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XRX - Q1 2017 Xerox Corp Earnings Call

EVENT DATE/TIME: APRIL 25, 2017 / 2:00PM GMT

OVERVIEW:

Co. reported 1Q17 total revenue of \$2.45b and GAAP EPS of \$0.02. Expects 2017 adjusted EPS to be \$0.80-0.88.



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PRESENTATION

Operator

Good morning, and welcome to the Xerox Corporation First Quarter 2017 Earnings Release Conference call hosted by Jeff Jacobson, Chief Executive Officer. He is joined by Bill Osbourn, Chief Financial Officer.

During this call, Xerox executives will refer to slides that are available on the web at www.xerox.com/investor. At the request of Xerox Corporation, today's conference call is being recorded. Other recording and/or rebroadcasting of this call are prohibited without the express permission of Xerox. After the presentation, there will be a question-and-answer session. (Operator Instructions)

During this conference call, Xerox executives will make comments that contain forward-looking statements, which by their nature address matters that are in the future and are uncertain. Actual future financial results may be materially different than those expressed herein.

At this time, I would like to turn the meeting over to Mr. Jacobson. Mr. Jacobson, you may begin.

Jeffrey Jacobson - Xerox Corporation - CEO

Good morning, and welcome to Xerox's First Quarter 2017 Earnings Conference Call. During today's call, we will provide an update on our financial progress in the quarter as well as our expectations for 2017.

Let me begin by saying that overall, I am pleased with our start to the year. Our operational performance delivered revenue, operating margin and cash flow that were all in line with our expectations for the quarter. Additionally, we made progress on our strategy to pursue the growing segments in the market. Recognizing that this is the first quarter out of 4 and we still have a lot to do, our performance laid the foundation for us to deliver on our full year commitments. Let me walk you through an overview of our first quarter financial results.

The first quarter was a good start to the year. We delivered GAAP EPS of \$0.02 and adjusted EPS of \$0.15. Our earnings were impacted by a charge related to our 25% equity ownership of Fuji Xerox, resulting in a \$0.03 reduction in our GAAP and adjusted EPS. If this charge was excluded, our first quarter EPS was in line with our expectations for the quarter.



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Revenue of \$2.45 billion was down 6.2% year-over-year or 4.3% on a constant-currency basis, consistent with 2016. We experienced softness in Europe, which was offset by improvements in our developing markets.

We saw a rebound in equipment sale revenue. While down 7.4% or 5.7% at constant currency, it was better than the declines of 10.1% in the fourth quarter and 8.7% during the full year of 2015 in constant currency.

High-end products recovered, and we had better results in Entry products, driven by developing markets and early benefits from newly introduced color products.

Post sale revenue was 80% of total revenue and declined 5.8% or 3.9% at constant currency. Most post sale revenue stream trends were stable, but we did see a deceleration in Managed Document Services revenue. This was partially driven by lower signings in prior quarters.

We have high expectations for this business and we are taking action and making investments to drive improvement. Our newly launched products will allow us to be more competitive, and our channel expansion initiatives will make our industry-leading Xerox Partner Print Services offering available to more partners. We expect to begin to see benefits in the second half of the year.

Adjusted operating margin, excluding the impact of the Fuji Xerox charge, was 11.4%, an improvement of 90 basis points year-over-year despite a 110 basis point headwind from currency. We continued to realize productivity benefits from our strategic transformation initiatives, which are helping maintain our profitability and strong margins, while offsetting our revenue decline.

Operating cash flow was up \$103 million year-over-year driven by working capital, a good start to the year. But I would also highlight that our cash flow does not yet reflect higher pension contributions which are expected during the balance of the year.

We repaid \$1.3 billion in debt during the quarter as part of our plan to optimize our capital structure and maintain investment-grade metrics. Our results are indicative of our ability to operate the business well and to continue to deliver on our productivity and cost savings initiatives as we work to change the trajectory of our revenue.

In December, we shared with you our plan to drive long-term earnings expansion and reverse our revenue trajectory over time. It's a 2-pronged approach. We are improving our efficiency and changing the way we work with our strategic transformation program, while aggressively pursuing strategic growth areas in our market.

During the first quarter, we made progress on both initiatives. We are now in the second year of our 3-year strategic transformation program and are on track to deliver \$600 million in gross savings this year. We are driving increased productivity to expand margins while offsetting significant currency headwinds and enabling us to reinvest in the business.

We remain relentless in our efforts to improve our internal processes and systems to capture productivity in our work. Initiatives range small to large, local to global, and here are 2 examples:

We are rolling out a new deal scoring process that includes a dynamic pricing methodology in our proposal and pricing tool. This process provides business intelligence to our sales resources. The expected outcomes are improvements in the turnaround of customer pricing proposals, increases in our win rate and the capture of margin upside on new signings.

In our supply chain, we completed the transition of our major U.S. equipment warehouse to a third-party logistics provider as part of our optimization efforts. Our global supply chain and field teams work together to make sure we continue to serve our customers during the transition and ensure all first quarter customer orders were delivered and installed.

Turning to the strategic growth areas. In 2016, 62% of our revenue was in mature markets. So to ensure we can change the revenue trajectory, we are working to maintain our leadership positions in those mature markets, while shifting more of our business into the growth markets. We've targeted 4 strategic growth areas to pursue: First is Managed Document Services. We are the leader in this segment and we are building both new



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offerings, such as customized analytics and personalized workflows, as well as extending our reach to more customers including small and medium-sized businesses or SMBs.

Second is A4 Entry product. This area includes desktop and multifunction printers where we are underpenetrated. Pages in this area are moving from single-function A4-size printers to higher-value A4 multifunction printers where we are better positioned. New A4 products will strengthen our Managed Document Services solutions and offerings to all our channels.

Third, we are going to leverage channel partners to reach the SMBs. We are getting partners that understand this industry, are local experts, are close to the customers and are looking to grow their own businesses and provide great experiences for their customers.

Finally, production color, including inkjet and packaging. We are extending our leadership position in cut-sheet color, building a footprint in the growing inkjet market and creating new solutions that will automate and customize packaging.

In the first quarter, 39% of our revenue was in our targeted growth areas, representing a mix improvement of 2 points year-over-year. Additionally, we laid the foundation for continued progress with the launch of new products. The big news in the quarter was the announcement of the largest product launch in our company's history, 29 new entry and workgroup multifunction devices. The new portfolio is the next stage of the product strategy we started in 2013 when we launched ConnectKey, the first ecosystem-based platform for A3 workgroup devices. We followed that up in subsequent years with a broader range of specialized apps, customizable workflows and solutions to deliver a better user experience. And now, we are increasing the range of ConnectKey-enabled devices to include both A3 Entry and workgroup A4 with fleet coherency between A3 and A4 devices. These new products extend the functionality of multifunction printers. They go beyond the base printing, copying, scanning and faxing functions and change the fundamental nature of the connected workplace, with features and the ability to use customized apps that enable a truly personalized experience.

The portfolio directly supports 3 of our strategic growth areas. Each new device is ConnectKey-enabled, perfect for Managed Document Services where our common tool set will make it easy to monitor, manage and optimize a fleet of devices more effectively.

12 of the new devices are A4-sized and will give us a significant presence in the A4 market where our participation has been limited. The new A4 products are cost competitive, cloud connected, app-enabled and possess benchmark security, a perfect fit for SMBs that are looking for more than just print, copy, scan and faxing capabilities to help them grow.

Finally, these new devices are ideal for our channel partners. By selling existing apps or creating custom apps, dealers can achieve real differentiation and stickiness with their customers.

A number of new ConnectKey products are available now. Others will roll out during the second and third quarters of 2017. We expect to see the impact on our results start to ramp during the second half of the year.

The fourth strategic growth area is production color. As I mentioned, we saw a rebound in equipment sale revenue during the quarter including high-end color, and we continue to take steps to drive additional activity. We were present in several important trade shows demonstrating our inkjet technology among others. And during the first week of April, we launched 3 new production color products: The Versant 180, Versant 180 Performance Package and Versant 3100 Presses, with many new features that exceed what's currently available in the market and complement our growing line of production print engines. My thanks to the Xerox team for their efforts to improve our business, bring new products to market and serve our customers well during the quarter.

I'll now turn the call over to our CFO, Bill Osbourn.

William F. Osbourn - Xerox Corporation - CFO and Corporate EVP

Thanks, Jeff. Before diving into quarter 1 results, I want to highlight a few changes we made to our reporting, beginning in 2017.



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As we previewed last quarter, post the spinoff of Conduent, we have streamlined the management of the business along geographic sales channels and, therefore, now have one reportable segment. We are at the same time enhancing our disclosures to provide additional insight on our results.

Around revenue, we are providing additional details by geographic sales channel, by product grouping for equipment sales revenue. And we'll continue to provide line of sight to our document outsourcing, or what we now call Managed Document Services revenues, as well as progress on the shift over time of our revenues toward our strategic growth areas.

On profitability, we'll be providing gross margins for both equipment and post sale revenues. On cash flow, we're providing some commentary around our expectations for normalized operating cash flow after we have passed near-term higher restructuring payments and pension contributions.

We believe these reporting changes will give greater context to our results and perspective on our business model. I'll talk more about them as we go through the presentation.

With that, let's start with the review of the income statement, which I'm going to mainly talk to on an adjusted basis that excludes non-service retirement-related costs, restructuring and related costs and amortization of intangible assets. In addition, this quarter, we had 2 other discrete items that we adjusted for and that essentially offset: A \$13 million charge related to the extinguishment of debt and a \$16 million benefit from the re-measurement of a tax matter related to a previously adjusted item. Revenue, which I will cover in more detail on the next slide, was down \$161 million or 6.2% in actual currency, or 4.3% at constant currency, which is consistent with full year 2016.

Looking at the cost ratios, savings from our strategic transformation program more than offset the impact of revenue decline and the negative transaction currency impact of 110 basis points, resulting in gross margin expansion of 20 basis points and an improvement in SAG as a percentage of revenue of 20 basis points.

Within our definition of operating income is equity income, which was down year-over-year due to the Fuji Xerox receivable write-off that Jeff mentioned. As Fujifilm recently announced, they are reviewing the appropriateness of accounting practices related to certain sales of leasing transactions involving Fuji Xerox New Zealand. Our first quarter results include a charge of approximately \$30 million within equity income, representing our share of the current Fujifilm estimated adjustment for this review. Although the approximate \$0.03 impact of the Fuji Xerox New Zealand receivable matter is included in our adjusted EPS, we are modifying our definition of adjusted operating margin to exclude this matter in order to present a more normalized view. On this basis, overall adjusted operating margin expanded 90 basis points and adjusted operating profit was up \$6 million. So from an operating perspective, overall good cost management offset revenue declines, consistent with our expectations.

Turning to the below-the-line items. Other expenses net of \$41 million was \$4 million better year-over-year as lower interest expense roughly offset the gain on sales of assets in the prior year.

The tax rate of 27.5% was within our full year range of 25% to 28% and was higher by 6.1 points year-over-year, an approximate negative \$0.01 impact year-over-year to adjusted EPS.

Overall, adjusted EPS of \$0.15 was down \$0.03 from Q1 2016, driven by the higher tax rate and the Fuji Xerox matter.

GAAP EPS was \$0.02 in the quarter. The difference between GAAP and adjusted EPS includes our normal adjustments around restructuring and related costs, non-service retirement-related costs and amortization of intangible assets as well as the 2 discrete items I described earlier.

Turning to the next slide, I will drill down more on revenue, starting with total revenue. From a geographic perspective, North America was down 4.5% or 4.8% in constant currency and represents 60% of our revenues. International represented 35% of total revenue and reflected higher declines in Europe that were partially offset by growth in developing markets as we saw a turn there in overall improvement off a weak Q1 2016. The remaining 5% of our revenues are in Other, which includes our OEM business, sales to Fuji Xerox and licensing.



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Within total revenue, equipment sales were down 7.4% or 5.7% in constant currency. From a product offering perspective, Entry equipment sales was down 6.4% or 5.5% in constant currency, an improvement in trend reflecting the rebound in developing markets as well as early benefits from new products, offset by continued higher OEM equipment declines.

Mid-range was down 8.6% or 7% in constant currency, so relatively weaker, but anticipated given that none of our recently announced new mid-range workplace products were available in quarter 1.

Lastly, we saw better performance in high-end equipment sales, which were down 6.1% or 3.7% in constant currency, an improvement from the fourth quarter.

A couple of points to highlight in the high-end. First, color equipment grew 1% in constant currency; and second, the growth was driven by the higher end of the portfolio, continuous feed and iGen products. Entry production color products were down year-over-year as we have yet to benefit from the new Versant products we only just announced.

Moving on. Post sale revenue was down 5.8% or 3.9% at constant currency. This compares to a decline of 2.9% in 2016. The higher Q1 post sale decline was driven by Managed Document Services, which essentially is our previously reported Document Outsourcing revenues now expanded to include Managed Print Services within Global Imaging. In Q1, Managed Document Services was 33% of our revenues and was down 2% in actual currency and up 0.4% in constant currency. This compares to 2.6% constant currency growth in 2016. The slowdown could be attributed to lower signings in recent quarters within the enterprise space as well as a challenging compare in Q1, as Q1 2016 Managed Document Services was up 4.9% at constant currency, driven by strong equipment growth.

I will now shift to discuss our key performance metrics, a few of which I have already touched on. Strategic growth areas in the first quarter grew 1% at constant currency and drove 39% of our total revenues, a 2-point mix shift from the year-ago period. The growth of 1% does not reflect benefits from our newly-launched products and compares to growth of 2% in 2016, with the trend change coming from the Managed Document Services component I just discussed.

Jeff highlighted earlier that we made progress in Q1 laying the foundation to drive improvement in strategic growth areas, with a target shift to mix by approximately 3 points this year

Turning to installs. As expected, color was stronger than black and white. We saw improved performance in Entry, although at a weaker mix, given the better developing markets performance where units tend to weigh toward the lower end of the portfolio. Mid-range units likewise were dampened, as expected, by not benefiting yet from the newly launched products. And high-end installs were weaker than equipment revenue performance I described earlier as mix improved with stronger performance in the higher-end products like continuous feed and iGen, offsetting install declines in entry production products, given product launch timing.

Signings in the quarter of \$532 million were down 6% year-over-year and down 5% on a trailing 12 months basis at constant currency. With that, we did see improvement in new business signings, which were up 1% year-over-year at constant currency. Signings, as Jeff mentioned, is an area where we are making investments in sales coverage and taking action to drive better results. I should note that we only have a line of sight to signings in the lower-growth, large enterprise areas. So broadly speaking, total Managed Document Services revenue growth outperforms signings as the higher market growth is coming from the SMB area.

The last key measurement I'd like to cover is strategic transformation. This is a critical program to drive both expanding margins and enabling investments to improve revenue trajectory. We have many projects underway spanning the company, and we continue to target \$600 million in gross savings for 2017. We took, as anticipated, a fairly large restructuring charge of \$120 million in quarter 1 to position us to achieve our full year gross savings objectives. There are headwinds related to revenue declines as well as currency that partially offset these savings, but net-net, we anticipate continued margin expansion for the full year.

Before moving on to cash flow, I'd like to take some time to cover the trends we're seeing at a high level and how we expect them to play out as we progress through the year. The total revenue decline of 4.3% in constant currency was consistent with 2016 and an improvement over Q4. We



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continue to expect full year constant currency revenue decline in the mid-single digits, with about 2 points of negative translation currency. From a calendarization perspective, Q2 will face the most challenging year-over-year compare, and we won't see a full quarter's benefit from the new product launch. So net-net, we'd expect higher declines in Q2 with moderating declines in the second half, driven by improving equipment revenue trends.

Operating margin is seasonally weakest in Q1. So we expect improvement in absolute terms as we move through the year, supported by our continued focus on our transformation and productivity initiatives.

Transaction currency is dampening some of that improvement and was a negative 110 basis point year-over-year impact to margin in Q1. At current rates, we expect a slightly higher negative impact in Q2 and more moderate impacts in the second half.

Lastly, in looking at the trends for adjusted EPS, we are continuing to guide for full year adjusted EPS between \$0.80 and \$0.88, which compares to \$0.88 in 2016. The drivers of full year 2017 adjusted EPS, as we highlighted last quarter, are currency and higher tax rate, partially offset by lower interest expense. These factors impacted our first quarter results. And while we are not giving guidance for the second quarter, we expect EPS to decline year-over-year in Q2 before we get into the second half, where compares should ease as currency should moderate at current rates and benefits from our recent product launches should begin to flow through.

I'll now shift to discuss cash flow. Operating cash flow generation coming from continuing operations in the quarter was \$190 million, up \$103 million year-over-year. And free cash flow was \$164 million, up \$109 million year-over-year. So a good result, driven in part by working capital timing as inventories were a smaller use year-over-year given product launch timing, and payables were also a source. As we indicated last quarter, our operating cash flow guidance of \$700 million to \$900 million will be about \$200 million lower this year than normalized operating cash flow of about \$1 billion, driven by higher restructuring payments and pension contributions.

Q1 operating cash flow reflected the higher restructuring payment expectations, \$60 million versus \$21 million in the prior year. The pension contributions of \$23 million were only a small portion of our guidance of \$350 million for the full year. Investing cash flows were a use of \$35 million and included CapEx spend of \$26 million and \$11 million related to a small GIS acquisition.

Cash used in financing was over \$1 billion and reflected \$1.3 billion in senior note repayments and \$87 million in dividends, both common and preferred

Turning now to the capital structure slide, I will spend a few minutes on debt before handing it back to Jeff.

We ended Q1 with \$5 billion of debt, which is lower than 2016 ending debt of \$6.3 billion, reflecting the \$1.3 billion of senior note debt repayments I just highlighted. Two elements made up the repayments. The first was a repayment of \$1 billion associated with 2 senior notes that matured. In addition, in the quarter, we exchanged \$600 million of certain senior notes due 2018 through 2020 for \$300 million in cash and \$300 million in new senior notes due 2022 with a fixed coupon rate of 4.07%. This transaction in essence allowed us to early retire \$300 million in debt and extend out the term of an additional \$300 million.

Of our \$5 billion in debt, \$3.7 billion is allocated to financing debt, calculated by applying a 7:1 leverage to our customer financing assets of \$4.2 billion, which are comprised of \$3.7 billion of finance receivables and \$472 million of equipment on operating leases. This financing debt is adjusted out, in one form or another, by rating agencies when calculating our core leverage.

So to summarize, overall, a positive start to the year with most operational metrics in line with expectations, putting us on track to meet our full year guidance. With that, I will hand it back to Jeff.



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Jeffrey Jacobson - Xerox Corporation - CEO

Thank you, Bill. During the quarter, I made several international and domestic trips to meet with customers, partners and employees. It's one of the most important parts of my job. It enables me to have an unfiltered view of what is occurring in our operations, while having direct discussions with our stakeholders.

Our customers are always candid in their assessments of how we are doing. They have told me they are pleased with our renewed focus on the document technology market and the new products we have introduced, and that we can never let up on our efforts to serve them better and bring innovations to market that make the way they work easier. They depend on Xerox to keep them at the forefront of technology.

Our partners and potential partners provide a great perspective on their local markets. They continue to challenge us to be better, and our team has stepped up with new products, tools and support to make us the partner of choice. And employees, the heart and soul of our company, are engaged and excited by the opportunities we have before us. We understand the realities of the market and the needs of our customers and partners, and we are laying the foundation to deliver what is needed to win.

I feel good about the new products and offerings being launched, our strategic direction and our operating discipline. The Strategic Transformation program remains a critical focus to continue to drive strong margins and cash flow while we work on reversing the revenue trajectory.

All in all, we made good progress in the first quarter. We have more work to do, and the team is intensely focused on delivering on our full year commitments.

We will now open up the line for questions. Jennifer?

Jennifer Horsley - Xerox Corporation - VP of Investor Relations

Thanks, Jeff. Before we get to your questions for Jeff and Bill, let me point out that we have a number of supplemental slides at the end of our deck which provide more financial details to support today's presentation and complement our prepared remarks. (Operator Instructions) At the end of our Q&A session, I will turn it back to Jeff for closing comments. Operator, please open the line for questions now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Shannon Cross of Cross Research.

Shannon Cross - Cross Research LLC - Co-Founder, Principal and Analyst

I wanted to ask first about cash flow. It seems like you're a little bit more positive in terms of the normalized cash flow at \$1 billion. So sort of what's getting you there? What are you seeing in terms of opportunity on the working capital side? Again, I understand this year, you have puts and takes with more restructuring and that. But when you get into 2018, can you talk a little bit about how you're thinking about cash flow? And then if you can talk a bit about how you're thinking about cash usage, if anything's changed, and where you plan on sort of targeting it, especially given the stock at this point is down. And at \$6.73, you could probably buy back a fair amount.

William F. Osbourn - Xerox Corporation - CFO and Corporate EVP

Yes. Shannon, this is Bill Osbourn, I'll touch on that. So cash flow, as we talked about at the year-end earnings call, it's really the same thought, so similar thoughts, that -- both 2017 and 2018 would be below what we would think our normalized cash flow would be, about \$1 billion. And 2

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primary items which you mentioned are the higher pension contributions over that period of time being approximately \$100-plus-million higher each given year. And then also we were going to have higher restructuring payments each of those 2 years as we were doing our strategic transformation. We'd expect those to normalize and have a 200-plus million dollar benefit versus -- to get to a more normalized \$1 billion cash flow in 2019 and beyond. So similar to what we said at year-end, both '17 and '18 would be dampened by approximately \$200 million. But we are working continuously to improve our working capital, both from an inventory management perspective, managing receivables, payables, timing, et cetera. And we have some specific projects in place to really focus on inventory management. But the primary things impacting the normalized cash flow are the higher restructuring payments this year, next year and the higher pension contributions.

As far as your second part of your question regarding the uses of cash, similar thoughts to year-end. Given the \$700 million and \$900 million of operating cash flow we're expecting this year and our cash on hand on the balance sheet at the end of the year, we projected to have around \$1 billion to \$1.2 billion in cash available. We're going to pay down an incremental \$300 million of debt, which we did during the quarter. Dividend's around \$280 million. CapEx, we're guiding about \$175 million, and M&A in the \$100 million range. That left, if you're doing the math, about \$100 million to \$300 million that we're evaluating the best uses of, whether that's paying down additional debt, whether M&A opportunities come along, et cetera. At this point, although we continually look at it regarding share repurchases, we're not planning on making any share repurchase at this time. But as we state, we look at the market and factor share price and we evaluate it. But at this point, our goal is to invest in future growth opportunities and maintain the quality of our balance sheet.

Shannon Cross - Cross Research LLC - Co-Founder, Principal and Analyst

Okay. And then just one quick follow-up. Jeff, can you talk a bit about what you're seeing in terms of pricing environment. And specifically, as the yen has sort of moved between, I don't know, JPY 100 and JPY 120 in the last few months, what have -- and are now sort of in the middle, how are you sort of thinking about and seeing from the Japanese competitors, their reaction in terms of being able to use the yen for pricing or perhaps pulling back a little bit?

Jeffrey Jacobson - Xerox Corporation - CEO

Yes, we've seen pricing being very stable in our market. If we look at the last few quarters, extremely stable, both -- certainly, in equipment. As you've seen from our Japanese competitors, they've actually made some public statements about trying to manage their businesses more for profitability. So we've seen a relatively stable market dynamic as we go through it.

Operator

Our next question comes from the line of George Tong from Piper Jaffray.

George Tong - Piper Jaffray Companies, Research Division - Principal and Senior Research Analyst

I'd like to dig deeper into the transformation savings program. You provided some examples of efficiencies you've achieved, including better sales force business intelligence, better supply chain management. As you look ahead, can you elaborate on what additional actions are required to unlock the remaining strategic transformation savings to get to your \$600 million gross savings target this year?

Jeffrey Jacobson - Xerox Corporation - CEO

Yes. This is Jeff, and I'll let Bill supplement. We have a really diligent process where literally, the team goes through this on a weekly basis. It's a cadence of, literally, hundreds of projects from -- the way we deliver products, the way we build into our technical services group remote connectivity, remote call assist, what we do in manufacturing, as I talked about. We outsourced our warehouses. So when you look at the supply chain procurement, what we do in delivery, what we're bringing down or doing to bring down our unit manufacturing costs, and certainly the area that we will continue to hit hard will be G&A. So as we move forward and we've delayered the organization and continue to reduce the number of layers in our spans of



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control -- actually, increase our spans of control, I think we'll be seeing G&A come out even more. We're looking at things in our IT of how we can become be more efficient in IT. I think G&A is certainly an area where we can do a lot more work.

William F. Osbourn - Xerox Corporation - CFO and Corporate EVP

Yes. Just to follow-on, I was going to say the same thing. G&A, clearly, we're looking for areas to cut costs where they are not going to be impacting future revenue growth, and G&A is one of those areas. We've done benchmark analysis and have identified areas that we plan on reducing costs in certain G&A sectors, and that will be clearly an area of focus.

George Tong - Piper Jaffray Companies, Research Division - Principal and Senior Research Analyst

Got it. And as a follow-up, some of those strategic savings will be reinvested back into the business. Can you talk about which areas of the business are priorities for reinvestments? And how do you think about the timing of reinvestments and the implications for the cadence of margin expansion as we move through the year?

William F. Osbourn - Xerox Corporation - CFO and Corporate EVP

Yes, there are -- the reinvestment, clearly, part of it is offsetting various headwinds from currency transactions, et cetera, but we are also utilizing these savings to reinvest in the business. Couple of examples would be -- and you may not think about it this way, but we are planning on and have been selling more A4s as part of our new product launch, and those have lower margins upfront. It's really investing in the business, because you get higher margins over the life of product due to post sale revenues, but it is actually an investment getting those machines in field or (inaudible) out there. And our goal is to -- this year, to increase our volume of A4s with our new product launch. That is one example in particular. We are investing in systems, as Jeff mentioned, the delivery area. There are costs there, some of it's CapEx, some of it's OpEx. And in some of our back-office IT infrastructure, we're also doing investments to be able to do things more efficiently and cost effective.

Jeffrey Jacobson - Xerox Corporation - CEO

Yes. And George, this is Jeff. As Bill hit on it, some of the investments are certainly going into the revenue generation to change the revenue trajectory. So Bill mentioned the product launch. If you look at channel expansion and just bringing on new partners, whether they're model-branded, multi-branded, use demand generation, there's training required. One of the areas that Bill talked about, we did grow a little bit in signings on new business generation, but we have a conservative program to hire what we call new logo hunters just going after non-Xerox accounts that we have today. That's an area of focus. So in some cases, where we're making trade-offs on G&A, we're investing it back into the S part of SG&A for the selling because we want to change that revenue trajectory.

George Tong - Piper Jaffray Companies, Research Division - Principal and Senior Research Analyst

And the timing of reinvestments?

Jeffrey Jacobson - Xerox Corporation - CEO

Yes, I mean, they're ongoing as we go. So what we do is we try not to get out ahead of our headlights. But if you look at it and you say, basically, our margin expansion was up 90 basis points, offsetting the 110 basis points of currency that Bill talked about, but we're still investing in the business in a judicious way and a prudent way to change revenue trajectory. So it's ongoing.



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Operator

Our next question comes from the line of Paul Coster of JPMorgan.

Paul Chung - *JP Morgan Chase & Co, Research Division - Analyst*

This is Paul Chung on for Paul Coster. Just on the new product launch, how is the firm dealing with older products where they are in existing inventory on the channel? Are there any promotions going on for existing inventory?

Jeffrey Jacobson - *Xerox Corporation - CEO*

Yes. So Paul, good question. We try to balance that all the time. So what we try to do is manage the inventory, manage the obsolescence. So there's no question. We do try to give some incentives so that we can clear out the existing product line, but not in an excessive rate by any means, or what I'd say a prudent rate, to clear out the existing inventory as the new products are going -- coming in. So I mean, if you were to look, for example, at our High-end business, that from an equipment standpoint, was down 3.7% at constant currency, which was an improvement, you might misjudge things if you were to look at the installs being down. The reason was, as Bill mentioned, we had good performance at the High-end with our production inkjet, with our iGen, which is higher production devices of the High-end. But if you look at Versant, basically, orders were down a little bit from that standpoint because we were just introducing the 3 new Versant lines. So we managed that pretty diligently, and our supply chain team does a great job.

Operator

Our next question comes from the line of Jim Suva of Citi.

Jim Suva - *Citigroup Inc, Research Division - Analyst*

I just got to say, the additional details provided in the slides and stuff are greatly appreciated, so we sincerely appreciate that. On the reported earnings, I think they were about \$0.15. And if I do the math correctly, it looks like that includes the cost of the Fujifilm of about \$0.03. And you're -- if you can confirm that. And you're keeping the full year EPS unchanged. So in essence, when you include Fuji costs, are you raising your full year because, now, you have Fuji costs for the investigation that's going on? Or is that something that you were kind of always anticipating and maybe just now it's more communicating to us? Then I have a follow-up.

William F. Osbourn - *Xerox Corporation - CFO and Corporate EVP*

Yes. Jim, it's Bill. Great question. As far as the Fuji Xerox, just to confirm, it is \$0.03 impact in our adjusted EPS. So the \$0.15 adjusted EPS does include that \$0.03 or \$30 million charge. Or we would've been, say it another way, \$0.18 without it. Clearly, we did not know anything when we gave guidance back in January about this charge when we were setting guidance for the full year. With that said, when you go throughout the year and we update and we do detailed analysis, internally projecting for the rest of the year, there are puts and takes that occur. And I'm not going to go through all the details of those, but one example of that is we give guidance at the beginning of the year and factor in a certain amount of transaction currency headwinds for the year. Updated based upon current foreign currency rates, we see that being a couple of pennies less for the rest of the year. And that would be something that we factor into our updated overall guidance analysis. So the \$0.03, clearly, was not expected. However, it is factored into the full year updated guidance now. And when we look at other puts and takes that come into play as we update each quarter-end, and we're reaffirming the \$0.80 to \$0.88, knowing that, that \$0.03 charge is in the Q1.



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Jim Suva - Citigroup Inc, Research Division - Analyst

Great. And then my follow-up is regarding this \$0.03 charge. Is that the full EPS impact or the estimated liability? Or is that like the cost quarter-to-date or expected investigation cost? So how should we think about it? Is there still more risk in another additional write-down or a \$0.03, \$0.05, \$0.10 dent in future quarters?

William F. Osbourn - Xerox Corporation - CFO and Corporate EVP

Yes. We're not going to go into really details regarding the Fuji Xerox matter, other than what they have disclosed. They -- Fujifilm put out a press release last week that specifically cited a JPY 22 billion receivable adjustment. This is our calculated estimate of the impact of that adjustment on our earnings. Fujifilm has stated they're in the process of an investigation. 30 -- or the JPY 22 billion is their current estimate that they put out there. With that said, as we made a note in our disclosures, that could change. But we are not aware of anything additional at this point, other than the JPY 22 billion, which we've calculated to have a \$30 million impact.

Operator

Our next question comes from the line of Kulbinder Garcha of Credit Suisse.

Kulbinder S. Garcha - Credit Suisse AG, Research Division - Analyst

Just a couple. Beyond the strategic part of your business, the 1% growth rate at constant currency, am I right in thinking that, that accelerates in this back half, driven by the product announcements? And then the second (inaudible) clarification I had. You mentioned this difficult (inaudible) compare you had in Q2. What is specifically causing the difficult compare? What was difficult (inaudible)?

Jeffrey Jacobson - Xerox Corporation - CEO

This is Jeff. I was having a little difficulty earlier hearing your question, but I think it had something to do with the strategic growth areas growing at 1% at this point. So we are overall relatively pleased with where we were from a revenue standpoint. So if you go back to our beginning of the year guidance of mid-single-digit decline, coming in at 4.3% down was what I would say good for the first quarter, especially if you consider that we had a 90 basis point impact from our OEM business and our CMS, which was a higher deceleration rate than we had last year. So if you back that out, we would've been in about 3.4, where instead of the 90 basis points, we have declined about 40 basis points last year on that rate. So that was really without the benefit of any of the new products. We did get 4 of the A4 products in towards the end of the quarter, so we got a little bit of a boost there. But what we've been saying consistently all along, as we bring the vast majority of the products out in the second quarter, a little overhang of the remaining A4 products into the third quarter, is that we'll start seeing this ramp much more in the second half of the year. We did get the 2 point year-over-year movement from the 37% to 39% into the growth markets, so we're pretty much on track for where we thought we'd be.

Jennifer Horsley - Xerox Corporation - VP of Investor Relations

And Kulbinder, I think there was a second part to your question that we may have missed, if you want to repeat it.

Kulbinder S. Garcha - Credit Suisse AG, Research Division - Analyst

Yes. Just in Q2, what is causing the difficult compares you mentioned...



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William F. Osbourn - Xerox Corporation - CFO and Corporate EVP

It's Bill. Yes, a couple of things really from a difficult compare perspective. We're expecting a little bit bigger headwind in Q2 from a transaction currency perspective. Also if you're looking at Q1 last year, we have not fully ramped up our strategic transformation, our restructuring process. By Q2, that had ramped up, was in full swing. So we now have full ramped up strategic transformation this year in Q2 and last year in Q2, so that creates a little bit tougher compare. And we won't fully benefit from all the products being out in Q2. Most of them will be out in Q2, but it won't fully be there yet. So with that said, we don't give -- we're not giving formal quarterly guidance on adjusted EPS or anything. But I think historically, if you do the math, Q2's been around 25% of the full year, and it looks to be in that zone for this year. But the headwinds are really that transaction currency in Q2, which we do, by the way, expect to moderate in the second half of this year.

Jeffrey Jacobson - Xerox Corporation - CEO

Yes. And Kulbinder, also just to supplement from revenue standpoint, last year, if you remember, we had the I-series launch in the second quarter. So our equipment revenue was down at 4.9%. Overall revenue was down at 3.4%. So that was our best quarter from a revenue standpoint in terms of relative declines. So just a little tougher compare. As Bill said, tougher compare top line and a little more transactional currency in the second quarter, which will become a better story in the second half.

Operator

Our next question comes from the line of Katy Huberty of Morgan Stanley.

Kathryn Lynn Huberty - Morgan Stanley, Research Division - MD and Research Analyst

With new business TCV growing again in the first quarter, albeit slightly versus the declines last year, can you just talk about where you are in terms of putting in place the sales force to chase new logos? And then just general ballpark of where you would want the new business TCV to be growing, say, exiting this year?

Jeffrey Jacobson - Xerox Corporation - CEO

This is Jeff. Yes, so if we go back to last year, last year was not a great year for us. On new business signings, we were down for the total year actually at 18%. And I think one of the things that's important as we talk about signings, we're actually referring to them now as enterprise signings. So about 80% of our Managed Document Services business today is in the enterprise. We really don't track signings for Global Imaging and for our Xerox Partner Print Services, which are more in the SMB arena where we expect to see the growth. So again, just to look at the marketplace, \$13 billion is the managed print services market, \$6 billion of that market, which is growing at about 2%, is in the enterprise, where we're really looking to capitalize on the growth of the \$7 billion of the SMB Managed Print Services base growing at 7%. We did grow at 1% on new business signings. We were down at about 12% on the renewals, but again, those were in the enterprise. The new logo hunters, we're starting to bring on now. Those 2 take time to ramp. So from the time they come, if you think about hiring somebody from the outside, calling on new accounts, that would be a ramp. We expect to get better ramp from the expanded channels, getting new partners, and certainly, when the new products come. And then obviously, increasing our renewal rate, which was at about 81%. So we think that the big one -- biggest benefits will come in the second half of the year really with the new product launch.

Kathryn Lynn Huberty - Morgan Stanley, Research Division - MD and Research Analyst

And then just as a follow-up, you saw a recovery in High-end equipment sales, still spotty in some of the other segments just given the product launches, but most of that is now in the field. And so do you have line of sight as to when you would expect equipment sales to stabilize and/or grow again?



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Jeffrey Jacobson - Xerox Corporation - CEO

Yes, so we were not dissatisfied, by any means, with the 5.7% decline in equipment revenue. If you look at the second half of last year, we were a little over 10% at constant currency declines in the second half and 8.7% for the full year. So the 5.7% was an improvement. And again, that was without really getting the benefits. With the Versant launch, which was 3 new products, if we go back to whenever we've launched Versant in past years, we did get a nice bump. It's just coming in April, so we would think, believe and hope in -- certainly, in May and June, we should start seeing the benefits of that. If I look at entry from an ESR standpoint, down 5.5%; and if I look at the installs, color installs were up 15%. Part of that was the nice bump we got towards the end where we did bring in 4 of A4 products. Mid-range really didn't help us. We didn't bring out any new products. But in Q2, we will be bringing out all 17 of the Mid-range A3 products. And again, I think that will help us much more in the second half of the year.

Operator

And our last question comes from the line of Matt Cabral of Goldman Sachs.

Matthew N. Cabral - Goldman Sachs Group Inc., Research Division - Analyst

I kind of wanted to follow up to that last question. I guess given that the product launch hit at the end of the quarter and it was pretty well telegraphed that you guys were going to do it, can you just talk about either quantitatively or even just qualitatively about the amount of demand hesitation that you saw just ahead of these new products hitting the market?

Jeffrey Jacobson - Xerox Corporation - CEO

Yes. Thanks, Matt. That's a good point. You always see some of that. I mean, so that's why if you were to look -- that's why you really have to disconnect, I'll say, between our installs and high-end and the negative 3.7% actual equipment revenue recognized in high-end. We had very positive mix with our inkjet installations as well as our iGen installations. Those are higher-volume, higher-priced product -- or higher-priced products. With the Versant, which is more of a volume type of play, what I'll call more of the entry production color, in anticipation of that, those installs were down significantly year-over-year. So to your point, we always see that in our business, that until the new products actually hit the supply chain, that's when you'll see the orders start coming.

Matthew N. Cabral - Goldman Sachs Group Inc., Research Division - Analyst

And maybe Jeff, just on that same point, thinking a little bit more about the Mid-range given the A3 launch that you had, was there any demand hesitation there that you saw as well?

Jeffrey Jacobson - Xerox Corporation - CEO

Yes. I mean, I think we would attribute that to being down to negative 7%. Certainly, the black and white, that was down 24%. Color was flat. So I don't think there's any question about that. When you look at our order flow and backlog, I think there definitely was that hesitation. As we start sitting on our supply chain, the normal course would be to see it starting to flow better, and again, I think we'll get those benefits in the second half.

Jennifer Horsley - Xerox Corporation - VP of Investor Relations

Great. Thanks, Matt. And that's all the time we have for questions today. Thanks for everyone's interest. Jeff, anything more to wrap up?



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Jeffrey Jacobson - Xerox Corporation - CEO

Yes. Thanks, Jennifer. Just thank you all for your questions. The first quarter was a positive beginning for the new Xerox. We are keenly focused on the work ahead of us, and we have confidence in our ability to meet our commitments. We look forward to updating you on our progress as we go along, and I want to thank you all for joining our call.

Jennifer Horsley - Xerox Corporation - VP of Investor Relations

Thanks, Jeff. That concludes our call today. If you have further questions, please don't hesitate to contact myself or anyone else on the Investor Relations team.

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