond Xerox equipment and services. This quarter, FITTLE added 24 dealers and grew indirect originations 7%, including a doubling of non-Xerox products. This growth was offset by 22% decline in Xerox direct originations for the quarter, due to an equipment shortage. FITTLE remains on track to achieve the financial targets provided at our Investor Day.

As a new business within Xerox, we expect CareAR to make consistent progress on KPIs that will drive strong revenue growth for the year. In Q1, CareAR grew its pipeline \$22 million, or 34% sequentially. It added 3 system integrator partners, 47 new customers and expanded ACV at another 60 customers. CareAR now serves clients across 13 industries and added solutions for banking, education, oil and gas and pharmaceutical clients during the quarter.

CareAR also announced the launch of CareAR Instruct, its second major product offering and a key competitive differentiator. Instruct expands on its flagship Assist product to incorporate self-solve capabilities for service agents and end users of complex devices. Instruct utilizes a full range of CareAR's IP, including AI, AR, document storage and content creation to provide critical insights.

At PARC, Eloque, Elem Additive Manufacturing and Novity target significant market opportunities, and each continue to gain traction within their respective markets this quarter. In Q1, Elem announced partnerships with Vertex, Oak Ridge National Laboratory and Siemens. These partners are using our 3D printers and working with Elem to expand its industrial use cases. Eloque plans to triple the number of bridges deployed in Australia during the first half of the year. It's also making headway in negotiations with several US states and European countries.

Novity is a newly launched company that will use PARC IoT expertise to commercialize a predictive maintenance platform for process manufacturing. Novity has a healthy pipeline of companies in the manufacturing and oil and gas industries and have signed two customers, including a pilot at Pennsy Supply, one of the leading manufacturers of building materials in the US.

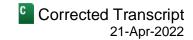
We continue to fund investments in innovation and launch new products and businesses. Going forward, we will increasingly look to monetize investments in innovation through strategic transactions. These transactions can take the form of minority investment, sales, partnerships or mergers of our businesses. We expect these transactions to create shareholder value by providing our newer businesses' access to additional capital and domain expertise.

We delivered positive free cash flow this quarter of \$50 million based on improved working capital discipline and returned \$159 million of cash to shareholders through dividends and buybacks. Notwithstanding an increasingly challenging operating environment, we expect to deliver at least \$400 million of free cash flow this year, while continuing to invest in new businesses. We will return at least 50% of free cash flow generated to shareholders. Additionally, cash may be used for value-accretive M&A and debt reduction.

To recap, our backlog remains strong, and page volumes are moving in the right direction as offices reopen. Supply chain challenges and broad-based inflationary pressures will challenge us to be smarter and more productive, as we remain committed to the guidance issued at the beginning of the year.

With that, I'll hand it over to Xavier.

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Xavier Heiss

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

Thank you, John; and good morning, everyone. As John mentioned, operational challenges persisted this quarter. We continue to face constraint on our ability to deliver and install order, and the cost of fulfilling those order have increased. Additionally, we halted shipment to Russia, a market that comprised a low-single-digit percentage of our revenue and profit in 2021. And we are seeing inflationary pressure across our cost base.

On the other end, revenue was in line with our expectation, and demand for our products and services remained strong, as evidenced by another increase in our backlog, to \$422 million in quarter one, which is close to 3 times higher than prior-year levels. Post-sales grew in actual and constant currency due to growth in IT Services; on growth in sole supplies on paper, which reflects higher printed pages. We also benefited from growth in our page-volume-driven contractual business, which continued to correlate with the return of worker to the office.

Turning to profitability. Similar to recent quarters, lower equipment sales or less profitable mix of equipment installed, higher supply chain cost, lower margin and post-sales revenue and incremental costs associated with new businesses drove our profitability lower year-over-year. In addition, we are seeing the effect of higher inflation across our cost base.

Gross margin declined 390 basis points in the first quarter. 280 basis points of this decline is attributable to supply chain cost and capacity restriction, including higher freight and shipping costs and constrained availability of higher-margin A3 devices. 110 basis points of the decline relate to investment to support future growth, lower royalty revenue from FUJIFILM Business Innovation and lower government subsidies. We continue to expect supply chain headwinds to moderate beginning the second half of the year.

Adjusted operating margin of minus 0.2% decreased 540 basis point year-over-year, reflecting lower gross profit, higher bad debt expense, prior-year benefit from temporary government subsidies on furlough measures on investment associated with our new businesses. These headwinds were partially offset by lower selling expenses resulting from lower sales volume and Project Own It savings.

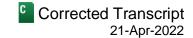
SAG expense of \$455 million increased \$7 million year-over-year. The increase was primarily driven by investment in new businesses, prior-year benefit from temporary government subsidies and furlough measure, higher bad debt provision resulting from the geopolitical environment in Eurasia on acquisition. These increases were partially offset by savings from Project Own It, lower sales and marketing expenses and currency.

RD&E was \$78 million in the quarter, or 4.7% of revenue, which was an increase of 40 basis point as a percentage of revenue year-over-year. The increase was driven primarily by continued investment in our new businesses this quarter, specifically CareAR and 3D, cleantech and IoT businesses at PARC.

Other expenses, net, was \$53 million higher year-over-year. The increase was primarily driven by a \$33 million charge associated with the termination of a product supply agreement. So, charge reflects a payment of a contractual cancellation fee, plus interest and related legal fee, which we expect to more than make up for over time via lower supply cost. Additionally, \$13 million of the increase relate to higher non-service retirement related interest cost due to an increase in interest cost associated with higher discount rates and higher settlement losses.

And \$5 million relate to increase in non-financing interest expenses, reflecting a higher allocation of interest to the non-financing or core debt. First quarter adjusted tax rate was 52.9%, compared to 27.7% last year. Since we

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generated a pre-tax loss, the higher tax rate reduced our tax obligation. This reduction was driven by benefit from additional tax incentives on lower indefinite reinvestment tax liability due to a recent acquisition.

Adjusted EPS of minus \$0.12 in the first quarter was \$0.34 lower than in the prior year. This decline was primarily driven by a year-over-year reduction in adjusted income. GAAP EPS of minus \$0.38 was \$0.56 lower year-over-year due to lower GAAP net income.

Turning to revenue. Total revenue was in line with our expectation, albeit with less favorable product mix, with equipment sales decline offset by modest improvement in post-sales revenue. The underlying fundamental of our business remains strong. Equipment orders once again outpaced supplies, resulting in a cumulative backlog this quarter of equipment and IT hardware of \$422 million, a 21% increase over quarter four and close to 3 times higher than prior-year level.

For context, our backlog is now larger than a full quarter's worth of equipment on hardware sales. Despite continued growth in our backlog, the quality of our backlog remain high. Close to half of our backlog is less than 60 days old. We have seen minimal cancellation of orders thus far. As customers are often willing to extend their existing leases, we are waiting for new equipment.

Further, we saw an uptick in page volume and page volume-driven post-sales revenue in March, as employee return to office following the Omicron variant. So continued correlation between page volume and workplace attendance and strong growth in usage based post-sales revenue, such as paper and supply, suggest workers are printing as they return to the office, as we expected.

Equipment sales of \$314 million in Q1 declined roughly 18% year-over-year, or 16% in constant currency. The decline was primarily driven by continued supply chain disruption, which limited our ability to fulfill demand. Installations were down year-over-year across all product type. And high-margin mid-range products continue to be the most impacted by supply chain issues.

Post-sales revenue of \$1.35 billion grew 1.9% year-over-year, or 3.7% in constant currency. Growth was driven by IT Services, which increased more than 20% year-over-year, excluding two months of revenue from our recent acquisition of Powerland, as well as higher sold supplies on paper revenues, which fluctuate with printing volume.

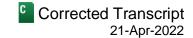
We saw modest growth in page volume-driven contractual revenue, corresponding with growth in printed pages. Post-sales revenue growth was partially offset by lower FUJIFILM Business Innovation royalties on lower XBS financing commission. In services, new businesses signing grew roughly 10% year-over-year, led by strong double-digit growth in signing of our capture and content digital services.

We generated free cash flow of \$50 million in Q1, down from \$100 million in the prior year. Lower cash earnings, which including investment in our new businesses and lower royalty payments were offset by working capital improvement and lower restructuring payment. We generated \$66 million of operating cash flow in the quarter, compared to \$117 million in the prior year.

Working capital was a source of cash of \$93 million this quarter, \$50 million higher than the prior year, mainly driven by accounts payable. Investing activity were use of cash of \$75 million, compared to a use of \$17 million in the prior year due to an increase in cash used for acquisition and venture investment.

CapEx of \$16 million was slightly lower year-over-year. CapEx primarily support our strategic growth program on investment in IT infrastructure. Financing activity consumed \$149 million of cash. During the quarter, we utilized

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remaining \$113 million of our buyback authorization and paid dividend totaling \$46 million. We also repaid \$300 million of maturing senior notes with \$322 million of net securitization proceed. For the year, we remain committed to returning at least 50% of our free cash flow to shareholder.

Next, looking at profitability. As noted earlier, adjusted operating income was negatively affected this quarter by incremental costs associated with supply constrain, inflation and investment in our new businesses, which had a negative impact to adjusted operating income margin of 470 basis point. We expect supply channel and new business costs to normalize as supply chain condition improve on our new businesses' scale.

Inflationary pressure may persist for some time, but we expect to pass on most of the effect of inflations through pricing action albeit by a delayed basis. Further offsetting this cost pressure will be additional savings generated through Project Own IT. Last quarter we announced \$300 million of targeting gross savings in 2022, which we will use to offset planned cost increase, as well as investment in innovation across our offerings. Due to incremental inflation across our cost base, we are now planning a 50% increase in our targeted savings amount for the year. We are expecting quarterly sequential margin improvement throughout the year, but the realization of this improvement will largely depend on macroeconomic factor.

Turning to segment, we are now providing segment level operating detail from Print and Other and Financing or FITTLE. We provide this information to help investor understand the Print and Other of business, excluding Financing as well as FITTLE Financing business, which in the future is expected to become less dependent on Xerox for origination growth.

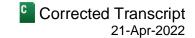
FITTLE revenue declined 12.2% in Q1, primarily due to a reduction in financing income and operating lease revenue, which reflect lower equipment in store. Segment profit was lower by \$1 million or 5.6%. Higher gross profit were offset by incremental costs associated with standing up the business. Segment margin of 11% was higher than our full-year estimate of 8% to 9%. We expect FITTLE margin to normalize as volume pick up driving increases in commission.

In Q1 FITTLE finance assets were down slightly quarter-over-quarter as portfolio runoff outpaced origination. FITTLE origination volume declined 10% year-over-year due primarily to a decline in Xerox product origination of 22%, which were negatively affected by product availability constrain. Indirect origination, which includes third-party dealers or non-Xerox vendor grew 7% year-on-year due to growth in new dealer relationship and non-Xerox originations volume.

Print and Other revenue declined 2% in Q1, primarily due to equipment sales, partially offset by modest improvement in post-sales revenue as previously discussed. This segment generated a loss due to lower equipment sales, a less profitable mix of equipment install, higher supply chain cost, lower margin on post-sales revenue, and incremental cost associated with new business.

Regarding capital structure, we ended Q1 with a net core cash position of around \$400 million. \$2.9 billion of the \$4.3 billion of our outstanding debt is allocated to and supports the FITTLE lease portfolio. The remaining debt of around \$1.4 billion is attributable to the core business. Debt primarily consists of senior unsecured bonds on finance asset securitization. We have a balanced bond maturity ladder and no unsecured maturities for the remainder of the year. In the first quarter, we'll return \$159 million of cash back to shareholder, return on with acquisition and investment, comprise a majority of the \$200 million quarter-over-quarter decrease in net core cash.

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Finally, I will address guidance. We are maintaining our guidance of at least \$7.1 billion of revenue at actual currency and free cash flow of at least \$400 million. Our free cash flow guidance excludes cash costs associated with this quarter, product supply termination charge, as it is a onetime in nature and obscure the true cash generation potential of our operation. Our business faced significant challenges that present the degree of risk to our outlook, but we continue to expect supply chain improvement on the broader return of employee to offices in the second half of the year.

Additionally, we are implementing control measure in response to geopolitical uncertainty and inflationary pressure, including a reallocation of equipment and supplies from Russia to market facing significant backlogs on additional Project Own It saving to offset inflationary pressure.

We will now open the line for Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] First question comes from Ananda Baruah with Loop Capital. Your line is open.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Hey. Good morning, guys. Thanks for taking my question. And good to see the revenue is continuing to trend as expected as well. Just a few for me, if I could. Xavier, how should we anticipate like the pacing of the margin recovery as we move through the year, and maybe for both gross margin, and operating margin – and OpEx?

Xavier Heiss

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

Yeah. So, hi, Ananda. Good morning. So, as you have seen it, we've faced some inflationary cost pressure during quarter one. And as we mentioned it, macroeconomics environment, we are expecting them to improve over time. This is driven by two driver. Number one would be the back to office. In quarter one, January and February activity was impacted by Omicron in some of the geographies, but we saw March recovering. So we are expecting a gradual recovery on back to office. This is as well signaled by external data points, showing that employees are going back to the office. March was a good data point. And we're expecting this to continue in quarter two; and gradually improving, quarter three, quarter four as well. Well, that's regarding back to office and print volume.

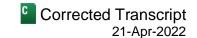
Regarding supply chain, we are monitoring this very closely. As we mentioned it in our call in Q4 and during Investor Day, we were expecting to have a gradual improvement during the second half of the year. And we are still monitoring – see some improvement in the situation, but this has impacted strongly our equipment gross margin because of mix of products that we have recognized or installed during this quarter was not the traditional high-margin mix up products that we could have installed. So, in summary, we expect gradual improvement in margin. Quarter two will be an improvement over quarter one, but we are expecting that the second half will be better than the total – the first half.

Ananda Baruah

Analyst, Loop Capital Markets LLC



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Okay. Got it. That's helpful. And just on supply chain, was it tougher than – I know with increased fuel costs, that was certainly incremental. But just in general, sort of excluding the fuel costs and maybe sort of transportation is impacted by that. How's supply chain availability relative to your expectations as you went through the quarter?

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

So the supply chain is two element. One element is capacity; the second element is cost. So, from the capacity point of view we were impacted in quarter one. As I mentioned it, and you saw, that the equipment revenue was down year-over-year. And we have not received the mix of equipment that high-margin A3 product equipment that we were expecting.

You saw the strength of the backlog as well. Our backlog is still growing 22% quarter-over-quarter, close to now more than a quarter of revenue that we have here. So, we are quite confident in our ability to get orders from customer and having this backlog being installed over time. So, quality of the backlog is also strong. We are currently monitoring, how long it take in average to install product. And I would say close to 50% of our backlog is less than 60-days old. So we turn it, but at the end of the day, we don't have the equipment we are expecting in order to close a gap in equipment revenue. So high-touch capacity.

Regarding cost, we have had during the first half – it started last year as you know it. But during the first half, cost pressure, inflationary pressure on specifically container cost, but also in-country, it could be, I would say, freight, truck, train cost pressure here. We are expecting this to ease. You read as we read as well some information regarding that consumer demand could decrease in the second half of the year. It should give more capacity and potentially price reduction for the type of demand our company cost that we are expecting.

Ananda Baruah

Analyst, Loop Capital Markets LLC

That's really helpful. I'll feed the floor there. Thanks so much.

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

Thank you, Ananda.

Operator: Your next question comes from Erik Woodring with Morgan Stanley. Your line is open.

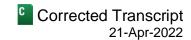
Erik W. Woodring

Hey. Good morning, guys. Thank you for taking my questions. I have two here as well. Maybe just to start, maybe, John, this would be for you. In the FAQ part of your earnings deck and you alluded to it here in the prepared remarks, I felt like there is a bit of a tone shift in your comments on monetizing or realizing shareholder value from some of your investments in innovation. Just talking about increasingly looking to do strategic reaction. So am I correct in saying that?

And maybe can you just parse that out maybe one level further just in terms of what that could actually mean in terms of potential actions you could take, or timing, or anything along those lines? And then, I have a follow-up.

Analyst, Morgan Stanley & Co. LLC

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John Visentin

Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Yeah, Erik. If there was a shift, I apologize. I don't think there's a shift. We're continuing to fund the investments in innovation. We know it's margin-dilutive in the quarter. We're launching new products and businesses. We've spoken about what we're doing at Eloque and Elem and at Novity; Novity being the latest one in predictive maintenance, where we have already two clients. And we have a pilot going with Pennsy Supply.

Going forward, we're going to continue to look at monetizing these investments, like we said, through strategic transactions. And they could take form of a minority investment, a sale, a partnership, a merger of our businesses. We stated that we want these transactions to create shareholder value by providing our new businesses access to capital and speed; a little bit what you and I spoke about also at the Analyst Day.

Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

Okay, great. That's really helpful. And then, maybe, Xavier, one for you, and just to follow-up on Ananda's question. I appreciate the color that operating margins or margins generally should improve sequentially through the year, second half better than first half. But we're now starting obviously off of a lower base in 1Q than was expected. So is it possible that operating margins could be down year-over-year. I know you've guided them to grow last quarter. So just any color that you can share on how we should maybe think about the year-over-year change in margins, realizing that there are some macro factors that could impact that? And that's it for me. Thank you.

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

Yeah. So that's a good point, Erik, here, which is, okay, macroeconomic environment is something that we are monitoring very closely. So far, the leading indicator we have on the page volume are positive, based on what we have seen. The key point for us would be to address the supply chain challenges that were faced in quarter one and being able to address the cost pressure.

As you have certainly noted it, we have increased our internal, I would say, goal around Project Own It. Project Own It has a goal of \$300 million of gross cost saving this year. We have increased it by 50%. So if you remember, our Project Own It is much more than a cost-cutting type of program. This is more of the DNA on how the company is addressing the cost base on some of the challenge when we face them, and ensuring that we can still deliver the guidance on revenue and on free cash flow.

So, so far, assuming the macroeconomic environment trend, Ukraine, we did not comment too much, had limited impact here. And we will also be able to redirect some of the product outside of Ukraine and Russia towards other geographies. So I will say, assuming this economic environment on macroeconomic trend are in line with what we are commenting here. We should see the gross margin improvement and the ability to achieve or being close to the goal that we have for this year.

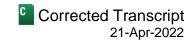
Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

Great. Thank you, Xavier.



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Xavier Heiss

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

Thank you, Erik.

Operator: Thank you. Your next question comes from Samik Chatterjee with JPMorgan. Your line is open.

Samik Chatterjee

Analyst, JPMorgan Securities LLC

Hi. Thanks for taking my question, and good morning. I guess, if I can just follow-up on the last question there. Xavier, you talked about the additional savings coming from Project Own It. It really is a difficult time, particularly where inflation is, to drive additional savings. So maybe if you can give us a bit more color, are these sort of projects that were sort of far away from commercialization that you're trying to pull back on? Like, what is the source of these additional savings that you're targeting, particularly at a time where it does look a bit more tougher of an environment to drive those savings? And I have a follow-up. Thank you.

Xavier Heiss

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

Yes. Well, good morning, Samik. So we will look at the entire scope of the cost base, but specific focus on what we call infrastructure cost and also the ability to negotiate some – or renegotiate some of the cost. I mentioned the freight cost and [the ability] to see versus the costs we see today if these costs will decrease during the second half of the year. But also another items that I did not touch around there, you have Project Own It addressing the cost point but some of the inflation that we are seeing here, as you know it, we pass that back to customer.

So we have done last year some price increases. And what we are doing currently as well is to plan on certain product and services that we have here, additional price point so we can offset some of the inflationary cost pressure to customer as well. But Project Own It is not specifically directed to, I would say, areas one by one, we look at the entire cost base. We scrub it. And, as I mentioned it, infrastructure cost currently is our focus plus freight cost.

Samik Chatteriee

Analyst, JPMorgan Securities LLC

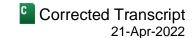
Okay. Got it. And for my follow-up, I think at the Analyst Day, you had mentioned that your target in terms of where page volumes can get to sort of in the recovery is, like, 80% number. And you talked about improvement here in post-sale, driven by some of the return to work. So maybe if you can ballpark where you are in terms of page volumes relative to the 80% target today. And the follow-up there is you also have a big backlog on the equipment side. Like, can you – are you able to get a sense of how that mix is or whether equipment demand is coming in higher end or lower end compared to pre-pandemic through your backlog? Thank you.

Xavier Heiss

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

Yes. So two good question, Samik. So, page volume, we are seeing a gradual improvement. Just as a data point, March was one of the highest months that we have had since the pandemic. So we still see the number. We monitor very strongly or very directly the correlation between vaccination rate or the presence of COVID vaccination rate, presence in the office on page volume. This correlation still stick. And clearly, after Omicron wave in January, February was over, we saw people going back to the office. We saw direction of manager and

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CEO asking employees to be back to the office. We see that day-to-day with customers. And we are monitoring this and see positive trend in this direction. So as I mentioned it, we are expecting quarter two to improve gradually, moderately, and then the second half as well here. So, that's for the page volume.

At the same time, as you know it, we are also gaining market share, which mean our MIF or presence here is also increasing, which give also additional revenue coming from the market share gains that we have.

Commenting on backlog, just to share with you, so, the data point is \$422 million, more than 20% increase quarter-over-quarter; close to, I will say, 2 times to 3 times our usual backlog. And, I will say, good sanity, good quality of the backlog with a little bit less than 50% of the backlog being less than [indiscernible] (00:42:30). That mean we are installing it quite quickly.

Regarding the mix of the backlog on the profitability, and this was one of the key driver of the gross margin erosion. Usually, we have around 50% of the backlog being on our A3 product, we have here much higher. And this is one of the reason. So mix and the margin mix that we have been able to generate and install have been impacted in quarter one. So again, very fluid situation. Main driver of the backlog is still the shortage of some component, specifically certain chips that we are waiting for.

Samik Chatterjee Analyst, JPMorgan Securities LLC	Q
Okay. Great. Thank you. Thank you for taking my questions.	
Xavier Heiss Chief Financial Officer & Executive Vice President, Xerox Holdings Corp.	А
Thank you, Samik.	
Operator: Thank you. And your next question comes from Jim Suva with Citigroup. Your line is ope	en.
lim Suva	

Thank you. Both of you mentioned additional actions under Project Own It. This program has been quite successful. So can you maybe explain to us or give some examples of what some of these additional actions are because I just kind of want to get a grasp for understanding what the new actions are for Project Own It because it's been quite successful in past, I'm just kind of wondering where else did you find some more savings.

John Visentin

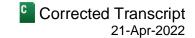
Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Analyst, Citigroup Global Markets, Inc.

Yeah, Jim. I wouldn't use the term where we find more savings. You're right, we've been very successful, and usually, we beat our Project Own It targets every year. And it's a philosophy where we promote continual process improvements. And what we plan to do is this additional \$150 million in gross cost savings, and where it comes through is flow-through of our in-flight initiatives. Is there more we can do there? Is there more investments in IT that we can do to go get it? Cross-functional operational efficiency projects. These are all things that are in-flight that we're going to and we're looking at growing and we're looking at going faster.

Of course, there could be some labor actions that are involved, overhead infrastructure and then investments in our products, in our services and even internally. And we look at them and say, are there things that we can hold off as supply chain eases, as it gets better going forward. But the plans are in place to go after it. And definitely,

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you'll be seeing some of it in the second half of the year. But there's no – we don't look at it as it's something new. It's always continuous improvement.

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Okay. And then a follow-up maybe for Xavier. Can you talk a little bit about the changing interest rate environment. Xerox is a very big and complicated company, whether it be debt obligations, your financing business or even your company pension accruals, I know those rules have all changed a lot. But how should we think about a raising or higher interest rate environment will impact on that – on your company or cash flows? Thank you.

Xavier Heiss

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

Thank you, Jim. So good question. So, regarding interest rate under pressure on our environment, I will say it is quite simple. The first thing is, as you know it, we have a debt. The vast majority of the debt Xerox has is related to the financing business to FITTLE. And this debt is associated to the leasing contract or financing contract with customer. For the vast majority, as you know it, we are now securitizing this debt, which mean that the debt will be aligned or the cost of the capital will be aligned with the market cost. But we have also as well the ability to pass the price back to customer. So when rate costs are increasing, we're able as well to pass the cost up.

Regarding the core debt, so the remaining part of the debt, we have, as you have seen it, in our debt ladder, no obligation for this year. So, we cover our \$300 million debt obligation in quarter one. And for the second part of the year, we have \$1 billion and that we have, at this stage, no concern on how we will be able to fund and drive the debt here. So, I would say, it's not my prime concern currently, interested here, mainly driven by the fact that via FITTLE, we can pass some of the cost increase back to customer.

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Okay. And the pension and the impact of pension [ph] in funding (00:47:04)?

Xavier Heiss

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

Yeah. It – you have an impact. But at the same time, that mean when interest rate are increasing, you have the double effect. You have one effect where you have your obligation that could grow. At the same time, the return on your investment is also growing. The vast majority of our pension are, I will say, align or connected with I call that derivative instrument, instrument that are manage or have a way to derisk the environment, specifically from an interest point of view. So, I don't see this as an immediate cost pressure as well or drive our cash pressure and debt pressure on Xerox.

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Thank you so much for the detail.

Xavier Heiss

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

Thank you.

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Operator: Thank you. And ladies and gentlemen, this does conclude the Q&A session. I would now like to turn the call over to John Visentin for any closing remarks.

John Visentin

Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Okay. Thank you, and thank you for being on the call. Our focus remains on executing the strategic road map that we presented on Investor Day, including a return of Print and Services to growth and monetization of our investment in innovation. Be safe and be well.

Operator: Well, ladies and gentlemen, this concludes today's conference call. Thank you for participating, and you may now disconnect.

Editor's Note: Text in [] was added after the conclusion of the event, to provide clarity on certain statements made on the call.

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