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Xerox Holdings Corp. (XRX)

Acquisition of Lexmark International Inc from Ninestar Corporation by Xerox Holdings Corp Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Xerox Holdings Corporation Conference Call. After the presentation [audio gap] (00:00:17) question-and-answer session. [Operator Instructions]

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

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

Good Morning, everyone. I'm David Beckel, Vice President and Head of Investor Relations at Xerox Holdings Corporation. Welcome to today's conference call hosted by Steve Bandrowczak, Chief Executive Officer. He is joined by John Bruno, President and Chief Operating Officer; 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 express permission of Xerox. During this call, Xerox executives will refer to slides that are available on the web at www.xerox.com/investor and will make comments that contain forward-looking statements, which by their nature address matters that are in the future and 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. Bandrowczak.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

Good morning, and thank you for joining us to discuss today's exciting news. I am pleased to announce Xerox has signed an agreement to acquire Lexmark, a leading global print and print services company based in Lexington, Kentucky, for $1.5 billion in cash and debt. This transaction accelerates Xerox's Reinvention by improving our core print business and increasing our mix of revenue from growing markets.

The industrial logic for combining these two companies is compelling. Lexmark and Xerox have complementary sets of operations, offering strengths and market reach. Xerox is a leading distributor of office print equipment and the leading provider of value-added managed print services. Xerox does not manufacture the equipment and most supplies for our Office Print business, nor do we have a market presence in APAC region.

Lexmark is a leading manufacturer in A4 office equipment and supplies, recently adding an A3 product range to its manufacturing lineup. Lexmark has a market presence in 170 countries, including a strong foothold in APAC region.

Combined, Xerox and Lexmark form a vertically integrated manufacturer, distributor and a service provider of print equipment and services, covering all major geographies and client types with a well-rounded portfolio of print and print services offerings.

We are confident this acquisition will create long-term value for our shareholders. The combination of our companies establishes a stronger, more stable presence in the evolving print and managed print services industry and enhances Xerox's portfolio, offering a more balanced and competitive range of print solutions, with increased presence in growing print market segments.

The transaction is expected to be immediately accretive to EPS and free cash flow, improving the financial results of the combined operations shortly after transaction close. Despite the use of debt to finance this acquisition, pro forma debt leverage will be lower than Xerox's debt leverage today. And more than $200 million of synergies are expected to drive incremental earnings accretion and free cash flow in the two years post transaction close, enabling a further reduction to our debt leverage ratio over time.

I will spend a few minutes describing Lexmark's business in more detail, but before I do, I'd like to put this transaction in the context of our strategic evolution over the past few years.

Moving to slide 4, we began our Reinvention journey two years ago in response to rapid changes in workplace behavior and the evolving nature of today's hybrid workplace. Reinvention is designed to enable long-term growth in Xerox's revenue and profitability by simplifying the business and optimizing our commercial operations, ensuring we diversify our revenue and provide the products and services our clients need most, in the most efficient manner.

Operational simplification and commercial optimization are designed to create a more agile Xerox, one that is capable of repositioning and diversifying to take advantage of favorable dynamics in print and value-add adjacencies while delivering positive client outcomes.

Today's announced acquisition continues the Reinvention journey we began last year. The divestiture of non-core operations in 2023 simplified our business and improved profitability, freeing up the capital and internal resources necessary to properly execute our Reinvention. The organizational redesign implemented earlier this year structurally simplified our business model and enabled closer alignment between our business and the economic buyer of our products and services.

The acquisition of ITsavvy, which closed a month ago, improves our value proposition with clients by enhancing our IT Solution (sic) [IT Solutions] (00:05:51) operations, an important adjacency to print in key markets. It also provides Xerox greater exposure to technology markets, exhibiting healthy underlying rates of growth.

The acquisition of Lexmark checks all the strategic Reinvention boxes. It will enable further business simplification as we streamline operations. Lexmark allows us to optimize our commercial offerings with a more balanced print portfolio, regional exposure, and breadth of distribution partners. And a more complete print offering is expected to improve client and partner perception, drive a stronger consideration of our growing portfolio of advanced Digital Services and IT Solutions.

Slide 5 provides an overview of Lexmark's current business. Lexmark, like Xerox, is a global leader in print and print services and is based in the US. Founded in 1991, Lexmark was spun out of IBM and traded publicly for 21 years before being taken private in 2016.

Lexmark is approximately one-third the size of Xerox in terms of revenue, having generated $2.2 billion of revenue in the last 12 months. Lexmark is particularly strong in A4 large workteam/workgroup, a category favorably positioned for today's hybrid workplace. Around 20% of Lexmark's revenue is comprised of OEM sales to branded print and supplies distributors, including Xerox. Given it's heavier weighted towards A4 and a high supplies attachment rate, Lexmark generates more than half its revenue from high-margin supplies.

Lexmark is also a leader in managed print services, complementing Xerox's leading managed print services business. Lexmark's balanced portfolio and leading position in A4 have resulted in a stable revenue profile over time. Despite periods of supply chain disruption and prevailing secular headwinds, it grew revenue 4% over the last 12 months. And Lexmark's operating discipline, vertically integrated business model, and supplies mix contributed to a healthy 14% adjusted EBITDA margin in the last 12-month period.

Moving to slide 6, this acquisition builds on a history of collaboration between the two companies. In 2021, we began providing break/fix services for Lexmark equipment in the US, Canada, and Europe. Later that year, we established an OEM relationship with Lexmark for the purchase of A4 equipment and supplies. Since that time, we have shipped more than 1 million units manufactured by Lexmark. And Lexmark was the first OEM partner of Xerox Financial Services, prior to its return to a captive-only leasing model.

Like Xerox, Lexmark has simplified its operation in recent years. Shortly after being taken private, its enterprise software business was spun off and sold to private equity. Thereafter, Lexmark has focused on strengthening its branded operations and growing its OEM business, which now serves 7 of the 10 largest global distributors of print equipment and supplies. In April of this year, Lexmark extended its product lineup into the A3 category with the launch of its 9-Series of printers and multi-function devices serving the A3 entry and mid categories.

Slide 7 provides a glimpse of Xerox and Lexmark as a combined entity. On a pro forma combined basis, in the last 12 months, Xerox and Lexmark generated more than $8 billion of revenue, excluding intercompany transactions, and more than $1 billion of EBITDA, inclusive of more than $200 million of expected run rate synergies.

Pro forma combined operating income would have been close to $700 million, including run rate synergies, resulting in an 8.4% adjusted pro forma operating margin. Operationally, the combined businesses create an industry leader in terms of customer reach and operating scale. Xerox and Lexmark collectively serve more than 200,000 clients of all sizes in more than 170 countries.

The acquisition also complements and diversifies Xerox's distribution footprint. On a combined basis, manufacturing and distribution facilities span more than 125 locations across 16 countries. And our fleet of more than 10,000 field service technicians, engineers, and delivery managers is unparalleled in the industry.

Combined, Xerox and Lexmark hold a top five share in each of the entry, mid and production markets globally. Lexmark adds to Xerox's leading position in the managed print services market. And even with the addition of more than $2 billion of print-related revenue resulting from the acquisition, Xerox's growing Digital Services and IT Solutions businesses would still comprise more 10% of the total company revenue on a pro forma basis.

I'll now hand the call over to John to provide more color on the strategic benefits of the acquisition.

John G. Bruno

Chief Operating Officer, President & Director, Xerox Holdings Corp.

Thank you, Steve. I would like to echo Steve's excitement for this announced transaction. We expect the acquisition of Lexmark will create a stronger, more stable Xerox, one that is better positioned to address the evolving needs of today's hybrid workplace and a more resilient company to weather unforeseen challenges in the future. We are bringing together two talented teams with great familiarity given our go-to-market partnership, partnership that, as Steve mentioned, recently celebrated an impressive milestone, the shipment of our 1 millionth A4 device together.

Let's spend a few minutes covering the industrial logic of this transaction in more detail. One of the key strategic merits of this acquisition is the diversification of our supply chain and end market exposure. With Lexmark, we will control manufacturing of a large and growing portion of our print equipment and toner supply and distribute our products across a wider breadth of countries and distribution partners.

We will have a more comprehensive portfolio of products to enhance our competitive position and reinforce our value proposition to clients, thereby facilitating market share growth opportunities across our portfolio of equipment and services.

Financially, as previously mentioned, we expect to generate more than $200 million of synergies by combining and streamlining our collective operations. These synergies will accelerate accretion in EPS and free cash flow.

I'll provide more context on expected benefits of supply chain and end-market diversification on slide 9. Since ending the joint venture with Fuji in 2019, Xerox has relied on external suppliers for the manufacturing of most of our products, resulting in supplier dependency and reduced competitiveness in some of our indirect markets. Lexmark provides us full manufacturing control over the majority of our A4 product, and with its new A3 product line, optionality to move more of our A3 production to Lexmark over time. Vertical integration and manufacturing diversification will enable us to be more responsive and provide a more competitive offering for our indirect channel partners.

Similarly, Xerox was previously prevented from investing in distribution infrastructure in the APAC market under the terms of our former joint venture with Fuji. Following the acquisition of Lexmark, we will have a presence we can build upon in this large market, from which we can round out Lexmark's portfolio of offerings with Xerox's leading portfolio of A3 equipment and advanced print services.

Moving to product offering diversification on slide 10, Lexmark is a leader in one of the fastest growing markets in print, A4 color. This acquisition improves our exposure to this large, growing market, which is expected to become increasingly important as companies continue to adopt more flexible, hybrid workplace configurations.

On a pro forma combined basis, Xerox expects to derive one-third of our equipment revenue from the A4 category, up from 14% today. Post acquisition, a balanced portfolio should enhance our value proposition across a more diverse base of clients, positioning us well to gain share in print and increase the penetration of our Digital Services and IT Solutions. I'll comment on both opportunities on slide 11.

Starting with the benefits of a more diverse client base, in the direct channel, Lexmark complements our business with particularly strong relationships in retail and in banking. These relationships with large, multinational organizations are expected to provide Xerox an opportunity to sell our mid and high-end A3 product, along with our portfolio of Digital Services.

Lexmark has a stronger mix of revenue from distribution channels, an area of growing strategic importance for Xerox. We expect our combined, enhanced print offerings to drive incremental opportunities with distributors and improve our win rates in this important channel. This acquisition also provides opportunities to expand Xerox's portfolio of workplace solutions in direct markets. The addition of Lexmark will enhance our leading position in managed print services. Once together, we will have an opportunity to combine best practices, optimize operations, create more value for clients, and further strengthen our business.

A more complete set of print and print services offerings is expected to improve client attach rates, allowing us to introduce more of our emerging Digital Services and IT Solutions to a larger group of existing clients. Both categories address large, growing TAMs and are expected to be strong contributors to our revenue trajectory post acquisition.

Before handing it back over to Xavier, I will address synergies on slide 12. We expect to realize more than $200 million of synergies within two years of the close of this transaction, which represents less than 5% of our combined operating cost base. Most of these synergies will come from the consolidation of duplicative functions in markets and regions where both Xerox and Lexmark operate today. We expect more than $50 million of our synergies to come from manufacturing scale and an optimized services infrastructure.

There are also identified opportunities to rationalize R&D spend without jeopardizing research initiatives. In fact, given our existing partnership, we believe, as one company, we will improve the competitiveness of our combined offerings going forward.

The Lexmark team are world class and proven operators with a strong track record of engineering, supply chain and manufacturing optimization. Together with our Global Business Services organization, the group responsible for delivering approximately $200 million of gross cost savings in 2024 and developing a pipeline of more than $400 million of gross cost savings to be realized over the next two years, we form a powerful combination. The synergies associated with this transaction are expected to be incremental and complementary to our projected Reinvention savings post integration.

Now, Xavier will discuss the financial benefits of this transaction in more detail.

Xavier Heiss

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

Thank you, John. I will review in more detail the financial benefits of this transaction and provide an update on capital allocation priorities following transaction close, starting with benefits to shareholders on slide 13. The acquisition of Lexmark accelerates Xerox's financial Reinvention targets. We believe this transaction will enable revenue stabilization and double-digit operating profitability sooner than what we could achieve on our own.

Lexmark is expected to improve our revenue trajectory through a more favorable positioning with print, opportunity to expand Lexmark A3 OEM platform and market share gains resulting from a more complete and balanced print offering.

From a profit perspective, we expect Lexmark will be immediately accretive to our margin profile. The more than $200 million of projected deal synergies, combined with the more than $400 million of expected future gross Reinvention savings already announced is expected to place us firmly on the path to achieve double-digit adjusted operating margins over time.

Moving to accretion, this transaction is expected to be immediately accretive to adjusted earning per share and free cash flow. We expect day one adjusted EPS accretion of more than $0.25, excluding the benefit of synergies, and more than $1 per share of adjusted EPS accretion upon the realization of our cost synergies.

Finally, this transaction is expected to improve Xerox's balance sheet health. Our pro forma debt leverage ratio is expected to be lower immediately following the transaction close, and simultaneously with this transaction, we will raise debt to refinance the remaining $388 million of 2025 senior unsecured notes.

I'll address pro forma capitalization and capital priorities on slide 14. Our gross debt leverage ratio post transaction is expected to drop from 6 time last 12 month EBITDA as of 9/30/2024 to around 5.4 times, even without the benefit of expected synergies. Assuming the benefit of synergies realizable over a two-year period, leverage will fall to around 4.4 times.

Following transaction close, repayment of debt will be a top capital allocation priority as we target a gross leverage ratio below 3 times last 12 month EBITDA. In connection with the acquisition, we announced today our plan to reduce the annual dividend payment from $1 per share to $0.50 per share, beginning with the dividend to be declared in Q1 2025. This lowered dividend payment provide incremental capacity to reduce debt post transaction close, while continuing to reward shareholders with an above-market yield.

Finally, we plan to continue to invest in value-added project and tuck-in acquisition that further improve our mix of revenue from businesses with higher underlying rate of growth and provide high returns on invested capital.

I'll now turn the call back to Steve.

Steven John Bandrowczak

Chief Executive Officer & Director, Xerox Holdings Corp.

Thank you, Xavier. To recap, this transaction brings together two industry leaders to create a stronger, more stable organization capable of sustainably gaining share in print and growing adjusted operating income. We expect an improved print business, growing levels of EPS and cash flow and a healthier balance sheet to create incremental shareholder value as we integrate Lexmark and execute on our plan to realize deal synergies over the next two years.

This transaction is expected to close in the second half of 2025 following customary regulatory approvals, including antitrust regulatory approvals, confirmation from CFIUS that the National Security Agreement will be terminated, and Ninestar's shareholder approval.

Operator, you may now open the line for questions.

QUESTION AND ANSWER SECTION

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

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Yeah, good morning, guys, and happy holidays and thanks for taking the questions. This is actually pretty interesting. I guess, Steve, just to pick up right where you left off, talking about sort of road to approval, do you anticipate any sort of regulatory challenges? I mean, anything that would be sort of more than typical routine?

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

No, we're not anticipated any regulatory challenges rather than just the timeline to get through the regulatory bodies. But no, we're not anticipating any.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Okay, great. That's helpful. And then, Xavier, can you remind us the debt levels that you just went over and the 6 times that are current, that debt ladder, it says total debt, so that's not the core debt, the core debt would be lower than that. Can you just walk us through that?

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

A

Yeah. So, Ananda, this is the total debt that we have here. So, we have 6 time currently here. And as you can see it, based on the transaction, we would be able to deleverage immediately. So moving from 6 time as of the end of September, up to 5.4 time, assuming a deal close of June 30 next year. So, if you then include the value of the $200 million of synergy, so pro forma gross debt leverage will drop to 4.4 times here, so put us very well in the trajectory of our targeted debt gross – gross debt leverage of 3 times.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

I got it. And just to ask a clarifying question there, this includes the debt that you guys take on based on your finance receivables that the rating agencies are – that partner with you in and telling you where you can go. So the core debt – is the core debt lower actually than these levels and the...

[indiscernible] (00:24:49)

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

Yeah, correct.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Got it.

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

Ananda, correct. This is the total debt there. What is remaining from the finance receivable, you know we have this Forward Flow program, where the finance receivable debt is reducing over time, but this is including in the total amount.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

I got it. And then, John, did I hear accurately, so sort of $50 million is – I'm going to say gross margin, is the cost of production benefit from the vertical integration?

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

One more time, Ananda, you talk about the vertical integration of us and Lex or...

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

And Lex...

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

...you're talking specifically our production?

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Yeah, no, of you guys and Lexmark, of the combined company, I thought I heard you mention that $50 million was the synergy benefit of the vertical integration.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

That's right.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Is that accurate?

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

You're correct. We see the – we have line of sight to integration relatively early on, because a lot of it is around the vertical integration in our go-to-market in places and where we have certain redundancies. So that's what I was referring to.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Got it. Awesome. That's super helpful.

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

And just to be transparent and clear here, the total synergies that we [ph] feel (00:26:09), we see, including all different [indiscernible] (00:26:13) there, is around $200 million. On these synergies, we expect them to be delivered after roughly two years, the bulk of it being in year one. But two years synergy, $200 million. All the number we provided were based on this assumption.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

When do you think...

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

I think – hey, Ananda, I think Xavier wants to make sure I have an aggressive goal. What do you think?

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Yeah. No, I mean, listen, it's very accretive if you guys can hit your signposts here. And...

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

Well indeed. That's why we wanted to break it out for you to give you a little bit of clarity, because there are things that we can do initially and immediately. And none of it interferes with our stated trajectories on geo simplification and our product simplifications and all the work we've done in production. So, that's why it's accretive as it is.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

And without trying to get too cute, when – the two years to hit the $200 million, is that run rate $200 million, so $50 million a quarter, it takes eight quarters?

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

That's correct.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

I got you.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

Yeah. That's correct. That's how we bottled it – its run rate.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Got it. That's helpful. And, okay, sort of strategic question here, what – to the best of your ability, can you give us any sense of sort of what managed print services conversations have you guys not had access to or sort of haven't been as firm sort of in your go to market about without having your own sort of print technology in-house? And like how much – and you made mention to – you touched on this a couple of times in the presentation, but sort of the plugging in of this asset, to what degree do you think that sort of substantially addresses those conversations?

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

Yeah, Ananda, let me start and then I'm going to turn it over to John for specific on managed print services, right? There are couple of things. First of all, we have very, very complementary go-to-market combinations. If you think about large retail, Lex is very, very prominent in the front end of the store. So, if we think about retail point of sales, tremendous amount of relationships there. We are in the back end. We do a lot of the back office, a lot of the big manufacturing printing in the back office. That gives us an opportunity to grow inside of existing accounts, where we have the same logo but we don't overlap.

The second thing is we now have an opportunity to expand into Asia Pacific, where they already have a footprint. We can now take our managed print services and we can expand into Asia Pac. And then the last thing is we really have and been building upon our relationships with other OEMs. We now can reshape some of that and go forward. We mentioned the A3 capabilities that we can potentially expand through our own manufacturing, our own R&D. So, that gives us some opportunities to do some things that we couldn't be able to do both in terms of go-to-market, in terms of product and geography expansion.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

Yeah. I would say, just to give you – oh, go ahead...

[indiscernible] (00:29:25)

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

No, no, no. No, go for it. Go for it, John.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

I was going to say, just to add to that, I think you have to kind of think about Lexmark's client and market exposure and how does it complement ours. I mean, they're – they have a leading presence in the A4 market. They're number two share in the large work stream (sic) [workteam] (00:29:42) and the workgroup space. And if you look at the geographic mix, revenue by geography is like 49% North America, 31% EMEA, 11% LATAM and just about 10% in APAC.

And really what contributes to their strong margins is more than half of their revenue is really is contributing others through supplies. So, when you think about a stronger A4, we're stronger in A3 and production. They have APAC and LATAM presence. We do not have the same. And as Steve pointed out, they have a strong direct presence in the mid-market. We have stronger exposures in certain enterprise segments than they have in others, like banks and retail.

So, with their stronger distribution and the channel market, I think that's what you can see in their operating margins, their indirect business, their supplies, that contributes to the strength of their operating margins. And that is really complementing with ours, which is really the thing is there's little dis-synergy in the deal from a revenue perspective.

Ananda Baruah
Analyst, Loop Capital Markets LLC Q

That's super helpful. Thanks, guys. Really appreciate it. I'll [ph] see you before there (00:30:47). Thanks a lot.

Operator: Thank you. [Operator Instructions] Our next question comes from Erik Woodring with Morgan Stanley. Your line is open.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC Q

Hey, guys. Thank you for taking my questions. And congrats on this deal. It is very interesting. Yeah.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp. A

Thanks, Erik.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC Q

Steve, maybe just high level big picture, I just wanted to ask kind of you're undertaking – Xerox is undertaking a number of significant initiatives right now under Reinvention, right? You've done a sizable workforce reduction. You're changing your go-to-market. You're shifting into services. Obviously, you're going through a CFO transition in the future as well. Can you maybe just big picture, why is now the right time to acquire Lexmark? Obviously it introduces even more operational complexities into what has already been a complex Reinvention.

I understand the accretion math. So, financially, assuming you hit the numbers, I can understand the accretion side. But just from a timing perspective and how you think about balancing the complexities of absorbing another business on top of all of the changes that you guys have been – that you've been doing over the last 12 months? And then I have a quick follow-up.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.
A

Yeah, Erik. Thank you. It actually fits very well, Erik. And if you think about taking a step back on the Reinvention from a strategy standpoint, the components of Lex fit very nicely into what we're trying to do. So, we talked about how we're going to drive and expand our partner portfolio and expansion. At the beginning of the year, we named that as a dedicated resource. We said we're going to grow that business. Lexmark absolutely helps us with that.

We talked about expanding A4 business, which is a growing segment specifically in color. And we said there's a growing – there's growth in print specifically around A4. Absolutely Lex allows us to do that. We talked about geography expansion, the ability to be able to expand into other adjacencies and other markets. We now go into Asia Pacific.

When you take a look at the components of everything they've done with supply chain, what they've done with their supplies, these are all things that we are driving as part of our reinvention. So, we now take the integration of the company of Lex, put it directly under our Reinvention programs and we put those two together.

So, we see them incredibly complementary. As we talked about the value of the deal, you think about the accretiveness of it, you think about we can deleverage, we expand our revenue, we start growing again in areas of print that they're growing. We have absolutely more coverage in areas that we didn't play before. John talked about both retail and banking, the frontend of the stores, where we can now play and an incredibly strong partner network that they already have. We put all that together, it actually accelerates our Reinvention.

Think about where we're going from an overall operating profit when we put the two companies together, think about what we're doing from deleveraging our balance sheet when we put the two companies together. So, for me, it was time to accelerate our Reinvention program.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.
A

I mean, the only thing I would add to that is because there's no doubt that what you described is a lot of addition to our strategy with regard to the kind of things as we de-risk them. But it's really important to come back to what we described when we talked about the acquisition of ITsavvy.

Diversifying our revenue is part of what we're trying to do. And so, the addition of ITsavvy into our IT Solutions space was very important, but it's a reverse integration. We actually took the CEO of that company and their leadership team and they are running the combined business, where we've put the assets of Xerox into it. So, it is not a distraction to try and drive both. We've actually segmented them intentionally, and that was part of our strategy because we had obvious knowledge of our desire to do what we're doing here with Lexmark long before we made the decision on the integration of ITsavvy.

And of course, we all know none of these things can be perfectly timed. You have to seize opportunities when they present themselves, processes present themselves in certain ways, and you have to take advantage of the moments when they occur. Nothing can be ever perfectly timed, but I couldn't be more confident in our Reinvention strategy and the synergies of how this actually accelerates and doesn't compete with it, and the revenue diversification through IT Solutions and the use of a reverse integration to do that, to make sure that management time and attention isn't spread so thinly that it interferes with our execution.

And entering into 2025, I feel much better about a revised go-to-market strategy and a realigned set of teams that we – going into 2025 and the changes we made in 2024. So, having that level of stability now for three quarters at a time where we're going to strengthen print because even at the end of our Reinvention journey, print represents 80-plus-percent of our overall revenue. Strengthening print is core to what we need to do as a print and print services provider.

So, I think it's highly synergistic and the timing is actually maybe not perfect, but it is very good because if it was this time last year, that would have been a much more disruptive set of initiatives than it is this year. And the last thing I'll say is, this doesn't close until the second half of the year. It's like we're targeting probably six months between now and the opportunity to close with all the regulatory pieces, the ITsavvy integration will be well along at that point in time and we should be in good shape by the time we have to start integrating this. So, we're announcing it today, but we're not closing on it until the second half.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

No, totally understand. And I want to give you credit because with the challenging end market backdrop you face and sometimes you need to make challenging and big decisions and this is obviously one of them. So, I applaud you guys for going after it.

Maybe my follow-up question, Steve and John too, is maybe broader. And that is just I understand the EPS accretion math that you can do here and that there's a lot of kind of cost synergies that you can capture in the backdrop. How do we think about this combined entity from a growth perspective? Because the way that I'm thinking about this is, clearly, there's cost synergies that you can get out in the near term. But once we get through that, what is the combined Lexmark-Xerox entity? Is the top line trajectory any different than it is today?

Some of the considerations I consider is Lexmark in 2016 was sold for $3.6 billion to private equity. You're buying them, I assume, with some embedded premium for $1.5 billion today. So, it is clearly a smaller business. I realize they sold their software business. But still, how do we think about the prospects of growth going forward? Does this change that at all?

And if you could also incorporate just your views on services and the importance of services, because obviously at one point, we thought services would become 20% of the business, now it's obviously you're kind of doubling down on print. So, that's a long-winded way of just asking how we think about the future growth of this combined entity once we get past cost synergies. Thanks so much.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

Yeah. Let me take a couple of shots there and turn it back over to John. So, first of all, the A4 color market is growing, right? We're absolutely betting on a growing market that's been growing. The second is Lex has been selling A4s into the OEM space. They now service 7 of the 10 large OEMs out there and that continues to grow. This is a path to double-digit operating income margin we're able to think about, so we're really going to accelerate that.

Channel expansion, we talked about at the beginning of the year. We need to grow our channels. We need to expand our channels. They have a tremendous channel business. And we grow – the two companies together have an expansion in our channel business. And I would say the last thing is, we talked about it a little bit a few minutes ago with Ananda, and that is that we don't have very big client overlap. That's very complementary from a front store and back store. And we talked about banking, we talked about retail, the front side of the store is an area that we don't play specifically in point of sales. We play very strongly in the back-end. And so, there's lots of area and I've talked about this before, lots of area TAM to grow within existing clients.

We now take ITsavvy, think about IT services, we now can bring that to an expanded both partner base and an expanded client base. So, we have a great opportunity to go grow our IT services and our Digital Services inside of that space as well. So we look at it as a broader TAM, geographic TAM expansion, partner TAM expansion, and certainly bigger wallet TAM expansion as we bring IT Solutions inside of the client base that we're going to have when we combine the two companies. John, anything else you want to add?

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

I would only say it's the consistency with what we've described before. So just to just double down on a couple of Steve's points, this is, for sure, an ability to have stabilization across the revenue environment. Like the trajectory of the print business overall is going to be what the trajectory of the print business is overall. However, what we do within that pie is very important. And so, to Steve's earlier point, focusing our print business in the places in which we see either growth or we see the rate of decline being slower is just how we're diversifying our business.

And in no way, shape or form does this change our trajectory of continuing to try and have the revenue diversification we talked about over time, the whole 80/20. So, yes, we have – the core to a strong Xerox and to a strong Reinvention is a strong print business. So adding elements of this print business in that are in the markets that are growing actually gives us revenue stabilization and it slows down the decline.

Yes, it actually on a raw basis adds more print. So therefore, we have to – from a services perspective, it will take a bit more time to get to that 20% to 80%, but we're not backing off the diversification on services and solutions. So our Digital Services and our IT Solutions portfolio will still have the same goals in line, which is to get to the right mix of revenue diversification, because it's the operating margin and the ability to drive the profitable growth that we're talking about.

There's not many transactions that can more than double the operating profit, but at the same time immediately deleverage a company and help stabilize our revenue in the print business and provide us optionality in our services and IT Solutions business. And that's why we like this transaction as much as we do.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Awesome. I appreciate all the detail, guys. Congrats and best of luck with everything.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

Thank you.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

Thanks, Erik.

Operator: Thank you. Our next question comes from Asiya Merchant with Citi. Your line is open.

Asiya Merchant
Analyst, Citigroup Global Markets Canada, Inc.

Q

Good morning. Thank you for taking the question. On slide 9, just kind of curious if you can double down a little bit on what the OEM relationships are that Lexmark engages in today and the crossover there and what's going to stay post the acquisition? Thank you.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

Yeah. So, today in the A4 space, they both design and manufacture for 7 of the 10 OEMs that are out there today, specific. So, we're not talking about the specific companies but 7 of the 10 that are out there in the OEM space, Lex manufacturers – designs and manufacturers A4 for them and they use their own brand too, both put their label and their distribution channel on top of it. By the way, we [indiscernible] (00:42:34)...

Asiya Merchant
Analyst, Citigroup Global Markets Canada, Inc.

Q

All right. And...

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

...right, we've had that relationship with them and we've shipped 1 million products with them. And obviously, we've had great success with them in the A4 space.

Asiya Merchant
Analyst, Citigroup Global Markets Canada, Inc.

Q

And is the expectation that the combined entity would do these A4 OEM relationships? And I don't know to the extent that you've had discussions with these 7 of the 10. I'm assuming they're your large competitors, the usual suspects, and are they still planning to continue this relationship with the combined entity?

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

A

Well with news just came out today, so we'll have those conversations as we get closer to close. But I would imagine that we will both maintain and we will actually expand those relationships.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

Yeah, we absolutely believe that our – together our two companies, our history and innovation around print, it's going to benefit Lexmark's future product designs and – because now there'll be a combined Xerox-Lexmark, it's going to make for a more attractive supplier to the OEM partners over time, which is going to have greater scale. And there's an opportunity to improve product cost. We can reinvest in innovation in ways that as independent companies we couldn't. And the OEM products are going to remain differentiated with different brand names. And so, we think that that's all very positive to the OEM channel.

Asiya Merchant
Analyst, Citigroup Global Markets Canada, Inc.

Q

Okay. Thank you.

Operator: Thank you. Our next question is a follow-up from Ananda Baruah with Loop Capital. Your line is open.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Yeah. Thanks, guys, for the follow-up. Just, guys, when Lexmark went private, they had been in the couple years prior talking about and highlighting actually the development of domain-specific services and solutions. And some of this is based on software development. Is there anything there that's interesting that you guys see? And if there is anything interesting that you guys see, is that portable, is any of that IT portable sort of across the broader portfolio?

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

I think the way I would describe it is it's not material in our model or in our growth. And even some of the – even some of their more edge cases on what they're doing in IoT is similar to what we've done with augmented reality and so forth, are not – none of those things are embedded into our model. They're all opportunistic. But what we do share is we both believe that print and print-related services are going to be very vertically integrated, as things evolve over time and print, and when I say that, I mean that by print-heavy verticals.

So, when you think about education or a legal and e-discovery or document management or contract workflows, all those types of things, we're really looking forward to bringing forward the integrated – I should say, the vertical integrated knowledge that the Lexmark team has, because over time, not immediately, we just see more vertically integrated software opportunities for our company. We've talked about that in the past, will evolve into that because print is part of a broader solution that is really unique by the vertical you serve. Patient healthcare records and scanning is different than, like I said, what happens in the legal vertical. So, their vertical knowledge will be very complementary to the way we think about the future.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Yeah, that's great. That's helpful. Appreciate it, guys. Thanks a lot.

John G. Bruno
Chief Operating Officer, President & Director, Xerox Holdings Corp.

A

You're welcome.

Operator: Thank you. There are no further questions at this time. I'd like to turn the call back over to Steve for any closing remarks.

Steven John Bandrowczak
Chief Executive Officer & Director, Xerox Holdings Corp.

Thank you, operator. Thank you, everyone, for joining the conference call. Today's announcement marks a pivotal moment in the print industry. We look forward to welcoming Lexmark to the Xerox family and creating a value for shareholders, employees, clients and partners. We wish everybody a safe and happy holiday season.

Operator: Thank you for your participation. This does conclude the program and you may now disconnect. Good day.