

# Non-GAAP Financial Measures

Q3 2020 RESULTS | OCTOBER 27, 2020

# Non-GAAP Financial Measures

We have reported our financial results in accordance with generally accepted accounting principles (GAAP). In addition, we have discussed our financial results using the non-GAAP measures described below. We believe these non-GAAP measures allow investors to better understand the trends in our business and to better understand and compare our results. Accordingly, we believe it is necessary to adjust several reported amounts, determined in accordance with GAAP, to exclude the effects of certain items as well as their related income tax effects.

A reconciliation of these non-GAAP financial measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are set forth below.

These non-GAAP financial measures should be viewed in addition to, and not as a substitute for, the company's reported results prepared in accordance with GAAP.

## Adjusted Earnings Measures

- Net Income and Earnings per share (EPS)
- Effective Tax Rate

The above measures were adjusted for the following items:

- Restructuring and related costs: Restructuring and related costs include restructuring and asset impairment charges as well as costs associated with our transformation programs beyond those normally included in restructuring and asset impairment charges. Restructuring consists of costs primarily related to severance and benefits paid to employees pursuant to formal restructuring and workforce reduction plans. Asset impairment includes costs incurred for those assets sold, abandoned or made obsolete as a result of our restructuring actions, exiting from a business or other strategic business changes. Additional costs for our transformation programs are primarily related to the implementation of strategic actions and initiatives and include third-party professional service costs as well as one-time incremental costs. All of these costs can vary significantly in terms of amount and frequency based on the nature of the actions as well as the changing needs of the business. Accordingly, due to that significant variability, we will exclude these charges since we do not believe they provide meaningful insight into our current or past operating performance nor do we believe they are reflective of our expected future operating expenses as such charges are expected to yield future benefits and savings with respect to our operational performance.
- Amortization of intangible assets: The amortization of intangible assets is driven by our acquisition activity which can vary in size, nature and timing as compared to other companies within our industry and from period to period. The use of intangible assets contributed to our revenues earned during the periods presented and will contribute to our future period revenues as well. Amortization of intangible assets will recur in future periods.

# Non-GAAP Financial Measures (cont'd)

- Transaction and related costs, net: Transaction and related costs, net are costs and expenses primarily associated with certain strategic M&A projects. These costs are primarily for third-party legal, accounting, consulting and other similar type professional services as well as potential legal settlements that may arise in connection with those M&A transactions. These costs are considered incremental to our normal operating charges and were incurred or are expected to be incurred solely as a result of the planned transactions. Accordingly, we are excluding these expenses from our Adjusted Earnings Measures in order to evaluate our performance on a comparable basis.
- Non-service retirement-related costs: Our defined benefit pension and retiree health costs include several elements impacted by changes in plan assets and obligations that are primarily driven by changes in the debt and equity markets as well as those that are predominantly legacy in nature and related to employees who are no longer providing current service to the company (e.g. retirees and ex-employees). These elements include (i) interest cost, (ii) expected return on plan assets, (iii) amortization of prior plan amendments, (iv) amortized actuarial gains/losses and (v) the impacts of any plan settlements/curtailments. Accordingly, we consider these elements of our periodic retirement plan costs to be outside the operational performance of the business or legacy costs and not necessarily indicative of current or future cash flow requirements. This approach is consistent with the classification of these costs as non-operating in other expenses, net. Adjusted earnings will continue to include the service cost elements of our retirement costs, which is related to current employee service as well as the cost of our defined contribution plans.
- Other discrete, unusual or infrequent items: We excluded the following items given their discrete, unusual or infrequent nature and their impact on our results for the period.
  - Contract termination costs – IT services
  - Impacts associated with the Tax Cuts and Jobs Act (the “Tax Act”) enacted in December 2017.

We believe the exclusion of these items allows investors to better understand and analyze the results for the period as compared to prior periods and expected future trends in our business.

# Non-GAAP Financial Measures (cont'd)

## Adjusted Operating Income/Margin

We calculate and utilize adjusted operating income and margin measures by adjusting our reported pre-tax income and margin amounts. In addition to the costs and expenses noted as adjustments for our Adjusted Earnings measures, adjusted operating income and margin also exclude the remaining amounts included in Other expenses, net, which are primarily non-financing interest expense and certain other non-operating costs and expenses. We exclude these amounts in order to evaluate our current and past operating performance and to better understand the expected future trends in our business.

## Constant Currency

To better understand trends in our business, we believe that it is helpful to adjust revenue to exclude the impact of changes in the translation of foreign currencies into U.S. dollars. We refer to this adjusted revenue as “constant currency.” This impact is calculated by translating current period activity in local currency using the comparable prior year period's currency translation rate. This impact is calculated for all countries where the functional currency is not the U.S. dollar. Management believes the constant currency measure provides investors an additional perspective on revenue trends. Currency impact can be determined as the difference between actual growth rates and constant currency growth rates.

## Free Cash Flow

To better understand trends in our business, we believe that it is helpful to adjust operating cash flows by subtracting amounts related to capital expenditures. Management believes this measure gives investors an additional perspective on cash flow from operating activities in excess of amounts required for reinvestment. It provides a measure of our ability to fund acquisitions, dividends and share repurchase.

## **Summary:**

Management believes that all of these non-GAAP financial measures provide an additional means of analyzing the current period's results against the corresponding prior period's results. However, these non-GAAP financial measures should be viewed in addition to, and not as a substitute for, the company's reported results prepared in accordance with GAAP. Our non-GAAP financial measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures and should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. Our management regularly uses our supplemental non-GAAP financial measures internally to understand, manage and evaluate our business and make operating decisions. These non-GAAP measures are among the primary factors management uses in planning for and forecasting future periods. Compensation of our executives is based in part on the performance of our business based on these non-GAAP measures.

A reconciliation of these non-GAAP financial measures and the most directly comparable measures calculated and presented in accordance with GAAP are set forth on the following tables:



# Net Income and EPS reconciliation

(in millions, except per share amounts)	Three Months Ended September 30, 2020		Three Months Ended September 30, 2019	
	Net Income	EPS	Net Income	EPS
<b>Reported<sup>(1)</sup></b>	\$ 90	\$ 0.41	\$ 157	\$ 0.68
<b>Adjustments:</b>				
Restructuring and related costs	20		27	
Amortization of intangible assets	13		9	
Transaction and related costs, net	(6)		4	
Non-service retirement-related costs	(13)		(2)	
Contract termination costs – IT services	-		(8)	
Income tax on adjustments <sup>(2)</sup>	1		(7)	
Tax Act	-		4	
<b>Adjusted</b>	<u>\$ 105</u>	<u>\$ 0.48</u>	<u>\$ 184</u>	<u>\$ 0.80</u>
Dividends on preferred stock used in adjusted EPS calculation <sup>(3)</sup>		\$ 4		\$ -
Weighted average shares for adjusted EPS <sup>(3)</sup>		213		231
Fully diluted shares at September 30, 2020 <sup>(4)</sup>		208		

(1) Net income and EPS from continuing operations attributable to Xerox Holdings.

(2) Refer to Effective Tax Rate reconciliation.

(3) Average shares for the calculation of adjusted diluted EPS for 2020 exclude 7 million shares associated with our Series A convertible preferred stock and therefore earnings include the preferred stock dividend. Average shares for the calculation of adjusted diluted EPS for 2019 include 7 million shares associated with our Series A convertible preferred stock and therefore exclude the preferred stock dividend.

(4) Represents common shares outstanding at September 30, 2020 plus potential dilutive common shares as used for the calculation of adjusted diluted EPS for the third quarter 2020. The amount excludes shares associated with our Series A convertible preferred stock as they are expected to be anti-dilutive for the year.

# Effective Tax Rate reconciliation

(in millions)	Three Months Ended September 30, 2020			Three Months Ended September 30, 2019		
	Pre-Tax Income	Income Tax Expense	Effective Tax Rate	Pre-Tax Income	Income Tax Expense	Effective Tax Rate
<b>Reported<sup>(1)</sup></b>	\$ 119	\$ 29	24.4%	\$ 223	\$ 66	29.6%
Non-GAAP Adjustments <sup>(2)</sup>	14	(1)		30	7	
Tax Act	-	-		-	(4)	
<b>Adjusted<sup>(3)</sup></b>	<u>\$ 133</u>	<u>\$ 28</u>	21.1%	<u>\$ 253</u>	<u>\$ 69</u>	27.3%

(1) Pre-tax income and income tax expense from continuing operations.

(2) Refer to Net Income and EPS reconciliation for details.

(3) The tax impact on Adjusted Pre-Tax Income from continuing operations is calculated under the same accounting principles applied to the Reported Pre-Tax Income under ASC 740, which employs an annual effective tax rate method to the results.

# Operating Income / Margin reconciliation

(in millions)	Three Months Ended September 30, 2020			Three Months Ended September 30, 2019		
	Profit	Revenue	Margin	Profit	Revenue	Margin
<b>Reported</b> <sup>(1)</sup>	\$ 119	\$ 1,767	6.7%	\$ 223	\$ 2,179	10.2%
<b>Adjustments:</b>						
Restructuring and related costs	20			27		
Amortization of intangible assets	13			9		
Transaction and related costs, net	(6)			4		
Other expenses, net	(15)			(1)		
<b>Adjusted</b>	<u>\$ 131</u>	<u>\$ 1,767</u>	7.4%	<u>\$ 262</u>	<u>\$ 2,179</u>	12.0%

<sup>(1)</sup> Pre-tax Income and revenue from continuing operations.

# Free Cash Flow reconciliation

(in millions)	Three Months Ended September 30,		
	2020	2019	Change
<b>Reported</b> <sup>(1)</sup>	\$ 106	\$ 348	\$ (242)
Capital expenditures	(18)	(17)	(1)
<b>Free Cash Flow</b>	<u>\$ 88</u>	<u>\$ 331</u>	\$ (243)

<sup>(1)</sup> Net cash provided by operating activities of continuing operations.



# Other Expenses, Net reconciliation

(in millions)	Three Months Ended	
	September 30,	
	2020	2019
<b>Reported</b>	\$ (15)	\$ (1)
Less: Non-service retirement-related costs	(13)	(2)
Less: Contract termination costs – IT services	-	(8)
<b>Adjusted</b>	<u>\$ (2)</u>	<u>\$ 9</u>

# Net Income (Loss) and EPS reconciliation – historical

(in millions, except per share amounts)	Q3-18		Q4-18		Year Ended December 31, 2018		Q1-19		Q2-19		Q3-19		Q4-19		Year Ended December 31, 2019		Q1-20		Q2-20	
	Net Income	EPS	Net Income	EPS	Net Income	EPS	Net Income	EPS	Net Income	EPS	Net Income	EPS	Net Income	EPS	Net Income	EPS	Net (Loss) Income	EPS	Net (Loss) Income	EPS
<b>Reported <sup>(1)</sup></b>	\$ 39	\$ 0.14	\$ 91	\$ 0.37	\$ 306	\$ 1.16	\$ 84	\$ 0.34	\$ 141	\$ 0.60	\$ 157	\$ 0.68	\$ 266	\$ 1.17	\$ 648	\$ 2.78	\$ (2)	\$ (0.03)	\$ 27	\$ 0.11
Restructuring and related costs	29		67		157		112		37		27		53		229		41		3	
Amortization of intangible assets	12		12		48		15		11		9		10		45		11		10	
Transaction and related costs, net	(33)		5		68		-		4		4		4		12		17		7	
Non-service retirement-related costs	33		67		150		13		10		(2)		(3)		18		1		(8)	
Contract termination costs - IT services	-		43		43		-		-		(8)		(4)		(12)		3		-	
Income tax on adjustments	(10)		(48)		(116)		(31)		(17)		(7)		(22)		(77)		(21)		(3)	
US Tax Act	95		(6)		89		(35)		-		4		(4)		(35)		-		-	
<b>Adjusted</b>	<u>\$ 165</u>	<u>\$ 0.64</u>	<u>\$ 231</u>	<u>\$ 0.94</u>	<u>\$ 745</u>	<u>\$ 2.88</u>	<u>\$ 158</u>	<u>\$ 0.66</u>	<u>\$ 186</u>	<u>\$ 0.79</u>	<u>\$ 184</u>	<u>\$ 0.80</u>	<u>\$ 300</u>	<u>\$ 1.33</u>	<u>\$ 828</u>	<u>\$ 3.55</u>	<u>\$ 50</u>	<u>\$ 0.21</u>	<u>\$ 36</u>	<u>\$ 0.15</u>
Dividends on preferred stock used in adjusted EPS calculation <sup>(2)</sup>	\$ -		\$ -		\$ -		\$ -		\$ -		\$ -		\$ -		\$ -		\$ (4)		\$ 3	
Weighted average shares for adjusted EPS <sup>(2)</sup>		261		246		258		240		235		231		227		233		216		216

<sup>(1)</sup> Net Income (Loss) and EPS from continuing operations attributable to Xerox Holdings.

<sup>(2)</sup> For those periods that exclude the preferred stock dividend the average shares for the calculations of diluted EPS include 7 million shares associated with our Series A convertible preferred stock, as applicable.

# Operating Income / Margin reconciliation – historical

(in millions)	Q3-18			Q4-18			Year Ended December 31, 2018			Q1-19			Q2-19			Q3-19			Q4-19			Year Ended December 31, 2019			Q1-20			Q2-20		
	Profit	Revenue	Margin	Profit	Revenue	Margin	Profit	Revenue	Margin	Profit	Revenue	Margin	Profit	Revenue	Margin	Profit	Revenue	Margin	Profit	Revenue	Margin	Profit	Revenue	Margin	(Loss) Profit	Revenue	Margin	Profit	Revenue	Margin
<b>Reported<sup>(1)</sup></b>	\$ 177	\$ 2,314	7.6%	\$ 124	\$ 2,498	5.0%	\$ 549	\$ 9,662	5.7%	\$ 73	\$ 2,180	3.3%	\$ 190	\$ 2,263	8.4%	\$ 223	\$ 2,179	10.2%	\$ 336	\$ 2,444	13.7%	\$ 822	\$ 9,066	9.1%	\$ (5)	\$ 1,860	(0.3%)	\$ 35	\$ 1,465	2.4%
<b>Adjustments:</b>																														
Restructuring and related costs	29			67			157			112			37			27			53			229			41			3		
Amortization of intangible assets	12			12			48			15			11			9			10			45			11			10		
Transaction and related costs, net	(33)			5			68			-			4			4			4			12			17			7		
Other expenses, net	57			144			271			39			38			(1)			8			84			23			7		
<b>Adjusted</b>	<u>\$ 242</u>	<u>\$ 2,314</u>	10.5%	<u>\$ 352</u>	<u>\$ 2,498</u>	14.1%	<u>\$1,093</u>	<u>\$ 9,662</u>	11.3%	<u>\$ 239</u>	<u>\$ 2,180</u>	11.0%	<u>\$ 280</u>	<u>\$ 2,263</u>	12.4%	<u>\$ 262</u>	<u>\$ 2,179</u>	12.0%	<u>\$ 411</u>	<u>\$ 2,444</u>	16.8%	<u>\$ 1,192</u>	<u>\$ 9,066</u>	13.1%	<u>\$ 87</u>	<u>\$ 1,860</u>	4.7%	<u>\$ 62</u>	<u>\$ 1,465</u>	4.2%

<sup>(1)</sup> Pre-Tax Income (Loss) and revenue from continuing operations.

# Free Cash Flow reconciliation – historical



(in millions, except per share amounts)

**Reported <sup>(1)</sup>**

Capital expenditures

**Free Cash Flow from Continuing Operations**

	Year Ended December 31, 2018	Q1-19	Q2-19	Q3-19	Q4-19	Year Ended December 31, 2019	Q1-20	Q2-20
	\$ 1,082	\$ 222	\$ 276	\$ 348	\$ 398	\$ 1,244	\$ 173	\$ 34
	(90)	(15)	(16)	(17)	(17)	(65)	(23)	(19)
	<u>\$ 992</u>	<u>\$ 207</u>	<u>\$ 260</u>	<u>\$ 331</u>	<u>\$ 381</u>	<u>\$ 1,179</u>	<u>\$ 150</u>	<u>\$ 15</u>

<sup>(1)</sup> Net cash provided by operating activities from continuing operations.



**xerox**<sup>TM</sup>