FORM 10-K
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)
(X) Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the fiscal year ended: December 31, 1998

( ) Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from: ______ to ______

XEROX CORPORATION
(Exact name of registrant as specified in its charter)

1-4471
(Commission file number)

New York	16-0468020
(State of incorporation)	(I.R.S. Employer Identification No.)
P.O. Box 1600, Stamford, Connecticut	06904
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (203) 968-3000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1 par value	New York Stock Exchange
	Chicago Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes: (X) No: ( )

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.
( )

The aggregate market value of the voting stock of the registrant held by non-affiliates as of February 26, 1999 was: $39,661,401,412.

(Cover Page Continued)

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

Class	Outstanding at February 26,1999
Common Stock, $1 Par Value	659,328,281 Shares

Documents Incorporated By Reference

Portions of the following documents are incorporated herein by reference:

Document	Part of 10-K in Which Incorporated
Xerox Corporation 1998 Annual Report to Shareholders	I & II
Xerox Corporation Notice of 1999 Annual Meeting of Shareholders and Proxy Statement (to be filed not later than 120 days after the close of the fiscal year covered by this report on Form 10-K).	III & IV

Forward-Looking Statements

From time to time Xerox Corporation (the Registrant or the Company) and its representatives may provide information, whether orally or in writing, including certain statements in this Form 10-K under "Management's Discussion and Analysis of Results of Operations and Financial Condition," which are deemed to be "forward-looking" within the meaning of the Private Securities Litigation Reform Act of 1995 ("Litigation Reform Act"). These forward-looking statements and other information relating to the Company are based on the beliefs of management as well as assumptions made by and information currently available to management.

The words "anticipate," "believe," "estimate," "expect," "intend," "will," and similar expressions, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Registrant with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated or expected. The Registrant does not intend to update these forward-looking statements.

In accordance with the provisions of the Litigation Reform Act we are making investors aware that such "forward-looking" statements, because they relate to future events, are by their very nature subject to many important factors which could cause actual results to differ materially from those contained in the "forward-looking" statements. Such factors include but are not limited to the following:

Competition - the Registrant operates in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. There are a number of companies worldwide with significant financial resources which compete with the Registrant to provide document processing products and services in each of the markets served by the Registrant, some of whom operate on a global basis. The Registrant's success in its future performance is largely dependent upon its ability to compete successfully in its currently-served markets and to expand into additional market segments.

Transition to Digital - presently black and white light-lens copiers represent approximately 40% of the Registrant's revenues. This segment of the general office market is mature with anticipated declining industry revenues as the market transitions to digital technology. Some of the Registrant's new digital products replace or compete with the Registrant's current light-lens equipment. Changes in the mix of products from light-lens to digital, and the pace of that change as well as competitive developments could cause actual results to vary from those expected.

Pricing - the Registrant's ability to succeed is dependent upon its ability to obtain adequate pricing for its products and services which provide a reasonable return to shareholders. Depending on competitive market factors, future prices the Registrant can obtain for its products and services may vary from historical levels.

Financing Business - a significant portion of the Registrant's profits arise from the financing of its customers' purchases of the Registrant's equipment. On average, 75 to 80 percent of equipment sales are financed through the Registrant. The Registrant's ability to provide such financing at competitive rates and realize profitable spreads is highly dependent upon its own costs of borrowing which, in turn, depend upon its credit ratings. Significant changes in such ratings could reduce the profitability of such financing business and/or make the Registrant's financing less attractive to customers thus reducing the volume of financing business done. The Registrant's present credit ratings permit ready access to the credit markets. There is no assurance that these credit ratings can be maintained and/or ready access to the credit markets can be assured.

Productivity - the Registrant's ability to sustain and improve its profit margins is largely dependent on its ability to maintain an efficient, cost-effective operation. Productivity improvements through process reengineering, design efficiency and supplier cost improvements are required to offset labor cost inflation and potential materials cost changes and competitive price pressures.

International Operations - the Registrant derives approximately half its revenue from operations outside of the United States. In addition, the Registrant manufactures many of its products and/or their components outside the United States. The Registrant's future revenue, cost and profit results could be affected by a number of factors, including changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country's political conditions, trade protection measures, licensing requirements and local tax issues.

New Products/Research and Development - the process of developing new high technology products and solutions is inherently complex and uncertain. It requires accurate anticipation of customers' changing needs and emerging technological trends. The Registrant must then make long-term investments and commit significant resources before knowing whether these investments will eventually result in products that achieve customer acceptance and generate the revenues required to provide anticipated returns from these investments.

Restructuring - the Registrant's ability to ultimately reduce pre-tax annual expenditures by approximately $1 billion is dependent upon its ability to successfully implement the 1998 restructuring program including the elimination of 9,000 net jobs worldwide, the closing and consolidation of facilities, and the successful implementation of process and systems changes.

Year 2000 - the Registrant's ability to complete its Year 2000 plan is dependent upon the availability of resources, the Registrant's ability to discover and correct the potential Year 2000 sensitive problems which could have a serious impact on the Registrant's information management systems, facilities and products, and the ability of the Registrant's suppliers and customers to bring their systems into Year 2000 compliance.

PART I

Item 1. Business

Overview

Xerox Corporation (Xerox or the Company) is The Document Company and a leader in the global document market, providing document solutions that enhance business productivity. References herein to "us" or "our" refer to Xerox and consolidated subsidiaries unless the context specifically requires otherwise. We distribute our products in the Western Hemisphere through divisions and wholly-owned subsidiaries. In Europe, Africa, the Middle East and parts of Asia including India, China and Hong Kong, we distribute through Xerox Limited and related companies (collectively Xerox Limited). Fuji Xerox, an unconsolidated entity jointly owned by Xerox Limited and Fuji Photo Film Company, Limited develops, manufactures and distributes document processing products in Japan and the Pacific Rim. Japan represents approximately 90 percent of Fuji Xerox revenues, and Australia, New Zealand, Singapore, Malaysia and Korea represent the remaining 10 percent. Fuji Xerox conducts business in other Pacific Rim countries through joint ventures and distributors.

Since 1995, the results of our Insurance operations have been accounted for as discontinued operations and the Document Processing business has been the only component of continuing operations.

Our Document Processing activities encompass developing, manufacturing, marketing, servicing and financing a complete range of document processing products and solutions designed to make offices around the world more productive. We believe that the document is a tool for productivity, and that documents - both electronic and paper - are at the heart of most business processes. Documents are the means for storing, managing, and sharing business knowledge. Document technology is key to improving productivity through information sharing and knowledge management and we believe no one knows the document - paper to digital, digital to paper - better than we do. The financing of Xerox equipment is generally carried out by Xerox Credit Corporation (XCC) in the United States and internationally by foreign financing subsidiaries and divisions in most countries. Document Processing operations had 92,700 Xerox employees at year-end 1998.

Continuing Operations

The Document Processing Strategy

We believe that documents represent the knowledge base of an organization and play a dynamic and central role in business, government, education and other organizations:

- - Increasingly, documents are being created and stored in digital electronic form. In addition, the internet is increasing the amount of information which can be accessed in the form of electronic documents.
- - While the percentage of printed documents will decline, the total of all documents produced by organizations (printed and electronic) will grow at an even faster rate.
- - This will result in an overall continuing increase in the volume of printed documents.

As The Document Company, we believe that by helping our customers navigate and manage the world of documents, we can help them improve their productivity and grow their businesses. We help customers make documents better, make better documents, and work better with documents.

We create customer value by providing innovative document technologies, products, systems, services and solutions that allow our customers to:

- - Move easily within and between the electronic and paper forms of documents.

- - Scan, store, retrieve, view, revise and distribute documents electronically anywhere in the world.

- - Print or publish documents on demand, at the point closest to their needs, including those locations of our customers' customers.

- - Integrate the currently separate modes of producing documents, such as the data center, production publishing and office environments into a seamless, user-friendly enterprise-wide document systems network - with technology acting as an enabler.

We have formed alliances to bring together the diverse infrastructures that currently exist and to nurture the development of an open document services and solutions environment to support complementary products from our partners and customers. We are working with more than 50 industry organizations to make office, production and electronic printing an integrated, seamless part of today's digital work place.

Market Overview

We estimate that the global document market that we serve, excluding Japan and the Pacific Rim countries served by Fuji Xerox, was approximately $120 billion in 1998 and is estimated to grow to over $200 billion in 2001. With our many new product introductions during this decade and in particular, the transition from light-lens to digital technology, our participation in the global document market has been considerably broadened from the slower growing segments of the market to the faster growing segments of the market. We are leading the transition in our industry from light-lens to digital technology, from standalone devices to network-connected systems, from black and white to color capable devices, and from box sales to services and solutions which solve customer problems. Xerox growth will be driven by the transition to digital copying and printing in the office, the transfer of document production from offset printing to digital publishing, the increase in customer requirements for network and distributed printing, the accelerating demand for color documents, and increasingly, our participation in the small office / home office / personal document processing market.

We have traditionally had a strong position in the general office document market, the largest segment, which is projected to reach approximately $79 billion in 2001. Growth in this market is driven by the transition to the use of digital and color documents. The production market, which includes production publishing and production printing, is expected to reach $27 billion in 2001. The small office / home office / personal document processing market is growing at an annual rate of more than 25 percent to $48 billion by 2001 due to increases in the number of home offices and small businesses. This market segment acquires product primarily through indirect distribution channels. Document outsourcing, the fastest growing served market segment, is projected to grow 35 to 40 percent annually, reaching $18 billion by 2001, as customers' increasingly focus on their core competencies and outsource their document processing requirements. Finally, the portion of the professional services market in which we participate through our 1998 acquisition of XLConnect, now Xerox Connect, an information technology services company, is growing very rapidly, to $20 billion by 2001.

Xerox Focus

We believe that our competitive advantages lie in our ability to continually improve the features and performance of our document processing products, services and solutions based on demonstrated customer needs; competitive pricing; our excellent reputation for performance and service; our substantial on-going investment in research and development; expanded sales coverage through our global direct sales force, agents and concessionaires; our leadership position in the rapidly growing document outsourcing business; maintenance of our strong market position in emerging markets; and building on the strength of the Xerox brand, an expanded presence in the burgeoning small office / home office / personal document processing market through expansion of retail chains, value added resellers and systems integrators, and increasingly telesales and e-commerce. As a result, we believe we are well positioned to participate in the anticipated growth in the market segments in which we compete.

Digital Products

Our digital products consist of five categories: black-and-white production publishing, black-and-white production printing, color copying and printing, black-and-white digital copiers, and channels/other. On a pre-currency basis, digital product revenues grew 36 percent in 1998, 25 percent in 1997, and 23 percent in 1996. The acceleration in digital product revenue growth resulted in 1998 digital revenues exceeding light-lens copier revenues for the first time. Revenues from digital products were 46 percent of total revenues in 1998, 36 percent in 1997, and 30 percent in 1996.

Production Publishing

In 1990, we launched the era of production publishing when we announced the introduction of our DocuTech Production Publishing family which was a major step beyond our traditional reprographics market into the publishing industry. Having installed more than 20,000 DocuTech systems around the world to date, our production publishing revenues in 1998 grew 15 percent pre-currency to $2.3 billion.

Digital production publishing technology is increasingly replacing older, traditional short-run offset printing as customers seek improved productivity and cost savings, faster turnaround of document preparation, and the ability to print documents "on demand." We offer the widest range of solutions available in the marketplace - from dial-up lines through the Internet to state-of-the-art networks - and we are committed to expanding these print-on-demand solutions as new technology and applications are developed.

The DocuTech family of digital production publishers scans paper documents and converts them into digital documents, or accepts digital documents directly from networked personal computers or workstations. A user-friendly electronic cut-and-paste workstation allows the manipulation of images or the creation of new documents. For example, in only a few minutes, a page of word-processed text, received over a network, can be combined with a scanned photograph and enhanced electronically: cropped, positioned precisely, rotated, brightened or sharpened. Digital masters can be prepared in a fraction of the time necessary to prepare offset printing plates, thereby allowing fast turnaround time. Further time can be saved, and frequently significant inventory and shipping costs, by transmitting electronically and printing where and when the documents are required. In 1998, we introduced DigiPath Production Software, a major productivity tool, which allows a printer's customers to use the World Wide Web to streamline print job submission and subsequent archiving, preparation, proofing, and reprinting.

DocuTech prints high-resolution (600 dots per inch) pages at up to 180 impressions per minute. The in-line finisher staples completed sets or finishes booklets with covers and thermal-adhesive bindings. Because the finished document can be stored as a digital document, hard copy documents can be printed on demand, or only as required, thus avoiding the long production runs and high storage and obsolescence costs associated with offset printing. The concept of print-on-demand took another major step forward in 1995 when we introduced the DocuTech 6135. It makes print-for-one publishing practical; personalized publishing runs can now be as short as one or two prints. Further steps forward were taken in 1997 when the DocuTech 6180 was introduced, increasing output speed to 180 cut-sheet pages per minute and again in 1998 with the introduction of DocuTech 65 (65 pages per minute) and DocuTech 6100, (96 pages per minute) making the technology affordable for much smaller customers.

Production Printing

Revenue from monochrome production printing was $2.3 billion in 1998.

This market has largely consisted of high-end host-connected printers. We expect future growth for robust, fully featured printers serving multiple users on networks. This growth will be driven by the increase in personal computers and workstations on networks, client-server processing, accelerating growth in the demand for enterprise-wide distributed printing, and declining electronics costs. These faster, more reliable printers print collated multiple sets on both sides of the paper, insert covers and tabs, and staple or bind, but without the labor-intensive steps of printing an original and manually preparing the documents on copiers. In addition, documents can be printed on these printers from remote data center computers, enabling the efficiencies of distributing electronically and then printing, rather than printing paper documents and then distributing them.

We have held the leading position in the production, high-volume computer printing market segment since 1977. We are well positioned to capitalize on the growth in the computer printing market because of our innovative technologies and our understanding of customer requirements for distributed printing from desktop and host computers. Our goal is to integrate office, production and data-center computer printing into a single, seamless, user-friendly network.

Xerox pioneered and continues to be a worldwide leader in computer laser printing, which combines computer, laser, communications and xerographic technologies. We market a broad line of robust printers with speeds up to the industry's fastest cut-sheet printer at 180 pages per minute, and continuous-feed production printers at speeds up to 1300 images per minute. Many of these printers have simultaneous interfaces that can be connected to multiple host computers as well as local area networks.

Breakthrough technology in our highlight color printers allows printing, in a single pass, black-and-white plus one customer-changeable color (as well as shades, tints, textures and mixtures of each) at production speeds up to 184 pages per minute. Other manufacturers' highlight color printers require additional passes to add variable color, which increase cost, reduce speed and reliability and introduce the possibility of color misalignment.

Productivity-enhancing features include printing collated multiple sets on both sides of the paper, inserting covers and tabs, printing checks with magnetic ink character recognition (MICR), and stapling or finishing with a thermal adhesive binding; all on cut sheet plain paper, with sizes up to 11 by 17 inches.

In 1995, we significantly expanded our opportunities with the introduction of two major new printer series that redefine our role in the electronic production printing industry. With the DocuPrint CF Series family, we entered the market for very high-volume, continuous-feed printers at speeds up to 420 pages per minute. The DocuPrint IPS Series makes the IBM Advanced Function Presentation (AFP) architecture directly available to our production printing customers.

In 1997, we introduced the DocuPrint 180 that prints on one or both sides of a page, on a wide variety of paper sizes and weights, and at 180 pages per minute. We also introduced the DocuPrint 184 hc (highlight color) which pairs two 92 page-per-minute Xerox highlight color laser printers with one print server for cut-sheet, highlight color production speeds up to 184 pages per minute.

In 1998, we demonstrated the DocuPrint 900 and the DocuPrint 1300 models, the first in a new class of ultra high-speed continuous feed production printing systems. Printing at up to 900 and 1300 duplex impressions per minute (200 and 300 feet per minute, respectively), these DocuPrint models combine the high reliability and throughput of web printing with the flexibility of electronic printing for unsurpassed productivity. These models also offer a number of in-line finishing options, including cut-sheet, fanfold, or roll and are compatible with many third party post-processing devices.

Color Copying and Printing

Our revenues from color copying and printing grew 19 percent pre-currency in 1998 to $1.9 billion.

The use of color originals in the office is accelerating. Independent studies have concluded that color documents are more effective at communicating information and that decision-making performance improves with the use of color documents. The vast majority of industry shipments of workstations and personal computers have color monitors, creating the need for economical, convenient and reliable, high-quality color copying and printing.

The color market has largely consisted of ink-jet and laser copiers and printers. Laser copiers and printers offer near-offset image quality, excellent printing speeds, and the accessories necessary to produce finished sets.

We entered the color laser market in 1991 with the introduction of a color laser copier/printer and a color laser printer, each of which printed at 7.5 pages per minute. More recent product introductions include the DocuColor 40, introduced in early 1996, which copies and prints at 40 full-color pages per minute and is the industry's fastest and most affordable digital color document production system. It has a market share of more than 50 percent. In 1997, we introduced the DocuColor 70, a continuous feed full-color digital press, based on a print engine from Xeikon with Xerox-exclusive digital front-ends, that produces 70 high-quality, full-color impressions per minute and in 1998, we introduced the DocuColor 100 Digital Color Press, also based on a Xeikon print engine with Xerox-exclusive digital front-ends, that produces 100 high-quality full-color impressions per minute.

For the general office, in 1997 we introduced the DocuColor 5750 Empress copier/printer which produces 6 full color copies per minute and the DocuColor 5799 which operates at 9 full color copies per minute. For networked workgroups, we introduced the DocuPrint C55, a full-featured, compact color laser printer that prints three full color pages per minute and includes automatic image enhancement and an embedded web server. In 1998, we introduced the DocuColor Office 6, a networked color copier/printer for the office that operates at twice the speed of most desktop color laser printers at the price of a mid-volume black and white copier. Also in 1998, we expanded the DocuColor 40 line, adding the DocuColor 40 CP, a network-connected color copier/printer equipped with a newly designed digital controller, designed to provide digital walk up copying as well as network printing for lower-volume environments. In March, 1999, we introduced the DocuColor 30 Pro and the DocuColor 30 CP, both 30 page per minute digital color copier/printers intended for entry-level production environments and high-end color intensive offices and the DocuColor 4 LP, a laser printer that operates at four full-color pages or 16 black and white pages per minute. Finally, in the latter part of 1998 we announced our first entry into the fast growing network color inkjet market, the DocuPrint C20 Color Inkjet Printer that costs about one-third the price of a color laser printer and have followed that with 1999 announcements including inkjet multi-function devices.

Black and White Digital Copiers

The volume of paper documents used in the office continues to grow. Pages per worker per day in the U.S. have doubled in the last decade and productivity has been impaired by the need to manage documents on computer monitors and as hard-copy originals.

We intend to help customers improve productivity by controlling their documents from a common interface; managing from the desktop; eliminating gaps, steps and devices in the work process; and moving smoothly from digital to paper and back.

Our strategy is to build from our current strength, the copier. We know how to design and build copiers with superior marking, paper handling and finishing technology. We know our customers, their requirements and how to sell sophisticated, fully featured copiers. In April 1997, we introduced the Document Centre family of black and white digital copiers at speeds ranging from 20 to 65 pages per minute, that are better quality, more reliable, and more feature rich than light-lens copiers and are priced at a modest premium over comparable light-lens copiers. This family is modular in design, offering the capability of upgrading the standalone copier to full network connectivity when the customer is ready.

Beginning in 1998, we began connecting the digital copiers to customers' networks so that their digital copiers can also be used as robust, high-speed network printers to gain incremental volume from computer printing and ultimately to replace desktop printers and single-purpose copiers and fax machines. The fax option and network upgrades have compelling economics versus the alternative of purchasing comparable printers and faxes since the print engine, output mechanics and most of the software required are part of the base digital copier.

Revenue from the Document Centre family more than quadrupled in 1998, reaching $1.8 billion. This product family alone represented about two-thirds of the company's digital revenue growth. The proportion of digital copiers installed with network connectivity continued to grow, with approximately 45 percent of new 20 and 30 page per minute Document Centre installations being network connected in December. Early results for the 65 page per minute Document Centre are equally promising; in the areas where available, roughly 40 percent of December Document Centre 265 installations were network connected.

Channels and Other Products

Revenues in this category grew 73 percent pre-currency to $0.7 billion in 1998, reflecting primarily network black and white laser printers sold through indirect sales channels such as retail, dealers, and value added resellers.

Significant market growth in the small office/home office and networked office is represented by customers who typically acquire product through indirect sales channels. In September, 1997, we launched the DocuPrint family of monochrome network laser printers which initially included 24 and 32 page per minute laser printers and which were faster, more advanced and less expensive than competitive models, offering "copier-like" features such as multiple-set printing, stapling and collating. In 1998, we expanded the DocuPrint line to include monochrome laser printers at speeds ranging from 8 - - 40 pages per minute.

Light-lens Copying

Our revenues from light-lens copiers declined 11 percent pre-currency in 1998 to $7.9 billion. The decline in light-lens copier revenues reflects several important factors, including customer transition to our new digital black-and-white products and continued price pressures. We believe the trend over the past few years will continue whereby digital products' revenues represent an increasing share of total revenues and light-lens copier revenues represent a declining share of total revenues. Revenues from light-lens copying represented 41 percent of total revenues in 1998, 51 percent in 1997 and 56 percent in 1996.

We market the broadest line of light-lens copiers and duplicators in the industry, ranging from a three copies-per-minute personal copier to a 135 copies-per-minute full-featured duplicator. Many of our state-of-the-art products have improved ease of use, reliability, copy quality, job recovery and ergonomics as well as productivity-enhancing features, including zoom enlargement and reduction, highlight color, copying on both sides of the paper, and collating and stapling which allow the preparation of completed document sets.

We have a strong position with major accounts that demand a consistently high level of service worldwide. Our competitive advantages include a focus on customer call response times, diagnostic equipment that is state-of-the-art and availability of 24-hour-a-day, seven-day-a-week service.

We also are increasing our leadership position in the most competitive copier market segment - small commercial accounts and small offices/home offices - through increased indirect sales coverage including sales through independent agents, retail outlets and trade associations and increased marketing programs, such as telemarketing and advertising.

We expect that light-lens copiers will increasingly be replaced by digital copiers. However, some portions of the market will continue to use light-lens copiers for many years, such as customers who care principally about price or whose work processes do not require digital products. Therefore, we intend to continually upgrade our light-lens products to maintain a leadership position in the industry.

Paper and Other Products

We also offer a wide range of other document processing products including devices designed to reproduce large engineering and architectural drawings up to 3 feet by 4 feet in size, facsimile products, and personal computer and workstation software.

We also sell cut-sheet paper to our customers for use in their document processing products.

Summary of Revenues by Product Category

The following table summarizes our revenues by major product category. The revenues for light-lens copiers and digital products include equipment and supplies sales, service, rental and document outsourcing revenues, and finance income.

Year ended December 31 (in billions)	1998	1997	1996
Digital products	$ 9.0	$ 6.6	$ 5.3
Light-lens copiers	7.9	8.9	9.7
Paper and other products	2.5	2.6	2.4
Total revenues	$19.4	$18.1	$17.4

Xerox Competitive Advantages

Customer Satisfaction

Our highest priority is customer satisfaction. Our research shows that satisfied customers are far more likely to repurchase products and that the cost of selling a replacement product to a satisfied customer is far less than selling to a "new" customer. We regularly survey customers on their satisfaction, measure the results, analyze the root causes of dissatisfaction, and take steps to correct any problems.

Because of our emphasis on customer satisfaction, we offer a Total Satisfaction Guarantee, one of the simplest and most comprehensive offered in any industry: "If you are not satisfied with our equipment, we will replace it without charge with an identical model or a machine with comparable features and capabilities." This guarantee applies for at least three years to equipment acquired from and continuously maintained by Xerox or its authorized agents.

Quality

We were an early pioneer in total quality management and are the only company to have won all three of the following prestigious quality awards: the Malcolm Baldrige National Quality Award in the United States in 1989; the European Quality Award in 1992; and the Deming Prize in Japan, won by Fuji Xerox in 1980. Xerox Business Services, our document outsourcing division, also won the Baldrige Award in the service category in 1997. In addition, we have won top quality awards in Argentina, Australia, Belgium, Brazil, Canada, China (Shanghai), Colombia, France, Germany, Hong Kong, India, Ireland, Mexico, the Netherlands, Norway, Portugal, the United Kingdom, and Uruguay. Our "Leadership Through Quality" program has enabled us to improve productivity, accelerate the introduction of new products, improve customer satisfaction and increase market share. Xerox products have been consistently rated among the worlds best by independent testing organizations. In 1997, Xerox reinforced its position as an environmental leader among Fortune 500 companies by receiving ISO 14001 certification for all its major manufacturing sites worldwide, as set by the International Standards Organization.

Research and Development

Xerox research and development (R&D) is directed toward the development of new products and capabilities in support of our document processing strategy. Our research scientists are deeply involved in the formulation of corporate strategy and key business decisions. They regularly meet with customers and have dialogues with our business divisions to ensure they understand customer requirements and are focused on products that can be commercialized.

In 1998, R&D expense was $1,043 million compared with $1,065 million in 1997 and $1,044 million in 1996. The modest reduction in 1998 reflected a reprioritization of our spending to focus on areas intended to produce significant growth, such as digital, color and solutions. We continue to invest in technological development to maintain our premier position in the rapidly changing document processing market with a heightened focus on increasing the effectiveness of our R&D investment as well as time to market. We expect the 1999 R&D growth rate will exceed the 1999 revenue growth rate. Xerox R&D is strategically coordinated with Fuji Xerox, which invested $636 million in R&D in 1998 for a combined total of $1.7 billion.

Marketing

Xerox document processing products are principally sold directly to customers by our worldwide sales force, a source of competitive advantage, totaling approximately 13,000 employees and through a network of independent agents, dealers, retail chains, value-added resellers and systems integrators. To market low-end copiers, laser printers, and multi-function devices, we are significantly expanding our indirect distribution channels. We currently have arrangements with U.S. retail marketing channels including CompUSA, Office Depot, OfficeMax, and Staples, and office channels that include distributors and value added resellers like Pinacor (formerly MicroAge), Ingram Micro, Tech Data, and Computer 2000. In 1998 we expanded our worldwide network of retail outlets and resellers by more than 40 percent. Our strategy is to target high-growth markets through high-volume distribution of laser and ink-jet printers, multi-function products, personal copiers, fax machines, and supplies, both for Xerox and competitive equipment, with a goal to be the fastest growing source of personal and networked document solutions in retail and reseller channels worldwide. In 1998 we began a major redesign of our Internet site to make it a more powerful tool for electronic commerce. We have begun to sell Xerox equipment and supplies over the Internet and will expand this initiative in 1999. We also plan to significantly expand our telebusiness capacity over the next three years, including opening new telebusiness centers in North America and Europe. Finally, we have increased our advertising spending.

Service

We have a worldwide service force of approximately 24,000 employees. In our opinion, this direct service force represents a significant competitive advantage: the service force is continually trained on our new products and its diagnostic equipment is state-of-the-art. 24-hour-a-day, seven-day-a-week service is available in most metropolitan areas in the United States. We are able to guarantee a consistent level of service nationwide and worldwide because we do not rely on independent local dealers for service and our service force is not focused exclusively on metropolitan areas.

Revenues

Our total document processing revenues were $19.4 billion in 1998, of which 52 percent were generated in the United States, 28 percent in Europe, and 20 percent in the remainder of the world, principally Brazil, the rest of Latin America, Canada, and China. The unconsolidated $6.8 billion of Fuji Xerox revenues were generated in Japan and much of the Pacific Rim.

Revenues from supplies, paper, service, rentals, document outsourcing and other revenues, and income from customer financing represented 62 percent of total revenues in 1998, 63 percent in 1997, and 65 percent in 1996. Because these revenues are derived from the installed base of equipment and are therefore less volatile than equipment sales revenues, they provide significant stability to overall revenues. Growth in these revenues is primarily a function of the growth in our installed population of equipment, usage and pricing. The balance of our revenues is derived from equipment sales. These sales, which drive the non-equipment revenues, depend on the flow of new products and are more affected by economic cycles from country to country.

Most of our customers have their equipment serviced by and use supplies sold by us. The market for cut-sheet paper is highly competitive and revenue growth is significantly affected by pricing. Our strategy is to charge a spread over mill wholesale prices. Rental revenues declined in 1998 and 1997 and were flat in 1996, due primarily to customers' preference for document outsourcing and the continuing trend of increased equipment sales.

Our document outsourcing business provides printing, publishing, duplicating and related services at more than 6,000 customer locations in 40 countries, including legal and accounting firms, financial institutions, insurance agencies and manufacturing companies. Revenues from our document outsourcing business were $2.7 billion in 1998. Document outsourcing revenues are split between equipment sales and document outsourcing. Where document outsourcing contracts include revenue accounted for as equipment sales, this revenue is included in equipment sales on the income statement. All other document outsourcing revenue, including service, equipment rental, supplies, paper and labor are included in document outsourcing. This has the effect of diverting some revenues from supplies, paper, service, rental, and finance income.

We offer our document processing customers financing of their purchases of Xerox equipment primarily through XCC in the United States, largely through wholly-owned financing subsidiaries in Europe, and through divisions in Canada and Latin America. While competition for this business from banks and other finance companies remains extensive, we actively market our equipment financing services on the basis of customer service, convenience and competitive rates. On average, 75 to 80 percent of equipment sales are financed through Xerox.

International Operations

Our international operations account for 48 percent of Document Processing revenues. Our largest interest outside the United States is Xerox Limited. Marketing and manufacturing operations are also conducted through joint ventures in India and China. Marketing and manufacturing in Latin America are conducted through subsidiaries or distributors in over 35 countries. Fuji Xerox develops, manufactures and distributes document processing products in Japan and other areas of the Pacific Rim, Australia and New Zealand.

Revenues in Brazil were $1.6 billion in 1998, $1.8 billion in 1997 and $1.6 billion in 1996. In the early part of 1999, the Brazilian real devalued substantially against the U.S. dollar. Such devaluation could adversely effect the Brazilian economy. However, we currently are unable to determine what effect, if any, this situation will have on our customers' intent or ability to purchase our products in 1999.

Our financial results by geographical area for 1998, 1997 and 1996, which are presented on pages 24, 25, and 47 of the Company's 1998 Annual Report to Shareholders, are hereby incorporated by reference in this document in partial answer to this item.

Restructuring

On April 7, 1998, we announced a worldwide restructuring program associated with enhancing our competitive position and lowering our overall cost structure. In connection with this program, we recorded a second quarter pretax provision of $1,644 million ($1,107 million after taxes, including our $18 million share of a restructuring charge recorded by Fuji Xerox). The program includes the elimination of approximately 9,000 jobs, net, worldwide, the closing and consolidation of facilities, and the write-down of certain assets.

Key initiatives of the restructuring include:
1. Consolidation of 56 European customer support centers into one facility and implementing a shared services organization for order entry, invoicing, and other back-office and sales operations.
2. Streamlining manufacturing logistics, distribution and service operations. This will include centralizing U.S. parts depots and outsourcing storage and distribution.
3. Overhauling our internal processes and associated resources, including closing one of four geographically-organized U.S. customer administrative centers with the remaining three refocused by customer segment, enabling improved customer support at lower cost.

When fully implemented, the ongoing pre-tax savings from the restructuring initiatives will be approximately $1 billion annually. Initially, more than half of the savings is being reinvested to implement business process and systems changes in order to enable the restructuring, and in ongoing efforts to broaden and strengthen marketing programs and distribution channels to enhance revenue growth. Selling, administrative and general expenses as a percentage of revenue will move from the high 20's to the low 20's over time, driven primarily by large reductions in overhead costs. Manufacturing and service productivity will also improve. These benefits will be somewhat offset by lower gross margins overall due to the increasing proportion of business conducted through indirect sales channels and outsourcing.

Our restructuring disclosure, presented on pages 28, 29, 42, and 43 of the Company's 1998 Annual Report to Shareholders, is hereby incorporated by reference in this document.

Acquisition of XLConnect Solutions

In May 1998, we acquired XLConnect Solutions, Inc. (XLConnect), an information technology services company, and its parent company, Intelligent Electronics, Inc. for $413 million in cash. The operating results of these companies, which are not material, have been included in our consolidated statements of income from the date of the acquisition. Based on the allocation of the purchase price, the transaction resulted in goodwill of $395 million (including transaction costs) which is being amortized over 25 years.

Discontinued Operations - Insurance and Other Financial Services

The discussion under the caption "Discontinued Operations - Insurance and Other Financial Services" on pages 38 and 39 set forth under the caption "Financial Review" and the information set forth under Note 10 "Discontinued Operations" on pages 47 through 49 in the Company's 1998 Annual Report to Shareholders are hereby incorporated by reference in this document in partial answer to this item.

As discussed in the incorporated sections referenced in the preceding paragraph, in 1998, the last remaining Talegen Holdings, Inc. insurance companies were sold and an additional after-tax charge of $190 million was recorded. At the end of 1998, our sole remaining Insurance operation is the Ridge Reinsurance Limited reinsurance business. Our other discontinued businesses, consisting of Other Financial Services and Third Party Financing and Real Estate, are primarily in asset and liability run-off.

Item 2. Properties

The Company owns a total of eleven principal manufacturing and engineering facilities and leases an additional such facility. The domestic facilities are located in California, New York and Oklahoma, while the international facilities are located in Brazil, Canada, England, France, Holland and Mexico. The Company also has four principal research facilities; two are owned facilities in New York and Canada, and two are leased facilities in California and France.

In addition, within the Company, there are numerous facilities that encompass general offices, sales offices, service locations and distribution centers. The principal owned facilities are located in the United States, England, and Mexico. The principal leased facilities are located in the United States, Brazil, Canada, England, Mexico, France, Germany and Italy.

The Company's Corporate Headquarters facility, located in Connecticut, is leased. A training facility, located in Virginia, is owned by the Company. In the opinion of Xerox management, its properties have been well maintained, are in sound operating condition and contain all the necessary equipment and facilities to perform the Company's functions.

Item 3. Legal Proceedings

The information set forth under Note 15 "Litigation" on pages 57 and 58 of the Company's 1998 Annual Report to Shareholders is incorporated by reference in this document in answer to this item.

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

Market Information, Holders and Dividends

The information set forth under the following captions on the indicated pages of the Company's 1998 Annual Report to Shareholders is hereby incorporated by reference in this document in answer to this Item:

Caption	Page No.
Stock Listed and Traded	68
Xerox Common Stock Prices and Dividends	68
Eleven Years in Review - Common Shareholders of Record at Year-End	64 and 65

Recent Sales of Unregistered Securities

During the quarter ended December 31, 1998, Registrant issued the following securities in transactions that were not registered under the Securities Act of 1933, as amended (the Act):

(a) Securities Sold: On October 1, 1998, Registrant issued 1,215 shares of Common stock, par value $1 per share.

(b) No underwriters participated. The shares were issued to each of the non-employee Directors of Registrant: B.R. Inman, A.A.Johnson, V.E. Jordan, Jr., Y. Kobayashi, H. Kopper, R.S. Larsen, G.J. Mitchell, N.J. Nicholas, Jr., J.E. Pepper, P. F. Russo, M.R. Seger and T.C.Theobald.

(c) The shares were issued at a deemed purchase price of $84.75 per share (aggregate price $102,625), based upon the market value on the date of issuance, in payment of the quarterly Directors' fees pursuant to Registrant's Restricted Stock Plan for Directors.

(d) Exemption from registration under the Act was claimed based upon

Section 4(2) as a sale by an issuer not involving a public offering.

Item 6. Selected Financial Data

The following information, as of and for the five years ended December 31, 1998, as set forth and included under the caption "Eleven Years in Review" on pages 64 and 65 of the Company's 1998 Annual Report to Shareholders, is hereby incorporated by reference in this document in answer to this Item:

Revenues
Income (loss) from continuing operations
Per-Share Data - Earnings (loss) from continuing operations
Total assets
Long-term debt
Preferred stock
Per-Share Data - Dividends declared

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information set forth under the caption "Results of Operations and Financial Condition" under the caption "Financial Review" on pages 22, 24-32, 34-35, and 37-39 of the Company's 1998 Annual Report to Shareholders other than the pictures and captions to the pictures is hereby incorporated by reference in this document in answer to this Item.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information set forth under the caption "Risk Management" on pages 35 and 37 of the Company's 1998 Annual Report to Shareholders other than the picture and caption to the picture is hereby incorporated by reference in this document in answer to this Item.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements of Xerox Corporation and subsidiaries and the notes thereto and the report thereon of KPMG LLP, independent auditors, which appear on pages 23, 33, 36, 40-61 and 63 of the Company's 1998 Annual Report to Shareholders, are hereby incorporated by reference in this document in answer to this Item. In addition, also included is the quarterly financial data included under the caption "Quarterly Results of Operations (Unaudited)" on page 62 of the Company's 1998 Annual Report to Shareholders.

The financial statement schedule required herein is filed as "Financial Statement Schedules" pursuant to Item 14 of this Report on Form 10-K.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

PART III

The information set forth in "Proposal 1--Election of Directors" in the Company's Notice of the 1999 Annual Meeting of Shareholders and Proxy Statement, to be filed pursuant to Regulation 14A not later than 120 days after the close of the fiscal year covered by this report on Form 10-K, is hereby incorporated by reference in this document in answer to this Part III.

Executive Officers of Xerox

The following is a list of the executive officers of Xerox, their current ages, their present positions and the year appointed to their present positions. There are no family relationships between any of the executive officers named.

Each officer is elected to hold office until the meeting of the Board of Directors held on the day of the next annual meeting of shareholders, subject to the provisions of the By-Laws.

Name	Age	Present Position	Year Appointed to Present Position	Officer Since
Paul A. Allaire*	60	Chairman of the Board, Chief Executive Officer and Chairman of the Executive Committee	1991	1983
G. Richard Thoman*	54	President and Chief Operating Officer	1997	1997
William F. Buehler	59	Executive Vice President Industry Solutions Operations	1999	1991
Allan E. Dugan	58	Executive Vice President Business Group Operations	1999	1990
Anne M. Mulcahy	46	Executive Vice President General Markets Operations	1999	1992
Carlos Pascual	53	Executive Vice President Deputy Executive Officer, Industry Solutions Operations	1999	1994
Barry D. Romeril	55	Executive Vice President and Chief Financial Officer	1993	1993
Patrick J. Martin	58	Senior Vice President President, Developing Markets Operations	1999	1992
Michael Miron	43	Senior Vice President Corporate Business Strategy and Development	1998	1998
Hector J. Motroni	55	Senior Vice President and Chief Staff Officer	1999	1994

* Member of Xerox Board of Directors.

Executive Officers of Xerox, Continued

Name	Age	Present Position	Year Appointed to Present Position	Officer Since
Mark B. Myers	60	Senior Vice President Xerox Research and Technology	1992	1989
Richard S. Paul	57	Senior Vice President and General Counsel	1992	1989
Eunice M. Filter	58	Vice President, Treasurer and Secretary	1990	1984
Philip D. Fishbach	57	Vice President and Controller	1995	1990

Each officer named above, with the exception of G. Richard Thoman and Michael Miron, has been an officer or an executive of Xerox or its subsidiaries for at least the past five years.

Prior to joining Xerox in 1997, Mr. Thoman had been with International Business Machines Corporation (IBM) where he was Senior Vice President and Chief Financial Officer from 1995 to 1997, and Group Executive for the Personal Systems Group from 1994 to 1995. He was President and CEO of Nabisco International from 1992 to 1994. He was Chairman and Co-CEO of Travel Related Services for American Express from 1989 to 1992.

Prior to joining Xerox in 1998, Mr. Miron had been with Airtouch Communications where he was Vice President, Corporate Strategy and Development from 1996 to 1998. Prior to this he was with Salomon Brothers Inc. where he was Managing Director, Strategic Planning and Analysis from 1994 to 1996, and Director, Strategy and Consulting Group from 1990 to 1993.

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a) (1) and (2) The financial statements, independent auditors' reports and Item 8 financial statement schedules being filed herewith or incorporated herein by reference are set forth in the Index to Financial Statements and Schedule included herein.

(3) The exhibits filed herewith or incorporated herein by reference are set forth in the Index of Exhibits included herein.

(b) No Current Reports on Form 8-K were filed during the last quarter of the period covered by this Report.

(c) The management contracts or compensatory plans or arrangements listed in the Index of Exhibits that are applicable to the executive officers named in the Summary Compensation Table which appears in Registrant's 1999 Proxy Statement are preceded by an asterisk (*).

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

XEROX CORPORATION

By: /s/ Barry D. Romeril_________
Executive Vice President and
Chief Financial Officer

March 22, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

March 22, 1999

Signature	Title
Principal Executive Officer:	
Paul A. Allaire	/s/ Paul A. Allaire_____________
	Chairman, Chief Executive Officer and Director
Principal Financial Officer:	

Barry D. Romeril	/s/ Barry D. Romeril_____________
	Executive Vice President and Chief Financial Officer

Principal Accounting Officer:

Philip D. Fishbach	/s/ Philip D. Fishbach___________
	Vice President and Controller

Directors:

/s/ B. R. Inman	Director
/s/ Antonia Ax:son Johnson	Director
/s/ Vernon E. Jordan, Jr.	Director
/s/ Hilmar Kopper	Director
/s/ Ralph S. Larsen	Director
/s/ George J. Mitchell	Director
/s/ N. J. Nicholas, Jr.	Director
/s/ John E. Pepper	Director
/s/ Patricia F. Russo	Director
/s/ Martha R. Seger	Director
/s/ Thomas C. Theobald	Director
/s/ G. Richard Thoman	Director

Report of Independent Auditors

To the Board of Directors and Shareholders of Xerox Corporation

Under date of January 25, 1999, we reported on the consolidated balance sheets of Xerox Corporation and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, cash flows and shareholders' equity for each of the years in the three-year period ended December 31, 1998, as contained in the Xerox Corporation 1998 Annual Report to Shareholders on pages 23, 33, 36, and 40-61. These consolidated financial statements and our report thereon are incorporated by reference in the 1998 Annual Report on Form 10-K. In connection with our audits of the aforementioned consolidated financial statements, we also have audited the related financial statement schedule listed in the accompanying index. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

Stamford, Connecticut
January 25, 1999

Index to Financial Statements and Schedule

Financial Statements:

The above consolidated financial statements, related notes, report thereon and the quarterly results of operations which appear on pages 23, 33, 36, 40-61, 63, and 62 of the Company's 1998 Annual Report to Shareholders are hereby incorporated by reference in this document.

Commercial and Industrial (Article 5) Schedule:

All other schedules are omitted as they are not applicable, or the information required is included in the financial statements or notes thereto.

SCHEDULE II

Valuation and Qualifying Accounts
Year ended December 31, 1998, 1997 and 1996

(in millions)	Balance at beginning of period	Additions charged to costs and expenses	Deductions, net of recoveries	Balance at end of period

1998				
Allowance for Losses on:				
Accounts Receivable	$ 92	$ 78	$ 68	$102
Finance Receivables	389	223	171	441
Deferred Tax Valuation Allowance	-	-	-	-
	$481	$301	$239	$543
1997				
Allowance for Losses on:				
Accounts Receivable	$ 92	$ 84	$ 84	$ 92
Finance Receivables	347	181	139	389
Deferred Tax Valuation Allowance	-	-	-	-
	$439	$265	$223	$481
1996				
Allowance for Losses on:				
Accounts Receivable	$ 90	$ 73	$ 71	$ 92
Finance Receivables	322	186	161	347
Deferred Tax Valuation Allowance	20	-	20	-
	$432	$259	$252	$439

Index of Exhibits

Document and Location

(3) (a) Restated Certificate of Incorporation of Registrant filed by the Department of State of New York on October 29, 1996.

Incorporated by reference to Exhibit 3(a)(1) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1996.

(b) By-Laws of Registrant, as amended through January 25, 1999.

Incorporated by reference to Exhibit (2) to Amendment No. 4 to Registrant's Registration Statement on Form 8-A dated January 26, 1999.

(4) (a) Indenture dated as of January 15, 1990 between Registrant and BankAmerica National Trust Company (as successor in interest to Security Pacific National Trust Company (New York)) relating to unlimited amounts of debt securities which may be issued from time to time by Registrant when and as authorized by or pursuant to a resolution of Registrant's Board of Directors.

Incorporated by reference to Exhibit 4(a) to Registration No. 33-33150.

(b) Indenture dated as of December 1, 1991 between Registrant and Citibank, N.A. relating to unlimited amounts of debt securities which may be issued from time to time by Registrant when and as authorized by or pursuant to a resolution of Registrant's Board of Directors.

Incorporated by reference to Exhibit 4(a) to Registration Nos. 33-44597, 33-49177 and 33-54629.

(c) Indenture dated as of September 20, 1996 between Registrant and Citibank, N.A. relating to unlimited amounts of debt securities which may be issued from time to time by Registrant when and as authorized by or pursuant to a resolution of Registrant's Board of Directors.

Incorporated by reference to Exhibit 4(a) to Registration Statement No. 333-13179.

(d) Indenture dated as of October 1, 1997 among Registrant, Xerox Overseas Holding Limited (formerly Xerox Overseas Holding PLC), Xerox Capital (Europe) plc (formerly Xerox Capital (Europe) plc) and Citibank, N.A. relating to unlimited amounts of debt securities which may be issued from time to time by Registrant and unlimited amounts of guaranteed debt securities which may be issued from time to time by the other issuers when and as authorized by or pursuant to a resolution or resolutions of the Board of Directors of Registrant or the other issuers, as applicable.

Incorporated by reference to Exhibit 4(b) to Registration Statement Nos. 333-34333, 333-34333-01 and 333-34333-02.

(e) Indenture dated as of April 21, 1998 between Registrant and The First National Bank of Chicago relating to $1,012,198,000 principal amount at maturity of Registrant's Convertible Subordinated Debentures due 2018.

Incorporated by reference to Exhibit 4(b) to Registration Statement No. 333-59355.

(f) Indenture dated as of March 1, 1988, as supplemented by the First Supplemental Indenture dated as of July 1, 1988, between Xerox Credit Corporation (XCC) and The First National Bank of Chicago relating to unlimited amounts of debt securities which may be issued from time to time by XCC when and as authorized by XCC's Board of Directors or the Executive Committee of the Board of Directors.

Incorporated by reference to Exhibit 4(a) to XCC's Registration Statement No. 33-20640 and to Exhibit 4(a)(2) to XCC's Current Report on Form 8-K dated July 13, 1988.

(g) Indenture dated as of March 1, 1989, as supplemented by the First

Supplemental Indenture dated as of October 1, 1989, between XCC and Citibank, N.A. relating to unlimited amounts of debt securities which may be issued from time to time by XCC when and as authorized by XCC's Board of Directors or Executive Committee of the Board of Directors.

Incorporated by reference to Exhibit 4(a) to XCC's Registration Statement No. 33-27525.

(h) Indenture dated as of October 2, 1995, between XCC and State Street Bank and Trust Company relating to unlimited amounts of debt securities which may be issued from time to time by XCC when and as authorized by XCC's Board of Directors or Executive Committee of the Board of Directors.

Incorporated by reference to Exhibit 4(a) to XCC's Registration Statement Nos. 33-61481 and 333-29677.

(i) Instruments with respect to long-term debt where the total amount of securities authorized thereunder does not exceed 10% of the total assets of the Registrant and its subsidiaries on a consolidated basis have not been filed. The Registrant agrees to furnish to the Commission a copy of each such instrument upon request.

(10) The management contracts or compensatory plans or arrangements listed below that are applicable to the executive officers named in the Summary Compensation Table which appears in Registrant's 1999 Proxy Statement are preceded by an asterisk (*).

*(a) Registrant's 1976 Executive Long-Term Incentive Plan, as amended through February 4, 1991.

Incorporated by reference to Exhibit (10)(a) to the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1991.

*(b) Registrant's 1991 Long-Term Incentive Plan, as amended through May 15, 1997.

Incorporated by reference to Registrant's Notice of the 1997 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

(c) Registrant's 1996 Non-Employee Director Stock Option Plan.

Incorporated by reference to Registrant's Notice of the 1996 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

*(d) Description of Registrant's Annual Performance Incentive Plan.

*(e) Registrant's 1997 Restatement of Registrant's Unfunded Retirement Income Guarantee Plan.

Incorporated by reference to Exhibit 10(e) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1997.

*(f) 1997 Restatement of Registrant's Unfunded Supplemental Retirement Plan.

Incorporated by reference to Exhibit 10(f) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1997.

(g) Registrant's 1981 Deferred Compensation Plan, 1985 Restatement, as amended through April 2, 1990.

Incorporated by reference to Exhibit 10(h) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 1990.

(h) 1996 Amendment and Restatement of Registrant's Restricted Stock Plan for Directors.

Incorporated by reference to Registrant's Notice of the 1996 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

*(i) Form of severance agreement entered into with various executive officers.

Incorporated by reference to Exhibit 10(j) to Registrant's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1989.

*(j) Registrant's Contributory Life Insurance Program, as amended as of January 30, 1998.

Incorporated by reference to Exhibit 10(j) to Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1997.

(k) Registrant's Deferred Compensation Plan for Directors, 1997 Amendment and Restatement.
Incorporated by reference to Exhibit 10(k) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1997.

*(l) Registrant's Deferred Compensation Plan for Executives, 1997 Amendment and Restatement.

Incorporated by reference to Exhibit 10(l) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1997.

*(m) Executive Performance Incentive Plan.

Incorporated by reference to Registrant's Notice of the 1995 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

*(n) Registrant's 1998 Employee Stock Option Plan.

Incorporated by reference to Registrant's Notice of the 1998 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

(11) Statement re computation of per share earnings.

(12) Computation of Ratio of Earnings to Fixed charges.

(13) Pages 22 through 65 and 68 of Registrant's 1998 Annual Report to Shareholders.

(21) Subsidiaries of the Registrant.

(23) Consent of KPMG LLP.

(27) Financial Data Schedule (in electronic form only).

EXHIBIT 10(d)

Annual Performance Incentive Plan

Under the Annual Performance Incentive Plan, executive officers of the Company may be entitled to receive performance related cash payments provided that annual, Committee-established performance objectives are met. At the beginning of the year, the Executive Compensation and Benefits Committee approves for each officer not participating in the Executive Performance Incentive Plan, an annual incentive target and maximum opportunity expressed as a percentage of annual base salary. The Committee also establishes overall Document Processing threshold, target and maximum measures of performance and associated payment schedules. For 1998, the performance measures were earnings per share (35%), revenue growth (25%), cash generation (10%), customer satisfaction (10%), customer loyalty (10%) and employee satisfaction (10%). Additional goals are also established for each officer that include business unit specific and/or individual performance goals and objectives. The weights associated with each business unit specific or individual performance goal and objective used vary and range from 20 percent to 50 percent of the total. Actual performance payments are subject to approval by the Committee following the end of the year.

EXHIBIT 11

Computation of Net Income Per Common Share

(Dollars in millions, except per-share data; shares in thousands)

	1998	1997	1996	1995	1994
I. Basic Net Income (Loss) Per Common Share					
Income (loss) from continuing operations	$ 585	$ 1,452	$ 1,206	$ 1,174	$ 794
Accrued dividends on ESOP preferred stock, net	(46)	(44)	(43)	(42)	(41)
Accrued dividends on redeemable preferred stock	-	-	(1)	(3)	(12)
Call premium on redeemable preferred stock	-	-	-	-	(11)
Adjusted income (loss) from continuing operations	539	1,408	1,162	1,129	730
Discontinued operations	(190)	-	-	(1,646)	-
Adjusted net income (loss)	$ 349	$ 1,408	$ 1,162	$ (517)	$ 730
Average common shares outstanding during the period	655,676	649,608	648,924	644,174	632,550
Common shares issuable with respect to exchangeable shares	3,280	3,763	5,464	7,854	10,160
Adjusted average shares outstanding for the period	658,956	653,371	654,388	652,028	642,710
Basic earnings (loss) per share:					
Continuing operations	$ .82	$ 2.16	$ 1.78	$ 1.73	$ 1.14
Discontinued operations	(.29)	-	-	(2.53)	-
Basic earnings (loss) per share					
II. Diluted Net Income (Loss) Per Common Share					
Income (loss) from continuing operations					
Accrued dividends on ESOP preferred stock, net					
Accrued dividends on redeemable preferred stock					
Call premium on redeemable preferred stock					
ESOP expense adjustment, net of tax					
Interest on convertible debt, net of tax					
Adjusted income (loss) from continuing operations					
Discontinued operations					
Adjusted net income (loss)					
Average common shares outstanding during the period					
Common shares issuable with respect to:					
Stock options, incentive and exchangeable shares					
Convertible debt					
ESOP preferred stock					
Adjusted average shares outstanding for the period					
Diluted earnings (loss) per share:					
Continuing operations					
Discontinued operations					
Diluted earnings (loss) per share					

$ .53	$ 2.16	$ 1.78	$ (.80)	$ 1.14
$ 585	$ 1,452	$ 1,206	$ 1,174	$ 794
(46)	-	-	-	-
-	-	(1)	(3)	(12)
-	-	-	-	(11)
-	-	(3)	(9)	(7)
3	3	3	4	3
542	1,455	1,205	1,166	767
(190)	-	-	(1,646)	-
$ 352	$ 1,455	$ 1,205	$ (480)	$ 767
655,676	649,608	648,924	644,174	632,550
13,091	11,691	16,108	19,206	18,005
5,287	5,287	5,287	5,287	5,287
-	54,687	55,960	57,325	58,620
674,054	721,273	726,280	725,992	714,462
$ .80	$ 2.02	$ 1.66	$ 1.61	$ 1.07
(.28)	-	-	(2.27)	-
$ .52	$ 2.02	$ 1.66	$ (.66)	$ 1.07

Exhibit 12

Computation of Ratio of Earnings to Fixed Charges

Year ended December 31 (in millions)	1998*	1997	1996	1995	1994
Fixed Charges:					
Interest expense	$ 748	$ 617	$ 592	$ 603	$ 520
Rental expense	145	140	140	142	170
Total fixed charges before capitalized interest and preferred stock dividend of subsidiary	893	757	732	745	690
Capitalized interest	-	-	-	-	2
Preferred stock dividend of subsidiary	55	50	-	-	-
Total fixed charges	$ 948	807	$ 732	$ 745	$ 692
Earnings available for fixed charges:					
Earnings**	$ 837	$2,268	$2,067	$1,980	$1,602
Less undistributed income in minority owned companies	(27)	(84)	(84)	(90)	(54)
Add fixed charges before capitalized interest and preferred stock dividend of subsidiary	893	757	732	745	690
Total earnings available for fixed charges	$1,703	$2,941	$2,715	$2,635	$2,238
Ratio of earnings to fixed charges (1)(2)	1.80	3.64	3.71	3.54	3.23

(1) The ratio of earnings to fixed charges has been computed based on the Company's continuing operations by dividing total earnings available for fixed charges, excluding capitalized interest, by total fixed charges. Fixed charges consist of interest, including capitalized interest and preferred stock dividend requirements of subsidiaries, and one-third of rent expense as representative of the interest portion of rentals. Debt has been assigned to discontinued operations based on historical levels assigned to the businesses when they were continuing operations, adjusted for subsequent paydowns. Discontinued operations consist of the Company's Insurance, Other Financial Services, and Third Party Financing and Real Estate businesses.

(2) The Company's ratio of earnings to fixed charges includes the effect of the Company's finance subsidiaries, which primarily finance Xerox equipment. Financing businesses are more highly leveraged and, therefore, tend to operate at lower earnings to fixed charges ratio levels than do non-financial businesses.

* Excluding the effects of the charges recorded in connection with the 1998 restructuring plan, the ratio of earnings to fixed charges would be 3.55.

** Sum of "Income before Income Taxes, Equity Income and Minorities' Interests" and "Equity in Net Income of Unconsolidated Affiliates."

Results of Operations and Financial Condition

Summary of Total Company Results

Document Processing revenues, which grew 8 percent on a pre-currency basis to $19.4 billion in 1998, were affected by some weaker economies. Excluding Brazil and Russia, precurrency revenues grew 10 percent. Total pre-currency revenue growth was driven by 12 percent growth in equipment sales and 25 percent growth in document outsourcing (excluding equipment accounted for as sales). The strong equipment sales growth was the direct result of our investments in sales coverage and excellent customer acceptance of our expanding portfolio of new digital products. Revenues increased 7 percent on a pre-currency basis to $18.1 billion in 1997 and 6 percent on a pre-currency basis to $17.4 billion in 1996.

The following table summarizes net income and diluted earnings per share (EPS):

(In millions, except per-share data)	1998	1997	1996
Document Processing before restructuring charge	$1,692	$1,452	$1,206
Restructuring Charge	(1,107)	-	-
Continuing operations	585	1,452	1,206
Discontinued operations	(190)	-	-
Net income	$ 395	$1,452	$1,206
EPS			
Document Processing before restructuring charge	$ 2.33	$ 2.02	$ 1.66
Restructuring charge	(1.53)	-	-
Continuing operations	0.80	2.02	1.66
Discontinued operations	(0.28)	-	-
Diluted EPS	$ 0.52	$ 2.02	$ 1.66

Income from continuing operations increased 17 percent in 1998, excluding the impact of a $1,107 million after-tax restructuring charge, and 20 percent in 1997.

Diluted earnings per share from continuing operations increased 16 percent in 1998, excluding the restructuring charge, and 22 percent in 1997. Earnings per share have been adjusted to reflect the 2-for-1 stock split to shareholders of record on February 4, 1999.

A quarterly analytical summary for 1998 is shown on page 28 and quarterly results of operations for 1998 and 1997 are shown on page 62.

Since 1995, the results of our Insurance operations have been accounted for as discontinued operations. Discontinued operations results for 1997 and 1996 were charged to previously established reserves and did not affect reported net income. For 1998, results include a $190 million after-tax charge in connection with the final disposition of the insurance businesses.

[The following data was represented by a bar chart]

Earnings per Share*
(dollars)

96	$1.66
97	$2.02

98	$2.33

* Document processing before restructuring charge.

Document Processing
Pre-Currency Growth
To understand the trends in the business, we believe that it is helpful to adjust revenue and expense growth (except for ratios) to exclude the impact of changes in the translation of foreign currencies into U.S. dollars. We refer to this adjusted growth as "pre-currency growth."

A substantial portion of our consolidated revenues is derived from operations outside of the United States where the U.S. dollar is not the functional currency. When compared with the average of the major European currencies on a revenue-weighted basis, the U.S. dollar was approximately 1 percent stronger in 1998, 8 percent stronger in 1997, and 2 percent stronger in 1996. As a result, foreign currency translation unfavorably impacted revenue growth by approximately 1 percentage point in 1998, 3 percentage points in 1997 and 1 percentage point in 1996.

We do not hedge the translation effect of revenues denominated in currencies where the local currency is the functional currency.

Revenues by Product Category
For the major product categories, the pre-currency revenue growth rates were:

	Pre-Currency Growth		
	1998	1997	1996
Total Revenues	8%	7%	6%
Digital products	36	25	23
Light-lens copiers	(11)	(2)	(1)
Paper and other products	1	3	--

Consolidated Statements of Income

Year ended December 31 (in millions, except per-share data)	1998	1997	1996
REVENUES			
Sales	$10,752	$ 9,881	$ 9,256
Service and rentals	7,626	7,257	7,107
Finance income	1,071	1,006	1,015
Total Revenues	19,449	18,144	17,378
COSTS AND EXPENSES			
Cost of sales	5,724	5,330	5,126
Cost of service and rentals	4,140	3,778	3,597
Inventory charges	113	-	-
Equipment financing interest	570	520	513
Research and development expenses	1,043	1,065	1,044
Selling, administrative and general expenses	5,320	5,212	5,074
Restructuring charge and asset impairments	1,531	-	-

Gain on affiliates' sales of stock, net	-	-	(11)
Other, net	245	98	91
Total Costs and Expenses	18,686	16,003	15,434
INCOME BEFORE INCOME TAXES, EQUITY INCOME AND MINORITIES' INTERESTS	763	2,141	1,944
Income taxes	207	728	700
Equity in net income of unconsolidated affiliates	74	127	123
Minorities' interests in earnings of subsidiaries	45	88	161
INCOME FROM CONTINUING OPERATIONS	585	1,452	1,206
Discontinued operations	(190)	-	-
NET INCOME	$ 395	$ 1,452	$ 1,206
Basic Earnings (Loss) per Share			
Continuing operations	$ 0.82	$ 2.16	$ 1.78
Discontinued operations	(0.29)	-	-
BASIC EARNINGS PER SHARE	$ 0.53	$ 2.16	$ 1.78
Diluted Earnings (Loss) per Share			
Continuing operations	$ 0.80	$ 2.02	$ 1.66
Discontinued operations	(0.28)	-	-
DILUTED EARNINGS PER SHARE	$ 0.52	$ 2.02	$ 1.66

The accompanying notes on pages 41 to 61 are an integral part of the consolidated financial statements.

FINANCIAL REVIEW

The digital product portfolio includes production publishing, color copying and printing, production printing, Document Centre digital black-and-white copiers, and network laser printers sold through indirect channels. Digital product revenues grew 36 percent in 1998, driven by outstanding revenue growth from our expanding Document Centre family, excellent laser printer revenue growth, strong production publishing and color copying and printing growth, and modest growth in production printing revenue.

Revenues from the DocuTech family of production publishing products reflected strong growth to $2.3 billion in 1998, up from $2.1 billion in 1997 and $1.8 billion in 1996. The 180 page-per-minute DocuTech Production Publisher, which became available in the middle of 1997, contributed to this growth. Revenues from color products reflected strong growth to $1.9 billion in 1998, although growth slowed in the second half in part due to the weak economic environment in Brazil. Color revenues were $1.5 billion in 1997 and $1.0 billion in 1996. The DocuColor 40, our 40 page-per-minute color document production system, introduced in April 1996, continued to contribute significantly to this growth.

The expanding line of Document Centre digital black-and-white copiers now includes models at speeds ranging from 20 to 65 pages per minute. Availability of network connectivity continues to expand and the proportion of new installations with network connectivity increased during the year. We expect the connectivity rate will continue to increase. Document Centre revenues represented almost 60 percent of the company's digital revenue growth.

Our expanding family of network laser printers sold through indirect channels experienced excellent growth in 1998 following launch of the initial models in September 1997.

The light-lens copier revenue decline reflects customer transition to our new digital black-and-white products and continued price pressures. We believe the trend over the past few years will continue and that digital product revenues will represent an increasing share of total revenues.

Fluctuations in paper and other products revenue growth were principally due to swings in paper prices and OEM sales.

For the major product categories, the revenue shares were:

	1998	1997	1996
Digital products	46%	36%	30%
Light-lens copiers	41	51	56
Paper and other products	13	13	14

The acceleration in digital product revenue growth from 23 percent in 1996 to 25 percent in 1997 and 36 percent in 1998 resulted in 1998 digital revenues exceeding light-lens copier revenues for the first time.

Worldwide Revenues (billions)

o United States: $10.1
o Latin America and Canada: $3.5
o Europe and Other: $5.8
Total Xerox: $19.4
o Fuji Xerox: $6.8

[Pictured here is a world map]

Revenues by Geography
Geographically, the pre-currency revenue growth rates were:

	Pre-Currency Growth		
	1998	1997	1996
Total Revenues	8%	7%	6%
United States	10	7	6
Xerox Limited	9	7	1
Other Areas	1	8	10
Memo: Fuji Xerox	(3)	3	11

Revenues in the United States were 52 percent of total revenues in 1998 compared with 49 percent in both 1997 and 1996. Revenues of Xerox Limited and related companies, which operate principally in Europe, represented 28 percent of total revenues in 1998. Other Areas, principally Latin America, Canada and China, contributed 20 percent of total revenues in 1998.

Revenue growth in 1998 and 1997 in both the U.S. and Xerox Limited was driven primarily by digital products; Xerox Limited also benefited from a strengthening economic environment in several European markets. Xerox Limited's relatively flat revenue growth in 1996 reflected weak economic environments in a number of major European markets. Other Areas 1998 revenue reflected a 7 percent decline in Brazil due to the difficult economic environment. Revenues in Brazil were $1.6 billion in 1998, $1.8 billion in 1997 and $1.6 billion in 1996. Although our operations in Russia are relatively small, with revenue of less than $100 million, revenues

declined very significantly in 1998 due to the weak economy in that country. Growth in Canada and Mexico was strong in 1998. 1997 revenue growth reflects good growth in Brazil and China, modest growth in Canada, and excellent growth in Mexico.

In the early part of 1999, the Brazilian real devalued substantially against the U.S. dollar. Financial reporting adjustments related to the devaluation will be recorded in shareholders' equity. Such a devaluation could adversely affect the Brazilian economy. However, we currently are unable to determine what effect, if any, this will have on our customers' intent or ability to purchase our products in 1999.

Fuji Xerox Co., Ltd. (Fuji Xerox), an unconsolidated entity jointly owned by Xerox Limited and Fuji Photo Film Co., Ltd., develops, manufactures and distributes document processing products in Japan and the Pacific Rim. Approximately 90 percent of Fuji Xerox revenues are generated in Japan, with Australia, New Zealand, Singapore, Malaysia, and Korea representing the remaining 10 percent. Fuji Xerox conducts business in other Pacific Rim countries through joint ventures and distributors. Xerox' exposure to economic turmoil in Asia is mitigated by our joint ownership of Fuji Xerox. Fuji Xerox revenues declined by 3 percent in 1998 reflecting a modest decline in Japan and a double-digit decline in Fuji Xerox' other Asia Pacific territories due to difficult economic conditions. Conversely, modest revenue growth in 1997 reflected good growth in the Asia Pacific countries and only modest growth in Japan due to difficult economic conditions. Revenue growth in 1996 reflects strong growth in Japan, driven by excellent growth in digital products sales and good growth in the Asia Pacific countries.

Revenues by Stream

The pre-currency growth rates by type of revenue were:

	Pre-currency growth		
	1998	1997	1996
Total revenues	8%	7%	6%
Equipment sales	12	14	10
Non-equipment sales revenues	5	3	3
Document outsourcing*	25	35	47
Supplies	6	2	8
Paper	3	2	(7)
Service	1	1	(1)
Rentals	(10)	(9)	-
Finance income	7	2	1

* Excludes equipment accounted for as equipment sales.

Equipment Sales: Equipment sales in 1998 grew 12 percent despite declines in Brazil and Russia due to their weak economies. Excluding Brazil and Russia, equipment sales grew 17 percent. Equipment sales growth is due primarily to the introduction of a stream of state-of-the-art digital products in 1996, 1997 and 1998. Approximately half of 1998 equipment sales was attributable to products introduced during 1997 and 1998, including our expanding line of Document Centre digital multifunction equipment, the DocuTech 6180 Production Publisher and the N series of network monochrome laser printers sold through indirect channels. Digital product equipment sales grew 46 percent in 1998, 40 percent in 1997 and 27 percent in 1996 and represented 62 percent of 1998 equipment sales, 47 percent of 1997 and 37 percent of 1996.

[The following data was represented by a bar chart]

Equipment Sales Growth
(percent)

96	10
97	14
98	12

Non-Equipment Sales: Non-equipment sales revenues from supplies, paper, service, rentals, document outsourcing and other revenues, and income from customer financing represented 62 percent of total revenues in 1998, 63 percent in 1997 and 65 percent in 1996. Growth in these post-sale revenues is primarily a function of the growth in our installed population of equipment, usage levels and pricing.

Document Outsourcing: Document Outsourcing revenues are split between Equipment Sales and Document Outsourcing. Where document outsourcing contracts include revenues accounted for as equipment sales, this revenue is included in Equipment Sales on the income statement. All other document outsourcing revenues, including service, equipment rental, supplies, paper and labor are included in Document Outsourcing. This has the effect of diverting some revenues from supplies, paper, service, and rental. The excellent Document Outsourcing growth reflects the trend of customers focusing on their core businesses and outsourcing their

document processing requirements to Xerox. The growth rate for total document outsourcing revenues is substantially higher than the growth included in Document Outsourcing, reflecting an increase in the proportion of equipment in outsourcing contracts accounted for as sales.

Supplies: Good supplies revenue growth in 1998 reflects excellent indirect channels sales and strong growth in Europe. Supplies growth decelerated in 1997 due principally to the increase in document outsourcing, which includes bundled supplies, and lower sales of OEM printer cartridges.

Paper Sales: Our strategy is to charge a spread over mill wholesale prices to cover our costs and value added as a distributor. The increases in 1998 and 1997 result from volume increases due to expanding distribution channels partially offset by moderating industry-wide price declines. In 1996, lower wholesale prices were partially offset by volume increases.

Service: Service revenue growth reflects the impact of higher machine populations resulting from higher equipment sales, partially offset by customer preference for document outsourcing as well as competitive price pressures.

Rentals: Rental revenues declined in 1998 and 1997 and were flat in 1996 due primarily to customers' preference for document outsourcing and the continuing trend toward equipment sales.

Finance Income: Our strategy for financing equipment sales in the industrialized economies is to charge a spread over our cost of borrowing and to lock in that spread by match funding the finance receivables with borrowings of similar maturities. In 1998, good growth in the financing of equipment sales in the U.S. and Latin America has been partially offset by lower average interest rates. In 1997, good financing growth in the U.S., Europe and Latin America was partially offset by lower average interest rates. In 1996, the strong growth in the financing of equipment sales in Latin America was partially offset by the impacts of the continuing decline in interest rates on financing contracts and the increasing customer preference for document outsourcing rather than purchase and finance. On average, 75 to 80 percent of customers finance purchases of equipment through Xerox.

Cost and Expenses

[The following data was represented by a bar chart]

SAG as a percentage of Revenues

	(percent)
96	29.2
97	28.7

98 27.4

The trend in key ratios was as follows:

	1998	1997	1996
Gross margin	46.3%	46.9%	46.9%
SAG % Revenue	27.4	28.7	29.2

The modest 1998 gross margin decline was due to the increasing proportion of lower margin channel product sales, the growing Document Outsourcing business, and continued competitive price pressure partially offset by manufacturing and service productivity. Including the inventory charges resulting from the restructuring, the 1998 gross margin was 45.8%. The 1997 total gross margin was essentially unchanged from 1996.

The improved ratio of selling, administrative and general expenses (SAG) to revenue in 1998 reflected declines in general and administrative expenses due to continuing productivity initiatives, restructuring, and expense control, partially offset by increased sales coverage and advertising investments. Similarly, the improvement in 1997 was due primarily to productivity initiatives and expense controls partially offset by investments to increase worldwide sales coverage. SAG, on a pre-currency basis, increased only 3 percent in 1998 compared with 5 percent in 1997 and 8 percent in 1996.

Research and development (R&D) expense declined 2 percent in 1998 and increased 3 percent in 1997 and 10 percent in 1996. The modest reduction in 1998 reflected a reprioritization of our spending to focus on areas intended to produce significant growth, such as digital, color and solutions. We continue to invest in technological development to maintain our premier position in the rapidly changing document processing market with a heightened focus on increasing the effectiveness of our R&D investment as well as time to market. Xerox R&D is strategically coordinated with Fuji Xerox, which invested $636 million in R&D in 1998 for a combined total of $1.7 billion. We expect the 1999 R&D growth rate will exceed the revenue growth rate.

Worldwide employment increased by 1,200 in 1998 to 92,700 primarily as a result of hiring 2,800 employees to support our fast-growing Document Outsourcing business, 1,700 associated with the acquisition of XLConnect Solutions, and hiring to increase sales coverage. These increases were partially offset by 5,400 employees leaving the company under the worldwide restructuring program.

Other expenses, net, were $245 million in 1998, $98 million in 1997 and $91 million in 1996. The increase of $147 million for 1998 reflected increased non-financing interest expense and goodwill amortization associated with our June 1997 acquisition of The Rank Group's remaining interest in Xerox Limited and our May 1998 acquisition of XLConnect Solutions; non-financing interest expense related to an increase in working capital; and increased Year 2000 remediation spending, partially offset by reduced currency losses from balance sheet remeasurement, primarily due to Latin American currency devaluations. The increase of $7 million for 1997 reflected increased non-financing interest expense associated with our June 1997 acquisition of The Rank Group's remaining interest in Xerox Limited, increased currency losses from balance sheet remeasurement due to currency devaluation in our Latin American operations, and Year 2000 remediation spending, partially offset by certain non-recurring charges in 1996. Also, we reduced debt with the proceeds from the issuance of $650 million of mandatorily redeemable preferred securities through a subsidiary trust in January 1997. This partially offsets the 1997 increase in non-financing interest expense because the after-tax impact of the dividend on these securities is included in the income statement in Minorities' Interests in Earnings of Subsidiaries.

- --

[Pictured here are San Francisco Bay Area high school students]

Young Authors,
New World

As part of our DocuWorld initiative, Xerox invited high school students in the San Francisco Bay Area to write on "A Vision of Life in the 21st Century." Winning poetry and essays were collected in an anthology which was published using state-of-the-art print-on-demand technologies from Xerox. The young authors gathered in Chicago to watch their ideas being published in a professional-quality book. Publishers and booksellers already are using this technology to bring out worthy books that might not otherwise get published because of fears that demand would be too low to justify the cost. DocuWorld is a worldwide learning initiative that offers tutorials and demonstrations of digital printing solutions from Xerox and two dozen partners. During the last two years, 135,000 industry professionals attended events in 50 cities, including Cairo, Hong Kong, San Francisco and Toronto.

- --

Income Taxes, Equity in Net Income of
Unconsolidated Affiliates, and Minorities'
Interests in Earnings of Subsidiaries

Income before income taxes and the restructuring charge was $2,407 million in 1998, $2,141 million in 1997 and $1,944 million in 1996.

The effective tax rates, before the restructuring charge, were 31.6 percent in 1998, 34.0 percent in 1997 and 36.0 percent in 1996. The 1998 and 1997 tax rates benefited from increases in foreign tax credits and refunds of foreign taxes, as well as, shifts in the mix of our worldwide profits.

Equity in Net Income of Unconsolidated Affiliates is principally Xerox Limited's share of Fuji Xerox income. Total equity in income declined to $74 million due principally to our share, $18 million, of a restructuring charge recorded by Fuji Xerox; a reduction in Fuji Xerox income reflecting difficult economic conditions in Japan and other Asia Pacific operations; adverse currency translation due to the weakening of the Japanese yen compared with the U.S. dollar for most of the year; and reductions in income from several smaller investments. The 1997 increase in total equity in income reflected strong pre-currency Fuji Xerox income growth largely offset by currency translation due to the weakening of the Japanese yen compared with the U.S. dollar and increases in income from several smaller investments. The Xerox Limited 50 percent share of Fuji Xerox income was $72 million (before our $18 million share of a restructuring charge recorded by Fuji Xerox) in 1998, $119 million in 1997 and $116 million in 1996.

Minorities' Interests in Earnings of Subsidiaries were $45 million in 1998, $88 million in 1997 and $161 million in 1996. The 1998 amount primarily consists of the dividends on the mandatorily redeemable preferred securities discussed above. The 1998 and 1997 declines reflect our acquisition of The Rank Group's remaining interest in Xerox Limited, effective June 1997. In 1997, this decline was partially offset by the after-tax impact of the $48 million dividend on the mandatorily redeemable preferred securities discussed above.

Income

In 1998, Document Processing income before the restructuring charge, increased 17 percent to $1,692 million. 1997 income of $1,452 million grew 20 percent compared with $1,206 million in 1996.

[Pictured here are children playing soccer]

Community Involvement -- Children play soccer at Vila Olimpica da Mangueira, a combined public school, sports complex, job training program and health clinic in Mangueira, an impoverished area of Rio de Janeiro in Brazil. The village is largely funded by Xerox do Brasil., Ltda., Vila Olimpica, cited by President Clinton as a sterling example of community involvement by a corporation, is credited with giving Mangueira's public schools one of the lowest dropout rates in Rio.

Quarterly Analytical Earnings Per Share

The following schedule summarizes the quarterly 1998 Continuing Operations revenues, income and Earnings per Share computations before and after the restructuring charge.

Continuing Operations (In millions, except per-share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Revenues	$4,304	$ 4,742	$4,607	$5,796	$19,449
Costs and expenses, excluding the restructuring charge	3,859	4,197	4,067	4,919	17,042
Restructuring charge	-	1,644	-	-	1,644
Income (Loss) before Income Taxes, Equity Income and Minorities' Interests	$ 445	$(1,099)	$ 540	$ 877	$ 763
Income from continuing operations before the restructuring charge	$ 301	$ 395	$ 381	$ 615	$ 1,692
Income (Loss)	$ 301	$ (712)	$ 381	$ 615	$ 585
Diluted Earnings per Share					
Adjusted average shares outstanding	725.0	731.6	735.2	735.8	733.0
Diluted Earnings per Share, excluding the restructuring charge	$ 0.42	$ 0.54	$ 0.53	$ 0.84	$ 2.33
Effect of restructuring charge*	-	(1.64)	-		(1.53)
Diluted earnings per share	$ 0.42	$ (1.10)	$ 0.53	$ 0.84	$ 0.80

* The restructuring charge impact is limited due to antidilutive restrictions. Additionally, the quarterly earnings per share differ from the full year amounts because certain antidilutuve securities are excluded from earnings per share calculations

Restructuring Charge

On April 7, 1998, we announced a worldwide restructuring program associated with enhancing our competitive position and lowering our overall cost structure. In connection with this program, we recorded a second-quarter pretax provision of $1,644 million ($1,107 million after taxes and including our $18 million share of a restructuring charge recorded by Fuji Xerox). The program includes the elimination of approximately 9,000 jobs, net, worldwide, the closing and consolidation of facilities, and the write-down of certain assets. The charges associated with the restructuring program include $113 million of inventory charges recorded as cost of revenues and $316 million of asset impairments. Included in the asset impairment charge is facility fixed asset write-downs of $156 million and other asset write-downs of $160 million. For facility fixed assets classified as assets to be disposed of, the impairment loss recognized is based on fair value less cost to sell, with fair value based on third-party valuations as well as our internal estimates of existing market prices for similar assets. The effect of suspending depreciation on assets no longer in use for 1998 is not material. The remaining $160 million of asset impairments includes the write-down of certain technology assets and other items impacted

by the consolidation initiatives described below. Key initia-
tives of the restructuring include:

1. Consolidating 56 European customer support centers into one facility and implementing a shared services organization for order entry, invoicing, and other back-office and sales operations.
2. Streamlining manufacturing, logistics, distribution and service operations. This will include centralizing U.S. parts depots and outsourcing storage and distribution.
3. Overhauling our internal processes and associated resources, including closing one of four geographically-organized U.S. customer administrative centers.

The reductions are primarily in administrative functions, but also impact service, research and manufacturing.

The following table summarizes the status of the restructuring reserve:

(in millions)	Total Reserve	Charges Against Reserve	12/31/98 Balance
Severance and related costs	$1,017	$ 304	$ 713
Asset impairment	316	316	-
Lease cancellation and other costs	198	28	170
Inventory charges	113	113	-
Total	$1,644	$ 761	$ 883

When fully implemented, the ongoing pre-tax savings from the restructuring initiatives will be approximately $1 billion annually. Initially, more than half of the savings is being reinvested to implement process and systems changes in order to enable the restructuring, and to sustain ongoing efforts to broaden and strengthen marketing programs and distribution channels to enhance revenue growth. Selling, administrative and general expenses as a percentage of revenue will move from the high 20s to the low 20s over time, driven primarily by large reductions in overhead costs. Manufacturing and service productivity will also improve. These benefits will be somewhat offset by lower gross margins overall due to the increasing proportion of business conducted through indirect sales channels and outsourcing.

As of December 31, 1998, approximately 5,400 employees had left the company under the restructuring program.

There have been no material changes to the program since its announcement in April 1998, and the majority of the remaining reserve will be utilized by December 31, 1999. However, the completion of certain European initiatives will likely be extended beyond 1999 due to local regulatory issues as they relate to the work force.

[Pictured here is Roosevelt Thompson]

A Helping Hand

Roosevelt Thompson, a Vietnam veteran shown here at the Vietnam Memorial in Washington, D.C., was among the first people hired by Xerox through the Welfare to Work Partnership. Thompson is an account associate assigned to the Document Technology Centre at the law firm of Steptoe & Johnson in Washington. Highly respected, Thompson has earned several promotions and has added to his responsibilities since joining Xerox. At the end of 1998, Xerox had placed 256 people through the program and achieved a 75 percent retention rate.

[The following data was represented by a bar chart]

Color Copying and Printing Revenue (millions)

96	$1,000
97	$1,500
98	$1,900

Acquisition of XLConnect Solutions
In May 1998, we acquired XLConnect Solutions, Inc. (XLConnect), an information technology services company, and its parent company, Intelligent Electronics, Inc. for $413 million in cash. The operating results of these companies, which are not material, have been included in our consolidated statements of income from the date of the acquisition. Based on the allocation of the

purchase price, the transaction resulted in goodwill of $395 million (including transaction costs) which is being amortized over 25 years.

[The following data was represented by a bar chart]

Document Outsourcing Revenue (millions)

96	$1,250
97	$2,000
98	$2,700

Share Repurchase
In April 1998, we announced that we were reactivating our $1 billion stock repurchase program, which was suspended in April 1997 when we acquired the remaining financial interest in Xerox Limited. During 1998, we repurchased 3.7 million shares for $172 million. Since inception of the program we have repurchased 20.6 million shares for $594 million.

Year 2000
The Year 2000 (Y2K) problem is the result of computer programs written in two digits, rather than four, to define the applicable year. As a result, many information systems are unable to properly recognize and process date-sensitive information beyond December 31, 1999. As with all major companies, certain of our information systems and products require remediation or replacement in order to render these systems Year 2000 compliant. Though a majority of the remediation and replacement work has been completed, 1999 will be used to finish any remaining mission-critical areas and develop and deploy business contingency plans.

We have divided the Year 2000 project into five major sections: Information Technology; and the non-Information Technology areas of Facilities, Vendor Compliance, Product Compliance and Facilities Management products and services. The general phases common to all sections are: 1) Awareness - a strategic approach was developed to address the Year 2000 problem. 2) Assessment - detailed plans and target dates were developed. 3) Programming - includes hardware and software upgrades, systems replacements, vendor certification and other associated changes. 4) Testing - includes testing and conversion of system applications. 5) Implementation - includes compliance achievement and user acceptance.

The Information Technology section includes applications (software), compute (mainframe/smaller computer environments), infrastructure (networks, servers, and workstations), and telecommunications. The status of each section as of December 31, 1998, is as follows:

Applications - 93 percent of the mission-critical applications are Y2K compliant. The remaining work is planned for completion by mid-1999.

Compute - 90 percent of our mainframe/smaller computer environments have been upgraded to be Y2K compliant with the remainder scheduled to be upgraded by mid-1999.

Infrastructure - 62 percent of networks, servers, and workstations have been upgraded to be Y2K compliant with the remainder to be upgraded by mid-1999.

Telecommunications - 71 percent of internal mission-critical components are Y2K compliant with the remainder planned for compliance by mid-1999. To date, 84 percent of our public utility providers have provided us letters of compliance assurance and processes are under way to obtain confirmation by the rest.

The Facilities section, which includes electrical systems, elevators, access control, security systems, etc., is primarily in the assessment phase. We anticipate achieving compliance by August 31, 1999.

We began our efforts in the Vendor Compliance area in November 1997. A general awareness letter was sent to all external suppliers, and an assessment survey was sent to all business-critical suppliers. Approximately 40 percent of our suppliers were rated "low confidence" or had not responded. Given our assessment as well as industry statistics that 23 percent of small to medium sized companies have not started Y2K compliance activity, we have decided that if necessary, we will acquire approximately $100 million of additional inventory by December 31, 1999 to ensure continuity of service to our customers should our vendors experience Y2K problems. This procedure is intended to provide a means of managing risk; however, no assurance can be given that it will eliminate the potential disruption caused by third party failure.

Regarding Product Compliance, all of our products, excluding end-of-life and a handful of engineering-related products, are Y2K compliant, or we have developed a software/hardware

patch or have another solution in progress. We have implementation plans in place to deploy these Y2K solutions so that all in-field Xerox products will be made compliant by mid-1999.

In Facilities Management, we have completed inventory and compliance assessment and have begun action planning and remediation activities for 80 percent of our customers. Completion of remediation, on-site integrated testing of components and full deployment is scheduled for mid-1999, while remediation of Xerox products at these sites is being coordinated with the product compliance area.

Contingency Planning--Certain of our processes have in place business resumption plans. In addition, we have established a contingency program which requires our critical business processes to develop alternative plans should our, or third party remediation efforts experience unforeseen difficulty.

We are also dependent upon our customers for sales and cash flows. Y2K interruptions in our customers' operations could result in reduced sales, increased inventory or receivable levels and cash flow reductions. While these events are possible, our customer base is sufficiently broad to minimize those risks.

In 1993, Xerox began a project to replace the majority of its legacy systems, which in many cases date back to the 1960s. These efforts continue today. As to remediation, we currently estimate that costs, exclusive of software and systems that are being replaced or upgraded in the normal course of business, and including our products and facilities, as well as legacy systems, will be $183 million of which $28 million was spent in 1997, $92 million in 1998 and we estimate $63 million will be spent in 1999.

We believe that the remediation of our information systems and products will occur in a timely fashion so that the Y2K problem will not result in significant operating problems with our operating systems, facilities and products. However, if such remediations are not completed in a timely manner or if third party suppliers of products or services have not completed their remediation efforts, the Y2K problem could potentially have a material adverse impact on our operations. Possible worst case consequences could include an interruption in our ability to: bill and apply collections from our customers; manufacture and deliver products to our customers; or meet our cash requirement needs.

[The following data was represented by a bar chart]

Operating Margins (percent)

96	11.6
97	12.3
98	13.6

- --

Personal Banker --

Florisdeo Paulo Monteiro Jr. of Unibanco of Brazil displays Multi-Extrato. This customized monthly banking statement serves as a personal banker for customers and a one-to-one marketing tool for the bank. Multi-Extrato is produced with data management software from Document Sciences Corp., a Xerox New Enterprises company, and Xerox high-speed printing and finishing systems. In one attractive, easy-to-understand booklet, Multi-Extrato provides comprehensive account information, a performance summary of a customer's investments vs. the market, plus information about new financial services. Unibanco was the first bank in Brazil to use this approach. Ten other Brazilian banks have followed.

- --

The Euro

On January 1, 1999, eleven of the fifteen member countries of the European Union established fixed conversion rates between their existing currencies and one common currency--the euro. The euro now trades on currency exchanges and may be used in business transactions. Xerox has processes in place in Europe to address the systems and business issues raised by the euro currency conversion. These issues include among others, 1) the need to adapt computer and other business systems and equipment to accommodate euro-denominated transactions, and 2) the competitive impact of cross-border price transparency, which may make it more difficult for businesses to price for local markets for the same products on a country-by-country basis. We estimate that the euro conversion will not have a material impact on our financial condition or results of operations.

New Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 requires companies to recognize all derivatives as assets or liabilities measured at their fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. We do not expect this Statement to have a material impact on our consolidated financial statements. This Statement is effective for fiscal years beginning after June 15, 1999. We will adopt this accounting standard beginning January 1, 2000.

Capital Resources and Liquidity

We manage the capital structure of our non-financing operations separately from that of our captive finance companies, which employ a more highly leveraged capital structure typical of captive finance companies.

Total debt, including ESOP and Discontinued Operations debt not shown separately in our consolidated balance sheets, increased to $15,107 million at

December 31, 1998 from $12,903 million in 1997 and $12,448 million in 1996.

(In millions)	1998	1997	1996
Total debt* as of January 1	$12,903	$12,448	$11,794
Non-Financing Businesses:			
Document Processing operations cash generation	(99)	(1,026)	(678)
Purchase of The Rank Group's remaining interests in Xerox Limited	-	1,534	-
Purchase of XLConnect, net of cash acquired	380	-	-
Mandatorily redeemable preferred securities	-	(637)	-
ESOP	(64)	(60)	(53)
Discontinued businesses	(381)	(541)	47
Subtotal Non-Financing	(164)	(730)	(684)
Financing Businesses	1,764	760	706
Shareholder dividends	531	475	438
Equity redemption and other changes	73	(50)	194
Total debt* as of December 31	$15,107	$12,903	$12,448

* Includes discontinued operations.

For analytical purposes, total equity includes common equity, ESOP preferred stock, mandatorily redeemable preferred securities and minorities' interests. Total equity decreased by $148 million in 1998 and increased by $523 million and $535 million in 1997 and 1996, respectively.

The following is a three-year summary of the changes in total equity:

(In millions)	1998	1997	1996
Total equity as of January 1	$6,454	$5,931	$5,396
Income from continuing operations, before restructuring charge	1,692	1,452	1,206
Restructuring charge	(1,107)	-	-
Loss from Discontinued Operations	(190)	-	-
Mandatorily redeemable preferred securities	-	637	-
Shareholder dividends	(531)	(475)	(438)
Purchase of treasury stock	(172)	(116)	(306)
Exercise of stock options	112	99	84
Change in minorities' interests	(3)	(716)	88
Translation adjustments	(56)	(463)	(138)
All other, net	107	105	39
Total equity as of December 31	$6,306	$6,454	$5,931

Debt related to non-financing operations grew by $439 million in 1998 and the non-financing debt-to-capital ratio increased to 43.8 percent compared with 38.9 percent and 39.3 percent as of year-end 1997 and 1996, respectively. The $1,107 million after-tax restructuring charge announced in April was a primary factor underlying the 4.9 point increase in 1998.

Non-Financing Operations

The following table summarizes 1998, 1997 and 1996 document processing non-financing operations cash generation and usage:

(In millions)	1998	1997	1996

Document Processing Non-Financing:			
Income	$1,381*	$1,217	$1,004
Depreciation and amortization**	821	739	715
Subtotal	$2,202	$1,956	$1,719
Additions to land, building and equipment	(566)	(520)	(510)
Cash charges against 1998 restructuring reserve	(332)	-	-
Increase in inventories, including rental equipment	(1,031)	(517)	(422)
Increase in accounts receivable	(540)	(188)	(180)
All other changes, net	366	295	71
Net Cash Generation	$ 99	$1,026	$ 678

* Before 1998 restructuring charge.
** Includes rental equipment depreciation of $411, $311 and $326 in 1998, 1997 and 1996, respectively.

Consolidated Balance Sheets

December 31 (in millions)	1998	1997
Assets		
Cash	$ 79	$ 75
Accounts receivable, net	2,671	2,145
Finance receivables, net	5,220	4,599
Inventories	3,269	2,792
Deferred taxes and other current assets	1,236	1,155
Total Current Assets	12,475	10,766
Finance receivables due after one year, net	9,093	7,754
Land, buildings and equipment, net	2,366	2,377
Investments in affiliates, at equity	1,456	1,332
Goodwill, net	1,731	1,375
Other assets	1,233	1,103
Investment in discontinued operations	1,670	3,025
TOTAL ASSETS	$30,024	$27,732
Liabilities and Equity		
Short-term debt and current portion of long-term debt	$ 4,104	$ 3,707
Accounts payable	948	776
Accrued compensation and benefits costs	722	811
Unearned income	210	205
Other current liabilities	2,523	2,193
Total Current Liabilities	8,507	7,692
Long-term debt	10,867	8,779
Postretirement medical benefits	1,092	1,079
Deferred taxes and other liabilities	2,711	2,469
Discontinued operations liabilities - policyholders' deposits and other	911	1,693
Deferred ESOP benefits	(370)	(434)
Minorities' interests in equity of subsidiaries	124	127
Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company	638	637
Preferred stock	687	705
Common shareholders' equity	4,857	4,985
TOTAL LIABILITIES AND EQUITY	$30,024	$27,732

Shares of common stock issued and outstanding at December 31, 1998 were (in thousands) 657,196 and 656,787, respectively. Shares of common stock issued and outstanding at December 31, 1997 were (in thousands) 652,482.

The accompanying notes on pages 41 to 61 are an integral part of the consolidated financial statements.

Non-financing operations' net cash generation of $99 million in 1998 was $927 million less than in 1997. Higher year-over-year income and non-cash charges were more than offset by restructuring payments and working capital increases. Inventories and receivables grew by $1,571 million in 1998, or $866 million more than in 1997. The higher level of inventory investment was driven by accelerated digital product sales growth. Accounts receivable growth reflects strong equipment sales in 1998 and some increase in days sales outstanding due to temporary effects from the reorganization and consolidation of U.S. customer administrative centers. A major initiative to improve our cash conversion cycle has been introduced in 1999 to reduce our working capital requirements. In 1997, non-financing operations' net cash generation totaled $1,026 million or $348 million more than in 1996. This significant improvement was largely due to higher income, higher growth in accounts payable and accrued compensation and benefits costs, and lower payments against restructuring reserves than in 1996.

Discontinued non-financing businesses generated $381 million in 1998 including net proceeds from the sales of Westchester Specialty Group and Crum & Forster, Inc., offset by debt service and other costs. In 1997, the discontinued non-financing businesses generated $541 million reflecting proceeds from the sales of Coregis Group, Inc., Industrial Indemnity Holdings, and The Resolution Group partially offset by debt service and other costs.

[Pictured here is Oscar Robertson]

A Commitment to Diversity
Xerox and Oscar Robertson, the NBA Hall of Fame player and now a successful entrepreneur, formed a strategic alliance to jointly provide printing solutions and facilities management services. As a Minority Business Enterprise assisted by Xerox quality and technology, Oscar Robertson Document Management Services should provide an economic boost to the urban enterprise zone in Pleasantville, N.J. Customers already include New Jersey's Public Service Electric & Gas Corporation and Caesar's Casino Hotel.

Financing Businesses

Customer financing-related debt grew by $1,764 million in 1998 or $1,004 million more than in 1997 due to equipment sales growth, currency translation effects and a modest increase in leverage from 7.0 to 1 to 7.5 to 1. Financing debt grew by $760 million in 1997, $54 million more than in 1996, reflecting growth in equipment sales partially offset by currency translation.

Debt related to discontinued third party financing and real estate activities, which is included in financing business debt, totaled $86 million in 1998, $117 million in 1997 and $223 million in 1996. Asset sales and portfolio run-off account for the changes in all three years.

Funding Plans for 1999

Decisions related to term funding of our non-financing businesses will remain based on the interest rate environment, capital market conditions and our desire to maintain ample liquidity. Our underlying strategy is to continue to maintain adequate funding duration while balancing the normal yield curve benefit of floating rates against the reduced volatility obtained from fixed-rate financing.

Customer financing-related debt is planned to increase in line with equipment sales growth while third party financing and real estate-related debt is expected to continue to decline. Decisions regarding the size and timing of term funding for our financing businesses will be made based on match funding needs, refinancing requirements and capital market conditions.

We believe our short-term credit facilities provide an ample source of funds to finance our day-to-day operations, and we have readily available access to the global capital markets to satisfy medium and long-term financing needs. Our $7 billion global revolving credit agreement with a group of banks expires in 2002. This facility is unused and available to provide back up to Xerox, Xerox Credit Corporation (XCC) and Xerox Capital (Europe) plc (XCE) commercial paper borrowings. Commercial paper balances supported by the global credit agreement totaled $4.5 billion at December 31, 1998. Xerox or XCC may access the facility up to its $7 billion limit.

XCE has access subject to a $4 billion limit. Total drawdowns cannot exceed $7 billion.

At December 31, 1998, Xerox and XCE had combined U.S. shelf capacity of $486 million and XCC had U.S. shelf capacity of $1,240 million. In addition, a $2 billion euro-debt facility is available to Xerox, XCC and XCE, of which $993 million remained unused at December 31, 1998.

[The following data was represented by a bar chart]

Manufacturing Productivity
(percentage decline in per unit equipment manufacturing cost)

96	7.8
97	8.6
98	10.4

Risk Management

Xerox is typical of multinational corporations because it is exposed to market risk from changes in foreign currency exchange rates and interest rates that could affect our results of operations and financial condition.

We have entered into certain financial instruments to manage interest rate and foreign currency exposures. These instruments are held solely for hedging purposes and include interest rate swap agreements, forward exchange contracts and foreign currency swap agreements. We do not enter into derivative instrument transactions for trading purposes and employ long-standing policies prescribing that derivative instruments are only to be used to achieve a set of very limited objectives.

Currency derivatives are primarily arranged in conjunction with underlying transactions that give rise to foreign currency-denominated payables and receivables. For example, an option to buy foreign currency to settle the importation of goods from foreign suppliers, or a forward exchange contract to fix the dollar value of a foreign currency-denominated loan.

As of December 31, 1998 and 1997 our primary foreign currency market exposures include the Japanese yen, Brazilian real, British pound sterling, French franc and Canadian dollar.

In order to manage the risk of foreign currency exchange rate fluctuations, we hedge a significant portion of all cash transactions denominated in a currency other than the functional currency applicable to each of our legal entities. From time to time, when cost-effective, foreign currency debt and currency derivatives are used to hedge international equity investments.

Consistent with the nature of the economic hedge of such foreign currency exchange contracts, associated unrealized gains or losses would be offset by corresponding decreases or increases in the value of the underlying asset or liability being hedged.

Assuming a 10 percent appreciation or depreciation in foreign currency exchange rates as of December 31, 1998, the potential change in fair value of our net foreign currency portfolio would approximate $32 million. The amount permanently invested in foreign subsidiaries and affiliates, primarily Xerox Limited, Fuji Xerox and Xerox do Brasil, and translated into dollars using the year-end exchange rate, was $6.5 billion at December 31, 1998, net of foreign currency denominated liabilities designated as a hedge of our net investment. Assuming a 10 percent appreciation or depreciation of the U.S. dollar against all currencies from the quoted foreign currency exchange rates at December 31, 1998 the unrealized loss or gain would approximate $650 million. In the early part of 1999 the Brazilian real has devalued substantially against the U.S. dollar. Financial reporting adjustments related to real devaluation will be recorded in shareholders' equity. A 10 percent devaluation of the real would reduce shareholders' equity by $230 million. Over time, such adjustments are expected to be at least partially recovered by our Brazilian operations.

We do not hedge foreign currency-denominated revenues of our foreign subsidiaries since these do not represent cross-border cash flows.

With regard to interest rate hedging, virtually all customer-financing assets earn fixed rates of interest. Therefore, within industrialized economies, we "lock in" an interest rate spread by arranging fixed-rate liabilities with similar maturities as the underlying assets and fund the assets with liabilities in the same currency. We refer to the effect of these conservative practices as "match funding" customer financing assets. This practice effectively eliminates the risk of a major decline in

Consolidated Statements of Cash Flows

Year ended December 31 (in millions)	1998	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES			
Income from continuing operations	$ 585	$ 1,452	$ 1,206
Adjustments required to reconcile income to cash flows from operating activities:			
Depreciation and amortization	821	739	715
Restructuring charge and asset impairments	1,531	-	-
Inventory charges	113	-	-
Provision for doubtful accounts	301	265	259
Provision for postretirement medical benefits, net of payments	33	29	38
Cash charges against 1998 restructuring reserve	(332)	-	-
Minorities' interests in earnings of subsidiaries	45	88	161
Undistributed equity in income of affiliated companies	(27)	(84)	(84)
Increase in inventories	(1,031)	(517)	(422)
Increase in finance receivables	(2,169)	(1,629)	(1,220)
Increase in accounts receivable	(540)	(188)	(180)
Increase in accounts payable and accrued compensation and benefit costs	127	250	63
Net change in current and deferred income taxes	(192)	361	293
Other, net	(430)	(294)	(519)
Total	(1,165)	472	310
CASH FLOWS FROM INVESTING ACTIVITIES			
Cost of additions to land, buildings and equipment	(566)	(520)	(510)
Proceeds from sales of land, buildings and equipment	74	36	40
Purchase of XLConnect, net of cash acquired	(380)	-	-
Purchase of additional interest in Xerox Limited	-	(812)	-
Other, net	5	45	14
Total	(867)	(1,251)	(456)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net change in debt	2,468	5	990
Dividends on common and preferred stock	(531)	(475)	(438)
Proceeds from sale of common stock	126	140	95
Repurchase of preferred and common stock	(172)	(116)	(316)
Dividends to minority shareholders	(4)	(7)	(36)
Proceeds from issuance of mandatorily redeemable preferred securities	-	637	-
Total	1,887	184	295
Effect of exchange rate changes on cash	(29)	(18)	(6)
Cash provided (used) by continuing operations	(174)	(613)	143
Cash provided (used) by discontinued operations	178	584	(175)
Increase (decrease) in cash	4	(29)	(32)
Cash at beginning of year	75	104	136
Cash at end of year	$ 79	$ 75	$ 104

The accompanying notes on pages 41 to 61 are an integral part of the consolidated financial statements.

interest margins during a period of rising interest rates. Conversely, this practice effectively eliminates the opportunity to materially increase margins when interest rates are declining.

Pay fixed-rate and receive variable-rate swaps are typically used in place of more expensive fixed-rate debt. Additionally, pay variable-rate and receive fixed-rate swaps are used from time to time to transform longer-term fixed-rate debt into variable rate obligations. The transactions performed within each of these categories enable more cost-effective management of interest rate exposures. The potential risk attendant to this strategy is the non-performance of the swap counterparty. We address this risk by arranging swaps with a diverse group of strong-credit counterparties, regularly monitoring their credit ratings and determining the replacement cost, if any, of existing transactions.

On an overall worldwide basis, and including the impact of our hedging activities, weighted average interest rates for 1998, 1997 and 1996 approximated 6.1 percent, 6.2 percent and 6.9 percent, respectively.

Many of the financial instruments we use are sensitive to changes in interest rates. Hypothetically, interest rate changes result in gains or losses related to the market value of our term debt and interest rate swaps due to differences between current market interest rates and the stated interest rates within the instrument. Applying an assumed 10 percent reduction or increase in the yield curves at December 31, 1998, the fair value of our term debt and interest swaps would increase or decrease by approximately $119 million.

Our currency and interest rate hedging are typically unaffected by changes in market conditions as forward contracts, options and swaps are normally held to maturity consistent with our objective to lock in currency rates and interest rate spreads on the underlying transactions.

- ---

[Pictured here is Momoe Takahashi Mehta]

Digital Artist -
Momoe Takahashi Mehta, a photographer and painter in Bangalore, India, uses the power of Xerox digital color to make copies of her paintings, which are in turn used for block print making.

- ---

Liquidity

Our primary sources of liquidity are cash generated from operations and borrowings. The consolidated statements of cash flows detailing changes in our cash balances are on page 36.

Operating activities resulted in a net cash outflow of $1,165 million in 1998 compared with $472 million of cash generation in 1997. This year-over-year change is largely due to strong growth in our customer financing businesses and a temporary decrease in inventory and receivables turnover, which more than offset higher income and non-cash charges. Conversely, 1997 operating cash generation was $162 million greater than in 1996 as growth in customer finance receivables was more than offset by lower working capital requirements.

1998 investing activities resulted in net cash usage of $867 million or

$384 million less than in 1997 due to an initial $812 million payment to The Rank Group in 1997 under our agreement to purchase The Rank Group's remaining interests in Xerox Limited, partially offset by a net $380 million payment in 1998 related to the purchase of XLConnect. Cash used for investing activities in 1997 was $795 million more than in 1996 largely due to the 1997 payment to The Rank Group.

Financing activities provided net cash flows totaling $1,887 million in 1998, up substantially from $184 million in 1997. Along with the changes to cash flows from operations and investing, 1997 financing cash flow reflects $637 million of cash generated by the issuance in January 1997 of mandatorily redeemable preferred securities.

Overall, continuing operations used $174 million and $613 million of cash in 1998 and 1997, respectively, and generated $143 million in 1996.

Discontinued operations provided $178 million and $584 million of cash in 1998 and 1997, respectively, and used $175 million in 1996.

Year-end cash balances were $79 million in 1998, $75 million in 1997 and $104 million in 1996, consistent with our objective to minimize investments that do not provide added value to our shareholders.

Discontinued Operations - Insurance and Other Financial Services

The net investment in the discontinued financial services businesses, which includes Insurance, Other Financial Services and Third Party Financing and Real Estate, totaled $759 million at December 31, 1998 compared with $1,332 million and $2,124 million at December 31, 1997 and 1996, respectively. The decrease in 1998 was primarily caused by the sale of the remaining Talegen Holdings, Inc. (Talegen) companies and a reserve increase recorded in the first quarter of 1998, somewhat offset by scheduled funding of reinsurance coverage to the former Talegen companies by Ridge Reinsurance Limited (Ridge Re) and interest for the period on the assigned debt. A discussion of the discontinued businesses follows.

- --

[Pictured here is a Xerox large-format color printing advertisement]

Scaling New Heights --

This is an award-winning advertisement used internationally to promote Xerox large-format color printing.
- --

Status of Insurance

In 1995, we recorded a $1,546 million after tax charge in connection with the disengagement activities for our five then remaining Talegen insurance companies and three related service companies.

In 1997, three of the insurance companies and one service company were sold. As part of the consideration for one of the companies, The Resolution Group, Inc. (TRG), which closed in the fourth quarter of 1997, we received a $462 million performance-based instrument. In 1998, the remaining insurance and service companies were sold. In the first quarter, we completed the sale of the Westchester Specialty Group, Inc. (WSG) for $338 million in cash, less approximately $70 million in transaction-related costs. In the third quarter, we completed the sale of Crum & Forster Holdings, Inc. (CFI) for $680 million, including the repayment of $115 million in debt, less approximately $75 million in transaction-related costs. With the completion of the CFI transaction, we have effectively completed our disengagement strategy from the Talegen companies. In the first quarter of 1998 an additional after-tax charge of $190 million was recorded.

Xerox Financial Services, Inc. (XFSI) continues to provide aggregate excess of loss reinsurance coverage to certain of the former Talegen units and TRG through Ridge Re, a wholly owned subsidiary. The coverage limits total $748 million, which is net of 15 percent coinsurance and exclusive of $234 million in coverage which was reinsured under a retrocessional arrangement during the fourth quarter of 1998 for a total cost to Ridge Re of $158 million. At December 31, 1998, Ridge Re had recognized the discounted value of approximately $445 million of the available coverage and it is possible that some additional reserves could ultimately be needed, although this is not currently anticipated.

XFSI has guaranteed to certain of the former Talegen units and TRG that Ridge Re will meet all of its financial obligations under the Reinsurance Agreements. Related premium payments to Ridge Re are made by XFSI and guaranteed by us. As of December 31, 1998, there were four remaining annual premium installments of $43 million, plus finance charges. We have also guaranteed that Ridge Re will meet its financial obligations on $578 million of the Reinsurance Agreements and have provided a $400 million partial guaranty of Ridge Re's $800 million letter of credit facility. This facility is required to provide security with respect to aggregate excess of loss reinsurance obligations under contracts with certain of the former Talegen units and TRG.

XFSI may also be required, under certain circumstances, to purchase over time additional redeemable preferred shares of Ridge Re, up to a maximum of $301 million.

Net Investment in Insurance

The net investment in Insurance at December 31, 1998 totaled $513 million compared with a balance of $1,076 million and $1,846 million at December 31, 1997 and 1996,

respectively. The decrease in 1998 versus 1997 primarily reflects the sales of WSG and CFI and the reserve increase recorded in the first quarter of 1998, somewhat offset by contractual payments to Ridge Re for annual premium installments and associated finance charges and interest on the assigned insurance debt.

Other Financial Services

The net investment in Other Financial Services at December 31, 1998 was $132 million compared with $125 million and $101 million at December 31, 1997 and 1996, respectively. Debt associated with these assets totaled $50 million at December 31, 1998, 1997 and 1996. The increase in the investment from 1997 to 1998 is primarily due to interest on the assigned debt. The increase in the investment from 1996 to 1997 primarily reflects the effect of a transfer from Insurance that had no effect on the total net investment in the discontinued financial services businesses.

On June 1, 1995, XFSI completed the sale of Xerox Financial Services Life Insurance Company and related companies (Xerox Life). In connection with the transaction, OakRe Life Insurance Company (OakRe), a wholly owned XFSI subsidiary, has assumed responsibility, via Coinsurance Agreements, for existing Single Premium Deferred Annuity (SPDA) policies issued by Xerox Life. The Coinsurance Agreements include a provision for the assumption (at their election) by the purchaser's companies, of all of the SPDA policies at the end of their current rate reset periods. A Novation Agreement with an affiliate of the new owner provides for the assumption of the liability under the Coinsurance Agreements for any SPDA policies not so assumed.

As a result of the Coinsurance Agreements, at December 31, 1998, OakRe retained approximately $0.8 billion of investment portfolio assets (transferred from Xerox Life) and liabilities related to the reinsured SPDA policies. Interest rates on these policies are fixed and were established upon issuance of the respective policies. Substantially all of these policies will reach their rate reset periods through the year 2000 and will be assumed under the Agreements as described above. Xerox Life's portfolio was designed to recognize that policy renewals extended liability "maturities," thereby permitting investments with average duration somewhat beyond the rate reset periods. OakRe's practice is to selectively improve this match over time as market conditions allow.

In connection with the aforementioned sale, XFSI established a $500 million letter of credit and line of credit with a group of banks to support OakRe's coinsurance obligations. The term of this letter of credit is five years and it is unused and available at December 31, 1998. Upon a drawing under the letter of credit, XFSI has the option to cover the drawing in cash or to draw upon the credit line.

- ---

[Pictured here is Ursula Burns]

Top 25 --
Ursula Burns, Xerox vice president for manufacturing operations, was featured in Working Woman magazine in an article about the top 25 companies for female executives. The copies Burns is holding were made on a Xerox 5385 departmental copier.

- ---

Third Party Financing and Real Estate

Third Party Financing and Real Estate assets at December 31, 1998, 1997 and 1996 totaled $250 million, $298 million and $450 million, respectively. The $48 million reduction in 1998 from 1997 primarily relates to asset sales and runoff activity that were consistent with the amounts contemplated in the formal disposal plan. Debt associated with these assets totaled $86 million, $117 million and $223 at December 31, 1998, 1997 and 1996, respectively.

In January and February 1999, six of our remaining eight financing leases were sold for $127 million, consistent with the amounts contemplated in the formal disposal plan.

FINANCIAL REVIEW

Consolidated Statements of Shareholders' Equity

(In millions, except share data in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income(1)	Treasury Stock Shares	Treasury Stock Amount	Total
Balance at December 31, 1995	650,060	$653	$1,008	$2,321	$(104)	-	-	$3,878
Net income				1,206				1,206
Translation adjustments - net of minority shareholders' interests of ($24)					(138)			(138)
Comprehensive income								1,068
Purchase of treasury stock						(12,986)	$(306)	(306)
Stock option, incentive plans and other	1,192	2	(25)	(15)		4,856	122	84
Xerox Canada Inc. exchangeable stock	205					2,694		
Convertible securities	347		10			994	23	33
Cash dividends declared								
Common stock ($0.58 per share)				(379)				(379)
Preferred stock				(59)				(59)
Tax benefits on ESOP dividends				16				16
Premiums from sale of put options			11					11
Tax benefits on stock options			21					21
Balance at December 31, 1996	651,804	655	1,025	3,090	(242)	(4,442)	(161)	4,367

Net income				1,452				1,452
Net income during stub period				8				8
Translation adjustments - net of minority shareholders' interests of ($44)					(463)			(463)

Comprehensive income								997
Purchase of treasury stock						(3,975)	(116)	(116)
Stock option, incentive plans and other	360		(17)	(129)		7,296	245	99
Xerox Canada Inc. exchangeable stock	116					126		
Convertible securities	202		9			995	32	41
Cash dividends declared								
Common stock ($0.64 per share)				(418)				(418)
Preferred stock				(57)				(57)
Tax benefits on ESOP dividends				14				14
Premiums from sale of put options			13					13
Tax benefits on stock options			45					45
Balance at December 31, 1997	652,482	655	1,075	3,960	(705)	-	-	4,985
Net income				395				395
Net loss during stub period				(6)				(6)
Translation adjustments - net of minority shareholders' interests of ($1)					(56)			(56)

Comprehensive income								333
Purchase of treasury stock						(3,683)	(172)	(172)
Stock option, incentive plans and other	3,899	4	69	(116)		2,364	111	68
Xerox Canada Inc. exchangeable stock	350					12		
Convertible securities	465	1	28			898	42	71
Cash dividends declared								
Common stock ($0.72 per share)				(475)				(475)
Preferred stock				(56)				(56)
Tax benefits on ESOP dividends				10				10
Premiums from sale of put options			5					5
Tax benefits on stock options			88					88
Balance at December 31, 1998	657,196	$660	$1,265	$3,712	$ (761)	(409)	$ (19)	$4,857

(1) Accumulated other comprehensive income is solely composed of cumulative translation adjustments.

The accompanying notes on pages 41 to 61 are an integral part of the financial statements.

Notes to Consolidated Financial Statements
(Dollars in millions, except per-share data and unless otherwise indicated)

1 Summary of Significant Accounting Policies
Basis of Consolidation. The consolidated financial statements include the accounts of Xerox Corporation and all majority-owned subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated. References herein to "we" or "our" refer to Xerox and consolidated subsidiaries unless the context specifically requires otherwise.

Xerox Limited, Xerox Holding (Nederland) BV, Xerox Investments (Bermuda) Limited, Xerox Holdings (Bermuda) Limited and their respective subsidiaries are referred to as Xerox Limited.

Investments in which we have a 20 to 50 percent ownership interest are generally accounted for on the equity method.

Upon the sale of stock by a subsidiary, we recognize a gain or loss equal to our proportionate share of the increase or decrease in the subsidiary's equity. During 1996, we recognized a pre-tax net gain of $11 from such transactions.

Fuji Xerox Co. Ltd. (Fuji Xerox), changed its reporting period from a fiscal year ending October 20, 1996 to a fiscal year ending December 20. The results of operations during the period between the end of the 1996 fiscal year and the beginning of the new fiscal year (the stub period) amounted to a gain of $8. Fuji Xerox again changed its reporting period from a fiscal year ending December 20, 1997 to a fiscal year ending December 31. The results of operations during this stub period amounted to a loss of $6. The stub period results were recorded directly in retained earnings to avoid reporting more than 12 months' results of operations in one year.

Earnings per Share. Basic earnings per share are based on net income less preferred stock dividend requirements divided by the average common shares outstanding during the period. Diluted earnings per share assume exercise of in-the-money stock options outstanding and full conversion of convertible debt and convertible preferred stock into common stock at the beginning of the year or date of issuance, unless they are antidilutive.

Use of Estimates. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Goodwill. Goodwill represents the cost of acquired businesses in excess of the net assets purchased and is amortized on a straight-line basis, generally over periods ranging from 25 to 40 years. Goodwill is reported net of accumulated amortization, and the recoverability of the carrying value is evaluated on a periodic basis by assessing current and future levels of income and cash flows as well as other factors. Accumulated amortization at December 31, 1998 and 1997 was $119 and $71, respectively.

Accounting Changes. Effective January 1, 1998, we adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income." This statement requires that companies disclose comprehensive income, which includes net income, foreign currency translation adjustments, minimum pension liability adjustments, and unrealized gains and losses on marketable securities classified as available-for-sale. Comprehensive income and the components thereof are included in the Consolidated Statements of Shareholders' Equity on page 40.

Effective December 1998, we adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 requires us to report segment information as it is used internally to assess performance and allocate resources. See Note 9 on page 45.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 requires companies to recognize all derivatives as assets or liabilities measured at their fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for

hedge accounting. We do not expect this Statement to have a material impact on our consolidated financial statements. This Statement is effective for fiscal years beginning after June 15, 1999. We will adopt this accounting standard beginning January 1, 2000.

Revenue Recognition. Revenues from the sale of equipment under installment contracts and from sales-type leases are recognized at the time of sale or at the inception of the lease, respectively. Associated finance income is earned on an accrual basis under an effective annual yield method. Revenues from equipment under other leases are accounted for by the operating lease method and are recognized over the lease term. Service revenues are derived primarily from maintenance contracts on our equipment sold to customers and are recognized over the term of the contracts.

Provisions for Losses on Uncollectible Receivables. The provisions for losses on uncollectible trade and finance receivables are determined principally on the basis of past collection experience.

Inventories. Inventories are carried at the lower of average cost or market.

Buildings and Equipment. Our fixed assets are depreciated over their estimated useful lives. Depreciation is computed using principally the straight-line method. Significant improvements are capitalized; maintenance and repairs are expensed. See Note 7 on page 44.

Classification of Commercial Paper and Bank Notes Payable. It is our policy to classify as long-term debt that portion of commercial paper and notes payable that is intended to match fund finance receivables due after one year to the extent that we have the ability under our revolving credit agreement to refinance such commercial paper and notes payable on a long-term basis. See Note 11 on page 49.

Foreign Currency Translation. The functional currency for most foreign operations is the local currency. Net assets are translated at current rates of exchange, and income and expense items are translated at the average exchange rate for the year. The resulting translation adjustments are recorded in accumulated other comprehensive income. The U.S. dollar is used as the functional currency for certain subsidiaries, which conduct their business in U.S. dollars or operate in hyperinflationary economies. A combination of current and historical exchange rates is used in remeasuring the local currency transactions of these subsidiaries, and the resulting exchange adjustments are included in income. Aggregate foreign currency losses were $28, $85 and $27 in 1998, 1997 and 1996, respectively, and are included in Other, net in the consolidated statements of income.

Effective July 1, 1997, we changed the functional currency for our Brazilian operation from the U.S. dollar to the Brazilian real, as the Brazilian economy is no longer considered hyperinflationary. The effect of this change was immaterial.

Reclassifications. Prior years' financial statements have been restated to reflect certain reclassifications to conform with the 1998 presentation. The impact of these changes is not material and did not affect net income.

2 Restructuring

On April 7, 1998, we announced a worldwide restructuring program associated with enhancing our competitive position and lowering our overall cost structure. In connection with this program, in the second quarter we recorded a pretax provision of $1,644 ($1,107 after taxes and including our $18 share of a restructuring charge recorded by Fuji Xerox). The program includes the elimination of approximately 9,000 jobs, net, worldwide, the closing and consolidation of facilities, and the write-down of certain assets. The charges associated with this restructuring program include $113 of inventory charges recorded as cost of revenues and $316 of asset impairments. Included in the asset impairment charge is facility fixed asset write-downs of $156 and other asset write-downs of $160. For facility fixed assets classified as

assets to be disposed of, the impairment loss recognized is based on fair value less cost to sell, with fair value based on third-party valuations as well as our internal estimates of existing market prices for similar assets. The effect of suspending depreciation on assets no longer in use for 1998 is not material. The remaining $160 of asset impairments includes the write-down of certain technology assets and other items impacted by the consolidation initiatives described below. Key initiatives of the restructuring include:

1. Consolidating 56 European customer support centers into one facility and implementing a shared services organization for order entry, invoicing, and other back-office and sales operations.

2. Streamlining manufacturing, logistics, distribution and service operations. This will include centralizing U.S. parts depots and outsourcing storage and distribution.

3. Overhauling our internal processes and associated resources, including closing one of four geographically organized U.S. customer administrative centers.

The reductions are occurring primarily in administrative functions, but also impact service, research and manufacturing.

The following table summarizes the status of the restructuring reserve (in millions):

	Total Reserve	Charges Against Reserve	12/31/98 Balance
Severance and related costs	$1,017	$304	$713
Asset impairment	316	316	-
Lease cancellation and other costs	198	28	170
Inventory charges	113	113	-
Total	$1,644	$761	$883*

AAA

* Of this amount, $543 is included in Other current liabilities.

As of December 31, 1998, approximately 5,400 employees have left the Company under the restructuring program.

There have been no material changes to the program since its announcement in April 1998, and the majority of the remaining reserve will be utilized by December 31, 1999. However, the completion of certain European initiatives will likely be extended beyond 1999 due to local regulatory issues as they relate to the workforce.

3 Common Stock Split
On January 25, 1999, the Board of Directors approved a two-for-one split of the Company's common stock. The effective date of the stock split was February 23 for share-holders of record as of February 4. Shareholders' equity has been restated to give retroactive recognition to the stock split in prior periods by reclassifying from additional paid-in capital to common stock the par value of the additional shares arising from the split. In addition, all references in the financial statements to number of shares and per-share amounts have been restated.

4 Acquisitions
In May 1998, we acquired XLConnect Solutions, Inc. (XLConnect), an information technology services company, and its parent company, Intelligent Electronics, Inc. for $413 in cash. The operating results of these companies, which are not material, have been included in our consolidated statement of income from the date of the acquisition. Based on the allocation of the purchase price, the transaction resulted in goodwill of $395 (including transaction costs) which is being amortized over 25 years.

In June 1997, we acquired the remaining 20 percent of Xerox Limited from The Rank Group Plc (Rank) in a transaction valued at (pound)940 million, or approximately $1.5 billion. As a result of this transaction, we now own 100 percent of Xerox Limited. The transaction was funded entirely by debt consisting of (pound)500 million of third-party debt and (pound)440 million of notes payable issued to Rank, which will be paid in deferred installments, half paid on June 29, 1998 and the other half by June 30, 1999. An additional payment of up to (pound)60 million would be made in 2000 based upon achievement of certain Xerox Limited earnings growth targets by 1999. The purchase price (including transaction costs) was allocated such that goodwill increased by $737, minority interest in equity of subsidiaries was reduced by approximately $720, with the balance of $70 applied to other assets and liabilities, primarily investment in affiliates, at equity.

5 Finance Receivables, Net

Finance receivables result from installment sales and sales-type leases arising from the marketing of our business equipment products. These receivables generally mature over two to five years and are typically collateralized by a security interest in the underlying assets. The components of finance receivables, net at December 31, 1998, 1997 and 1996 follow:

	1998	1997	1996
Gross receivables	$16,918	$15,035	$13,872
Unearned income	(2,863)	(2,850)	(2,551)
Unguaranteed residual values	699	557	398
Allowance for doubtful accounts	(441)	(389)	(347)
Finance receivables, net	14,313	12,353	11,372
Less current portion	5,220	4,599	4,386
Amounts due after one year, net	$ 9,093	$ 7,754	$ 6,986

Contractual maturities of our gross finance receivables subsequent to December 31, 1998 follow:

1999	2000	2001	2002	2003	Thereafter
$6,295	$4,570	$3,257	$1,911	$740	$145

Experience has shown that a portion of these finance receivables will be prepaid prior to maturity. Accordingly, the preceding schedule of contractual maturities should not be considered a forecast of future cash collections.

Allowances for doubtful accounts on our accounts receivable balances for the years ended December 31, 1998, 1997 and 1996 amounted to $102, $92 and $92, respectively.

6 Inventories

The components of inventories at December 31, 1998, 1997 and 1996 follow:

	1998	1997	1996
Finished goods	$1,923	$1,549	$1,570
Work in process	111	97	80
Raw materials	464	406	322
Equipment on operating leases, net	771	740	704
Inventories	$3,269	$2,792	$2,676

Equipment on operating leases consists of our business equipment products that are rented to customers and are depreciated to estimated residual value. Depreciable lives vary from two to four years. Our business equipment operating lease terms vary, generally from 12 to 36 months. Accumulated depreciation on equipment on operating leases for the years ended December 31, 1998, 1997 and 1996 amounted to $1,260, $1,198 and $1,259, respectively. Scheduled minimum future rental revenues on operating leases with original terms of one year or longer are:

1999	2000	2001	Thereafter
$367	$173	$84	$46

Total contingent rentals, principally usage charges in excess of minimum allowances relating to operating leases, for the years ended December 31, 1998, 1997 and 1996 amounted to $161, $186 and $199, respectively.

7 Land, Buildings and Equipment, Net

The components of land, buildings and equipment, net at December 31, 1998, 1997 and 1996 follow:

	Estimated Useful Lives (Years)	1998	1997	1996
Land		$ 80	$ 88	$ 89
Buildings and building equipment	25 to 50	973	1,012	991
Leasehold improvements	Lease term	425	403	378
Plant machinery	4 to 12	1,926	1,870	1,862
Office furniture and equipment	3 to 15	1,299	1,285	1,231
Other	3 to 20	260	190	218
Construction in progress		283	310	250
Subtotal		5,246	5,158	5,019
Less accumulated depreciation		2,880	2,781	2,763
Land, buildings and equipment, net		$2,366	$2,377	$2,256

We lease certain land, buildings and equipment, substantially all of which are accounted for as operating leases. Total rent expense under operating leases for the years ended December 31, 1998, 1997 and 1996 amounted to $436, $419 and $421, respectively. Future minimum operating lease commitments that have remaining non-cancelable lease terms in excess of one year at December 31, 1998 follow:

1999	2000	2001	2002	2003	Thereafter
$318	$258	$184	$138	$115	$396

In certain circumstances, we sublease space not currently required in operations. Future minimum sublease income under leases with non-cancelable terms in excess of one year amounted to $23 at December 31, 1998.

In 1994, we awarded a contract to Electronic Data Systems Corp. (EDS) to operate our worldwide data processing and telecommunications network through the year 2004. Subject to making a payment defined in the contract, effective July 1, 1999, Xerox has the right to terminate this agreement with six months' notice to EDS. Minimum payments due EDS under the contract follow:

1999	2000	2001	2002	2003	2004

$257	$229	$217	$198	$183	$95

8 Investments in Affiliates, at Equity

Investments in corporate joint ventures and other companies in which we generally have a 20 to 50 percent ownership interest at December 31, 1998, 1997 and 1996 follow:

	1998	1997	1996
Fuji Xerox	$1,354	$1,231	$1,173
Other investments	102	101	109
Investments in affiliates, at equity	$1,456	$1,332	$1,282

Xerox Limited owns 50 percent of the outstanding stock of Fuji Xerox, a corporate joint venture with Fuji Photo Film Co., Ltd. Fuji Xerox is headquartered in Tokyo and operates in Japan and other areas of the Pacific Rim, Australia and New Zealand, except for China. Condensed financial data of Fuji Xerox for its last three fiscal years follow:

	1998	1997	1996
Summary of Operations			
Revenues	$6,809	$7,415	$8,091
Costs and expenses	6,506	6,882	7,546
Income before income taxes	303	533	545
Income taxes	195	295	313
Net income	$ 108	$ 238	$ 232
Balance Sheet Data			
Assets			
Current assets	$2,760	$2,461	$3,008
Non-current assets	3,519	2,942	3,168
Total assets	$6,279	$5,403	$6,176
Liabilities and Shareholders' Equity			
Current liabilities	$2,628	$2,218	$2,546
Long-term debt	101	286	427
Other non-current liabilities	1,028	679	850
Shareholders' equity	2,522	2,220	2,353
Total liabilities and shareholders' equity	$6,279	$5,403	$6,176

9 Segment Reporting

In 1998, we adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for reporting information about operating segments in annual financial statements and requires that certain selected information about operating segments be reported in interim financial reports. It also establishes standards for related disclosures about products and services, and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision makers are our Chief Executive Officer and Chief Operating Officer. SFAS No. 131 differs from the previous accounting standard SFAS No. 14, which required companies to disclose certain financial information about each industry segment in which they operate. Under SFAS No. 14, we described ourselves as having one segment--Document Processing. Under the new standard, our reportable segments are as follows: Core Business, Fuji

Xerox, Paper and Media, and Other.

The Core Business operating segment consists of the worldwide development, manufacturing, marketing, financing and servicing of document processing products and services. We have aggregated all Core Business operating units due to commonality of economic characteristics, products and services, the production process, class of customer and distribution process. This segment also includes our corporate headquarters.

The Fuji Xerox operating segment is composed of our corporate joint venture with Fuji Photo Film Co., Ltd. (Fuji Photo), which operates throughout the Far East (except China). It is managed jointly by our Chief Executive Officer and the Chief Executive Officer of Fuji Photo.

The Paper and Media segment operates as a distributor of print media and supplies to our customers. The mission of Paper and Media is to charge a spread over mill wholesale prices to cover our costs and value added as a distributor. Although managed as a separate operating segment, our distribution of these products is important to maintain the integrated document services solution we offer our customers.

The Other operating segment is composed primarily of our Channels business and Xerox New Enterprises companies. Channels distributes products primarily through retail channels and value-added resellers. Xerox New Enterprises comprises our investments in emerging companies with important document processing hardware and software technologies in various stages of development. Total assets for this segment also includes our investment in discontinued operations.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies.

	Document Processing Segments				
	Core Business	Fuji Xerox	Paper and Media	Other	Total
1998					
Information about profit or loss					
Revenues from external customers	$16,037	-	$1,142	$1,199	$18,378
Finance income	1,071	-	-	-	1,071
Intercompany revenues	(326)	-	-	326	-
Total segment revenues	16,782	-	1,142	1,525	19,449
Depreciation and amortization	803	-	-	18	821
Interest expense	748	-	-	-	748
Segment profit (loss) before restructuring	2,434	-	53	(80)	2,407
Segment profit (loss) after restructuring	929	-	50	(216)	763
Earnings of non-consolidated affiliates(1)	19	$ 72	-	1	92
Information about assets					
Investments in non-consolidated affiliates	91	1,354	-	11	1,456
Total assets	26,214	1,354	83	2,373	30,024
Capital expenditures	539	-	-	27	566
1997					
Information about profit or loss					
Revenues from external customers	$14,937	-	$1,117	$1,084	$17,138
Finance income	1,006	-	-	-	1,006
Intercompany revenues	(118)	-	-	118	-
Total segment revenues	15,825	-	1,117	1,202	18,144
Depreciation and amortization	732	-	-	7	739
Interest expense	617	-	-	-	617
Segment profit (loss)	2,180	-	44	(83)	2,141
Earnings of non-consolidated affiliates	6	$ 119	-	2	127
Information about assets					
Investments in non-consolidated affiliates	91	1,231	-	10	1,332
Total assets	22,913	1,231	91	3,497	27,732
Capital expenditures	510	-	-	10	520
1996					
Information about profit or loss					
Revenues from external customers	$14,067	-	$1,226	$1,070	$16,363
Finance income	1,015	-	-	-	1,015
Intercompany revenues	(96)	-	-	96	-

Total segment revenues	14,986	-	1,226	1,166	17,378
Depreciation and amortization	708	-	-	7	715
Interest expense	592	-	-	-	592
Segment profit (loss)	1,892	-	85	(33)	1,944
Earnings of non-consolidated affiliates	5	$ 116	-	2	123
Information about assets					
Investments in non-consolidated affiliates	94	1,173	-	15	1,282
Total assets	20,689	1,173	102	4,854	26,818
Capital expenditures	500	-	-	10	510

(1) Excludes our $18 share of a restructuring charge recorded by Fuji Xerox.

Products and services and geographic area data for our continuing operations follow:

	Revenues		
	1998	1997	1996
Information about products and services			
Digital	$ 8,960	$ 6,628	$ 5,327
Light-lens	7,887	8,926	9,666
Paper and Other	2,602	2,590	2,385
Total	$19,449	$18,144	$17,378

	Revenues			Long-lived Assets		
	1998	1997	1996	1998	1997	1996
Information about Geographic Areas						
United States	$10,087	$ 9,187	$ 8,583	$2,095	$2,020	$1,881
Europe, Africa, Asia, Mideast	5,773	5,394	5,501	731	673	671
Other areas	3,589	3,563	3,294	571	584	527
Total	$19,449	$18,144	$17,378	$3,397	$3,277	$3,079

10 Discontinued Operations

In January 1993, we announced our intent to sell or otherwise disengage from our Insurance and Other Financial Services (IOFS) businesses. Since that time, we have sold all but one of our insurance businesses and have disposed of a number of other financial services businesses through sale and run-off collection activities. At December 31, 1998, our sole remaining Insurance operation is the Ridge Reinsurance Limited (Ridge Re) reinsurance business. Our other discontinued businesses, consisting of Other Financial Services and Third Party Financing and Real Estate, are primarily in asset and liability run-off. A discussion of the status of IOFS's three segments follows.

Insurance. In the fourth quarter of 1995, we recorded a $1,546 after-tax charge in connection with the disengagement activities for our five then remaining Talegen Holdings, Inc. (Talegen) insurance companies and three related service companies.

In 1997, three of the insurance companies and one service company were sold for an aggregate $890 in cash, the assumption of $154 of debt and, in the case of the sale of The Resolution Group, Inc. (TRG), a $462 performance-based instrument. We will participate in the future cash flows of TRG via the performance-based instrument. The recovery of this instrument is dependent upon the sufficiency of TRG's available cash flows. Based on current forecasts at December 31, 1998, we expect to realize $462 for this instrument. However, the ultimate realization may be greater or less than this amount.

In 1998, the remaining insurance and service companies were sold. In the first quarter, we completed the sale of the Westchester Specialty Group, Inc. for $338 in cash, less approximately $70 in transaction-related costs. In the third quarter, we completed the sale of Crum & Forster Holdings, Inc. (CFI) for $680, including the repayment of $115 in debt, less approximately $75 in transaction-related costs. In the first quarter of 1998, an additional after-tax charge of $190 was recorded. With the completion of the CFI transaction, we have effectively completed our disengagement strategy from the Talegen companies.

The net proceeds of the above sales transactions, after transaction-related costs were used primarily to retire debt.

At December 31, 1998, the Insurance business consists of Ridge Re and headquarters costs and interest expense associated with the insurance activities of Xerox Financial Services, Inc. (XFSI), a wholly owned subsidiary.

XFSI continues to provide aggregate excess of loss reinsurance coverage (the Reinsurance Agreements) to certain of the former Talegen units and TRG through Ridge Re, a wholly owned subsidiary of XFSI. The coverage limits total $748, which is net of 15 percent coinsurance and exclusive of $234 in coverage which was reinsured under a retrocessional arrangement during the fourth quarter of 1998 for a total cost to Ridge Re of $158. Through December 31, 1998, Ridge Re had recognized the discounted value of approximately $445 of the available coverage and it is possible that some additional reserves could ultimately be needed, although this is not currently anticipated.

XFSI has guaranteed to certain of the former Talegen units and TRG that Ridge Re will meet all of its financial obligations under the Reinsurance Agreements. Related premium payments to Ridge Re are made by XFSI and guaranteed by us. As of December 31, 1998, there were four remaining annual installments of $43, plus finance charges. We have also guaranteed that Ridge Re will meet its financial obligations on $578 of the Reinsurance Agreements and we have provided a $400 partial guaranty of Ridge Re's $800 letter of credit facility. This facility is required to provide security with respect to aggregate excess of loss reinsurance obligations under contracts with the former Talegen units and TRG.

XFSI may also be required, under certain circumstances, to purchase, over time, additional redeemable preferred shares of Ridge Re, up to a maximum of $301.

Insurance Financial Information. Summarized operating results of Insurance for the three years ended December 31, 1998 follow:

	1998	1997	1996
Revenues	$ 570	$1,760	$ 2,147
Costs and expenses	795	2,098	2,437
Loss before income taxes	(225)	(338)	(290)
Income tax benefits	59	143	100
Net loss from operations(*)	$(166)	$ (195)	$ (190)

* The 1998, 1997 and 1996 operating results exclude the gains and losses related to sales of the Insurance subsidiaries. The results in the above table, including the sale-related impacts, were charged to reserves established for this purpose and, therefore, did not impact our earnings. The 1998 results exclude the first quarter 1998 after-tax charge of $190.

Other Financial Services. In 1995, we completed the sale of Xerox Financial Services Life Insurance Company and related companies (Xerox Life). In connection with the transaction, OakRe Life Insurance Company (OakRe), a wholly owned XFSI subsidiary, assumed responsibility, via coinsurance agreements, for the Single Premium Deferred Annuity (SPDA) policies issued by Xerox Life. As a result of these coinsurance agreements, at December 31, 1998 and 1997, the consolidated balance sheet includes approximately $0.8 billion and $1.5 billion, respectively, of invested assets and the related reinsurance liabilities associated with these SPDA policies. These liabilities are expected to be substantially satisfied by the year 2000 as the policies are either terminated by the policyholder or renewed and transferred to the buyer.

In support of OakRe's coinsurance obligations, XFSI established a $500 letter of credit and line of credit, expiring in 2000, with a group of banks. These facilities are unused and available at December 31, 1998.

Third Party Financing and Real Estate. We have made substantial progress in disengaging from the Third Party Financing and Real Estate businesses that were discontinued in 1990. During the three years ended December 31, 1998, we received net cash proceeds of $236 ($48 in 1998, $152 in 1997 and $36 in 1996) from the sale of individual assets and from run-off and collection activities. The amounts received were consistent with our estimates in the disposal plan and were used primarily to retire debt. The remaining assets at December 31, 1998 primarily represent asset-based financing leases, many with long-duration contractual maturities and unique tax attributes.

Total Discontinued Operations. The consolidated financial statements present the Insurance, Other Financial Services and Third Party Financing and Real Estate businesses as discontinued operations. Debt was assigned to discontinued operations based on historical levels assigned to the businesses when they were continuing operations, adjusted for subsequent paydowns. Interest expense thereon is primarily determined based on our annual average domestic borrowing costs. Assigned and direct interest expense for the discontinued businesses for the years ended December 31, 1998, 1997 and 1996 was $143, $201 and $226, respectively.

Summarized information of discontinued operations for the three years ended December 31, 1998 follows:

	1998	1997	1996
Balance Sheet Data			
Assets			
Insurance			
Investment, net	$ 513	$1,076	$1,846
Other Financial Services			
Investments	805	1,537	1,991
Other assets, net	102	114	111
OFS assets	907	1,651	2,102
Third Party Financing and Real Estate			
Gross finance receivables	252	303	401
Unearned income and other	(2)	(5)	49
Investment, net	250	298	450
Investment in discontinued operations	$1,670	$3,025	$4,398

Liabilities			
OFS policyholders' deposits	$ 775	$1,523	$1,998
Other OFS liabilities	-	3	3
Long-term debt	136	167	273
Discontinued operations liabilities	$ 911	$1,693	$2,274
Net investment in discontinued operations	$ 759	$1,332	$2,124

Based on current estimates, we believe that the proceeds received from disposal of the remaining net discontinued assets will be consistent with our net carrying value of these businesses.

11 Debt

Short-Term Debt. Short-term borrowings data at December 31, 1998 and 1997 follow:

	Weighted Average Interest Rates at 12/31/98	1998	1997
Notes payable	3.34%	$ 536	$1,164
Foreign commercial paper	5.32%	384	629
Total short-term debt		920	1,793
Current maturities of long-term debt		3,184	1,914
Total		$4,104	$3,707

Notes payable generally represent foreign currency denominated borrowings of non-U.S. subsidiaries.

Long-Term Debt. A summary of long-term debt by final maturity date at December 31, 1998 and 1997 follows:

	Weighted Average Interest Rates at 12/31/98	1998	1997
U.S. Operations			
Xerox Corporation (parent company)			
Guaranteed ESOP notes due 1998-2004	7.63%	$ 370	$ 434
Notes due 1998	-	-	585
Notes due 1999	5.47	1,108	730
Notes due 2000	7.33	600	600
Notes due 2001	6.08	675	212
Notes due 2002	7.70	230	200
Notes due 2003	5.60	1,360	147
Notes due 2004	7.15	200	200
Notes due 2006	-	-	25
Notes due 2007	-	-	25
Notes due 2011	-	-	50
Notes due 2016	7.20	250	250
Convertible notes due 2018	3.63	575	-
Notes due 2026	-	-	350
Notes due 2038	5.07	25	-
Other debt due 1998-2014	6.88	137	126
Capital lease obligations	-	-	3

Subtotal		5,530	3,937
Xerox Credit Corporation			
Notes due 1998	-	-	795
Notes due 1999	6.01	1,175	300
Notes due 2000	5.37	536	201
Notes due 2001	5.17	51	126
Notes due 2002	-	-	250
Notes due 2007	-	-	25
Notes due 2012	-	-	225
Floating rate notes due 2048	5.09	60	60
Other notes due 1999 and 2000	-	-	4
Subtotal		1,822	1,986
Total U.S. operations		$7,352	$5,923

	Weighted Average Interest Rates at 12/31/98	1998	1997
International Operations			
Various obligations, payable in:			
Canadian dollars due 1998-2007	11.43%	$ 99	$ 124
Dutch guilders due 1998-2000	5.14	37	66
French francs due 1998-2001	4.14	7	21
German marks due 1998-1999	6.37	10	51
Pounds sterling due 1998-2003	8.75	207	206
Swiss francs due 1998-2000	3.59	13	35
Italian lire due 1998-2000	6.20	140	123
U.S. dollars due 1998-2008	5.66	1,013	229
Other currencies due 1998-2003	7.56	189	207
Capital lease obligations	7.50	1	3
Total international operations		1,716	1,065
Other borrowings deemed long-term		5,119	3,872
Subtotal		14,187	10,860
Less current maturities		3,184	1,914
Total long-term debt		$11,003	$ 8,946

Consolidated Long-Term Debt Maturities. Payments due on long-term debt for the next five years and thereafter follow:

1999	2000	2001	2002	2003	Thereafter
$3,184	$1,446	$1,242	$382	$1,614	$1,200

These payments do not include amounts relating to domestic commercial paper and foreign bank notes payable, which have been classified as long-term debt under the caption "Other borrowings deemed long-term." These borrowings are classified as long-term because we have the intent to refinance them on a long-term basis and the ability to do so under our revolving credit agreement.

Certain of our debt agreements allow us to redeem outstanding debt prior to scheduled maturity. Outstanding debt issues with these call features are classified in the preceding five-year maturity table in accordance with management's current expectations. The actual decision as to early redemption will be made at the time the early redemption option becomes exercisable and will be based on prevailing economic and business conditions and the relative costs of new borrowing.

Convertible Debt. In April 1998, we issued convertible subordinated debentures for net proceeds of $575. The amount due upon maturity in April 2018 is $1,012, resulting in an effective interest rate of 3.625 percent per annum, including 1.003 percent payable in cash semiannually beginning in October 1998. These debentures are convertible at any time at the option of the holder into 7.808 shares of our stock per $1,000 principal amount at maturity of debentures.

Lines of Credit. We have a $7 billion revolving credit agreement with a group of banks, which matures in 2002. This revolver is also accessible by the following wholly owned subsidiaries: Xerox Credit Corporation (up to a $7 billion limit), and Xerox Capital (Europe) plc (up to a $4 billion limit) with our guarantee. Any amounts borrowed under this facility would be at rates based, at the borrower's option, on spreads above certain reference rates such as LIBOR. This agreement is unused and is available to back commercial paper borrowings of our domestic operations, Xerox Capital (Europe) plc and Xerox Overseas Holdings Ltd., which amounted to $4.5 billion at December 31, 1998. In addition, our foreign subsidiaries had unused committed long-term lines of credit used to back short-term indebtedness that aggregate $0.1 billion in various currencies at prevailing interest rates.

Match Funding of Finance Receivables and Indebtedness. We employ a match funding policy for customer financing assets and related liabilities. Under this policy, which is more fully discussed in the accompanying Financial Review on page 35, the interest and currency

characteristics of the indebtedness are, in most cases, matched to the interest and currency characteristics of the finance receivables. At December 31, 1998, these operations had approximately $14.5 billion of net finance receivables, which will service approximately $12.0 billion of assigned short- and long-term debt, including $0.1 billion of debt assigned to discontinued third party financing businesses.

Guarantees. At December 31, 1998, we have guaranteed the borrowings of our ESOP and $3,159 of indebtedness of our foreign subsidiaries.

Interest. Interest paid by us on our short- and long-term debt, including amounts relating to debt assigned to discontinued operations, amounted to $859, $812 and $871 for the years ended December 31, 1998, 1997 and 1996, respectively.

Total Short- and Long-Term Debt. Our total indebtedness, excluding the direct indebtedness of Talegen, at December 31, 1998 and 1997 is reflected in the consolidated balance sheet captions as follows:

	1998	1997
Short-term debt and current portion of long-term debt	$ 4,104	$ 3,707
Long-term debt	10,867	8,779

Discontinued operations liabilities - policyholders' deposits and other	136	167
Total debt	$15,107	$12,653

A summary of changes in consolidated indebtedness for the three years ended December 31, 1998 follows:

	1998	1997	1996
Increase (decrease) in short-term debt, net	$ 553	$ (276)	$ 973
Proceeds from long-term debt	3,464	1,807	2,998
Principal payments on long-term debt	(1,580)	(1,632)	(2,989)
Subtotal	2,437	(101)	982
Less change in debt of discontinued operations	(31)	(106)	(8)
Total change in debt of continuing operations	$ 2,468	$ 5	$ 990

12 Financial Instruments

Derivative Financial Instruments. Certain financial instruments with off-balance-sheet risk have been entered into by us to manage our interest rate and foreign currency exposures. These instruments are held solely for hedging purposes and include interest rate swap agreements, forward exchange contracts and foreign currency swap agreements. We do not enter into derivative instrument transactions for trading or other speculative purposes.

We typically enter into simple, unleveraged derivative transactions which, by their nature, have low credit and market risk. Our policies on the use of derivative instruments prescribe an investment-grade counterparty credit floor and at least quarterly monitoring of market risk on a counterparty-by-counterparty basis. We utilize numerous counterparties to ensure that there are no significant concentrations of credit risk with any individual counterparty or groups of counterparties. Based upon our ongoing evaluation of the replacement cost of our derivative transactions and counterparty creditworthiness, we consider the risk of credit default significantly affecting our financial position or results of operations to be remote.

We employ the use of hedges to reduce the risks that rapidly changing market conditions may have on the underlying transactions. Typically, our currency and interest rate hedging activities are not affected by changes in market conditions, as forward contracts and swaps are arranged and normally held to maturity in order to lock in currency rates and interest rate spreads related to underlying transactions.

None of our hedging activities involves exchange traded instruments.

Interest Rate Swaps. We enter into interest rate swap agreements to manage interest rate exposure. An interest rate swap is an agreement to exchange interest rate payment streams based on a notional principal amount. We follow settlement accounting principles for interest rate swaps whereby the net interest rate differentials to be paid or received are recorded currently as adjustments to interest expense.

Virtually all customer financing assets earn fixed rates of interest. Accordingly, through the use of interest rate swaps in conjunction with the contractual maturity terms of outstanding debt, we "lock in" an interest spread by arranging fixed-rate interest obligations with maturities similar to the underlying assets. Additionally, in industrialized countries customer financing assets are funded with liabilities denominated in the same currency. We refer to the effects of these conservative practices as "match funding" our customer financing assets. This practice effectively eliminates the risk of a major decline in interest margins resulting from adverse changes in the interest rate environment. Conversely, this practice does effectively eliminate the opportunity to materially increase margins when interest rates are declining.

More specifically, pay fixed/receive variable interest rate swaps are often used in place of more expensive fixed-rate debt for the purpose of match funding fixed-rate customer contracts.

Pay variable/receive variable interest rate swaps ("basis swaps") are used to transform variable rate, medium-term debt into commercial paper or local currency LIBOR rate obligations. Pay variable/receive fixed interest rate swaps are used to transform term fixed-rate debt into variable rate obligations. During 1998, 17 such agreements were cancelled in connection with the early retirement of 17 issues of medium-term notes. The transactions performed within each of these three categories enable the cost-effective management of interest rate exposures. During 1998, the average notional amount of an interest rate swap agreement was $15.

For the three years ended December 31, 1998, no pay fixed/receive variable interest rate swap agreements were terminated prior to maturity.

The total notional amounts of these transactions at December 31, 1998 and 1997, based on contract maturity, follow:

	1998	1997
Commercial paper/bank borrowings	$ 2,242	$ 1,991
Medium-term debt	6,629	5,388
Long-term debt	5,128	4,313
Total	$13,999	$11,692

The aggregate notional amounts of interest rate swaps by maturity date and type at December 31, 1998 and 1997 follow:

	1998	1999	2000-2002	2003-2016	Total
1998					
Pay fixed/receive variable	$ -	$1,792	$4,706	$3,050	$ 9,548
Pay variable/receive variable	-	-	603	-	603
Pay variable/receive fixed	-	450	1,320	2,078	3,848
Total	$ -	$2,242	$6,629	$5,128	$13,999
Memo:					
Interest rate paid	-	6.36%	5.46%	4.87%	5.39%
Interest rate received	-	5.10%	5.21%	5.29%	5.22%
1997					
Pay fixed/receive variable	$1,136	$1,362	$4,817	$ 354	$ 7,669
Pay variable/receive variable	320	-	203	-	523
Pay variable/receive fixed	535	450	1,007	1,508	3,500

Total	$1,991	$1,812	$6,027	$1,862	$11,692
Memo:					
Interest rate paid	6.20%	6.88%	5.93%	6.05%	6.14%
Interest rate received	6.18%	5.72%	5.55%	6.93%	5.90%

Forward Exchange Contracts. We utilize forward exchange contracts to hedge against the potentially adverse impacts of foreign currency fluctuations on foreign currency denominated receivables and payables; firm foreign currency commitments; and investments in foreign operations. Firm foreign currency commitments generally represent committed purchase orders for foreign-sourced inventory. These contracts generally mature in six months or less. At December 31, 1998 and 1997, we had outstanding forward exchange contracts of $2,817 and $1,977, respectively. Of the outstanding contracts at December 31, 1998, the largest single currency represented was the British pound sterling. Contracts denominated in British pounds sterling, U.S. dollars, Brazilian reais, French francs and Japanese yen accounted for over 75 percent of our forward exchange contracts. On contracts that hedge foreign currency denominated receivables and payables, gains or losses are reported currently in income, and premiums or discounts are amortized to income and included in Other, net in the consolidated statements of income. Gains or losses, as well as premiums or discounts, on contracts that hedge firm commitments are deferred and subsequently recognized as part of the underlying transaction. At December 31, 1998, we had a net deferred gain of $17. Gains or losses on contracts that hedge an investment in a foreign operation are reported currently in the balance sheet as a component of cumulative translation adjustments. The premium or discount on contracts that hedge an investment in a foreign operation are amortized to income and included in Other, net in the consolidated statements of income. During 1998, the average notional amount of a forward exchange contract amounted to $17.

Foreign Currency Swap Agreements. We enter into cross-currency interest rate swap agreements, whereby we issue foreign currency denominated debt and swap the proceeds with a counterparty. In return, we receive and effectively denominate the debt in local currencies. Currency swaps are utilized as hedges of the underlying foreign currency borrowings, and exchange gains or losses are recognized currently in Other, net in the consolidated statements of income. During 1998, we entered into cross-currency interest rate swap agreements to convert U.S. dollar-denominated debt ($838) to yen-denominated debt (yen 95 billion) as of December 31, 1998. This synthetic yen debt is designated as a hedge of our investment in Fuji Xerox. Accordingly, related currency gains or losses have been included as a component of cumulative translation adjustments. At December 31, 1998, cross-currency interest rate swap agreements with an aggregate notional amount of $3,143 remained outstanding.

Fair Value of Financial Instruments. The estimated fair values of our financial instruments at December 31, 1998 and 1997 follow:

	1998		1997	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash	$ 79	$ 79	$ 75	$ 75
Accounts receivable, net	2,671	2,671	2,145	2,145
Short-term debt	920	920	1,793	1,793
Long-term debt	14,187	14,524	10,860	11,189
Interest rate and currency swap agreements	-	47	-	25

Forward exchange contracts	-	51	-	(44)

The fair value amounts for Cash, Accounts receivable, net and Short-term debt approximate carrying amounts due to the short maturities of these instruments.

The fair value of Long-term debt was estimated based on quoted market prices for these or similar issues or on the current rates offered to us for debt of the same remaining maturities. The difference between the fair value and the carrying value represents the theoretical net premium we would have to pay to retire all debt at such date. We have no plans to retire significant portions of our long-term debt prior to scheduled maturity. We are not required to determine the fair value of our finance receivables, the match funding of which is the source of much of our interest rate swap activity.

The fair values for interest rate and cross-currency swap agreements and forward exchange contracts were calculated by us based on market conditions at year-end and supplemented with quotes from brokers. They represent amounts we would receive (pay) to terminate/replace these contracts. We have no present plans to terminate/replace significant portions of these contracts.

13 Employee Benefit Plans

We sponsor numerous pension and other postretirement benifit plans in our U.S. and international operations.

	Pension Benefits		Other Benefits	
	1998	1997	1998	1997
Change in Benefit Obligation				
Benefit obligation, January 1	$ 7,399	$ 6,441	$ 1,029	$ 892
Service cost	172	167	26	25
Interest cost	916	948	72	66
Plan participants' contributions	13	31	-	-
Plan amendments	-	11	-	-
Actuarial loss	157	254	8	100
Currency exchange rate changes	31	(130)	(3)	(2)
Curtailments	(9)	(18)	20	-
Special termination benefits	99	-	2	-
Benefits paid	(738)	(305)	(59)	(52)
Benefit obligation, December 31	8,040	7,399	1,095	1,029
Change in Plan Assets				
Fair value of plan assets, January 1	7,708	6,771	-	-
Actual return on plan assets	872	1,293	-	-
Employer contribution	80	45	59	52
Plan participants' contributions	13	31	-	-
Currency exchange rate changes	23	(127)	-	-
Benefits paid	(738)	(305)	(59)	(52)
Fair value of plan assets, December 31	7,958	7,708	-	-
Funded status (including under-funded and non-funded plans)	(82)	309	(1,095)	(1,029)
Unamortized transition assets	(61)	(81)	-	-
Unrecognized prior service cost	28	34	(4)	(4)
Unrecognized net actuarial (gain) loss	121	(217)	7	(46)
Net amount recognized	$ 6	$ 45	$(1,092)	$(1,079)
Amounts recognized in the consolidated balance sheets consist of:				
Prepaid benefit cost	$ 349	$ 297	-	-
Accrued benefit liability	(343)	(252)	$(1,092)	$(1,079)
Net amount recognized	$ 6	$ 45	$(1,092)	$(1,079)
Under-funded or non-funded plans				
Aggregate benefit obligation	$ 345	$ 334	$ 1,095	$ 1,029
Aggregate fair value of plan assets	$ 35	$ 68	$ -	$ -
Weighted-average assumptions as of December 31				
Discount rate	7.0%	7.4%	7.0%	7.2%
Expected return on plan assets	9.2	9.5		
Rate of compensation increase	4.2	4.4		

	Pension Benefits			Other Benefits		
	1998	1997	1996	1998	1997	1996
Components of Net Periodic Benefit Cost						
Defined benefit plans						
Service cost	$ 172	$ 167	$ 164	$ 26	$ 25	$ 26
Interest cost	916	948	787	72	66	63
Expected return on plan assets	(1,010)	(1,014)	(849)	-	-	-
Recognized net actuarial (gain)/loss	10	16	8	-	(4)	(1)
Amortization of prior service cost	6	8	6	-	-	-
Recognized net transition asset	(19)	(20)	(18)	-	-	-
Recognized curtailment/settlement gain	(60)	(31)	(7)	-	-	-
Net periodic benefit cost	15	74	91	98	87	88
Defined contribution plans	32	23	17	-	-	-
Total	$ 47	$ 97	$ 108	$ 98	$ 87	$ 88

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. For measurement purposes, a 7.5 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for 1998. The rate was assumed to decrease gradually to 5.25 percent in 2002 and thereafter.

A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-percentage-point increase	One-percentage-point decrease
Effect on total service and interest cost components	4	(4)
Effect on postretirement benefit obligation	57	(54)

Employee Stock Ownership Plan (ESOP) Benefits. In 1989, we established an ESOP and sold to it 10 million shares of Series B Convertible Preferred Stock (Convertible Preferred) of the Company for a purchase price of $785. Each ESOP share is convertible into six common shares of the Company. The Convertible Preferred has a $1 par value, a guaranteed minimum value of $78.25 per share and accrues annual dividends of $6.25 per share. The ESOP borrowed the purchase price from a group of lenders. The ESOP debt is included in our consolidated balance sheets because we guarantee the ESOP borrowings. A corresponding amount classified as Deferred ESOP benefits represents our commitment to future compensation expense related to the ESOP benefits.

The ESOP will repay its borrowings from dividends on the Convertible Preferred and from our contributions. The ESOP's debt service is structured such that our annual contributions (in excess of dividends) essentially correspond to a specified level percentage of participant compensation. As the borrowings are repaid, the Convertible Preferred is allocated to ESOP participants and Deferred ESOP benefits are reduced by principal payments on the borrowings. Most of our domestic employees are eligible to participate in the ESOP.

Information relating to the ESOP for the three years ended December 31, 1998 follows:

	1998	1997	1996
Interest on ESOP Borrowings	$33	$38	$42
Dividends declared on Convertible Preferred Stock	$56	$57	$58
Cash contribution to the ESOP	$41	$39	$36
Compensation expense	$44	$40	$37

We recognize ESOP costs based on the amount committed to be contributed to the ESOP plus related trustee, finance and other charges.

14 Income Taxes

The parent company and its domestic subsidiaries file consolidated U.S. income tax returns. Generally, pursuant to tax allocation arrangements, domestic subsidiaries record their tax provisions and make payments to the parent company for taxes due or receive payments from the parent company for tax benefits utilized.

Income before income taxes from continuing operations for the three years ended December 31, 1998 consists of the following:

	1998	1997	1996
Domestic income	$625	$1,082	$ 781
Foreign income	138	1,059	1,163
Income before income taxes	$763	$2,141	$1,944

Provisions for income taxes from continuing operations for the three years ended December 31, 1998 consist of the following:

	1998	1997	1996
Federal income taxes			
Current	$265	$253	$210
Deferred	(149)	67	50
Foreign income taxes			
Current	178	168	205
Deferred	(143)	158	166
State income taxes			
Current	70	69	62
Deferred	(14)	13	7
Income taxes	$207	$728	$700

A reconciliation of the U.S. federal statutory income tax rate to the effective income tax rate for continuing operations for the three years ended December 31, 1998 follows:

	1998	1997	1996

U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
Foreign earnings and dividends taxed at different rates	(7.3)	(3.2)	.5
Goodwill amortization	.7	.3	.3
Tax-exempt income	(2.3)	(.8)	(.5)
State taxes	4.7	2.5	2.3
Change in valuation allowance for deferred tax assets	-	-	(1.0)
Other	(3.7)	.2	(.6)
Effective income tax rate	27.1%	34.0%	36.0%

The 1998 effective tax rate of 27.1 percent is 6.9 percentage points lower than 1997. Excluding the 1998 worldwide restructuring program, the 1998 effective tax rate is 31.6 percent, which is 2.4 percentage points lower than 1997. This lower 1998 rate is primarily attributable to an increase in foreign tax credits, refund of foreign taxes and mix of profits from our worldwide operations.

The 1997 effective tax rate of 34.0 percent is 2.0 percentage points lower than 1996. This lower 1997 rate is primarily attributable to an increase in foreign tax credits, refund of foreign taxes and mix of profits from our worldwide operations.

On a consolidated basis, including the effects of discontinued operations, we paid a total of $217, $241 and $252 in income taxes to federal, foreign and state income-taxing authorities in 1998, 1997 and 1996, respectively.

Total income tax expense (benefit) for the three years ended December 31, 1998 was allocated as follows:

	1998	1997	1996
Income taxes on income from continuing operations	$ 207	$ 728	$ 700
Tax benefit included in minorities' interests(*)	(20)	(19)	-
Discontinued operations	(54)	(166)	(84)
Common shareholders' equity(**)	(140)	(57)	(15)
Total	$ (7)	$ 486	$ 601

(*) Benefit relates to preferred securities as more fully described in Note 16 on page 58.

(**) For dividends paid on shares held by the ESOP; cumulative translation adjustments and tax benefit on nonqualified stock options.

Deferred income taxes have not been provided on the undistributed earnings of foreign subsidiaries and other foreign investments carried at equity. The amount of such earnings included in consolidated retained earnings at December 31, 1998 was approximately $4.7 billion. These earnings have been substantially reinvested, and we do not plan to initiate any action that would precipitate the payment of income taxes thereon. It is not practicable to estimate the amount of additional tax that might be payable on the foreign earnings.

The tax effects of temporary differences that give rise to significant portions of the deferred taxes at December 31, 1998 and 1997 follow:

	1998	1997
Tax effect of future tax deductions		
Depreciation	$ 443	$ 294
Postretirement medical benefits	419	406
Restructuring reserves	329	22
Other operating reserves	277	299
Deferred intercompany profit	76	60
Allowance for doubtful accounts	93	95
Deferred compensation	165	151
Tax credit carryforwards	104	125
Research and development	564	256
Other	116	133
Total	$ 2,586	$1,841
Tax effect of future taxable income		
Installment sales and leases	$(1,407)	$(1,282)
Leveraged leases	(23)	(21)
Deferred income	(630)	(353)
Other	(264)	(192)
Total	$(2,324)	$(1,848)

The above amounts are classified as current or long-term in the consolidated balance sheets in accordance with the asset or liability to which they relate. Current deferred tax assets at December 31, 1998 and 1997 amounted to $551 and $516, respectively.

We conclude that it is more likely than not that the deferred tax assets will be realized in the ordinary course of operations based on scheduling of deferred tax liabilities and income from operating activities.

At December 31, 1998, we have tax credit carryforwards for federal income tax purposes of $2 available to offset future federal income taxes through 2002 and $104 available to offset future federal income taxes indefinitely. We also have net operating loss carryforwards for income tax purposes of $80 which are available to offset future taxable income through 2005 and $90 available to offset future taxable income indefinitely.

15 Litigation

On March 10, 1994, a lawsuit was filed in the United States District Court for the District of Kansas by two independent service organizations (ISOs) in Kansas City and St. Louis and their parent company. Subsequently, a single corporate entity, CSU, L.L.C. ("CSU") was substituted for the three affiliated companies. CSU claimed damages predominately resulting from the Company's alleged refusal to sell parts for high volume copiers and printers to CSU prior to 1994. The Company's policies and practices with respect to the sale of parts to ISOs were at issue in an antitrust class action in Texas, which was settled by the Company during 1994. Claims for individual lost profits of ISOs who were not named parties, such as CSU, were not included in that class action. The Company asserted counterclaims against CSU alleging patent and copyright infringement relating to the copying of diagnostic software and service manuals. On April 8, 1997, the District Court granted partial summary judgment in favor of the Company on CSU's antitrust claims, ruling that the Company's unilateral refusal to sell or license its patented parts cannot give rise to antitrust liability. On January 8, 1999, the Court dismissed with prejudice all of CSU's antitrust claims. CSU has preserved for appeal only its claims that Xerox unlawfully refused to sell critical parts (including patented parts), to sell manuals and to license patented and copyrighted software and its claim that the Company's refusal to sell non-critical parts was unlawful because it was in conjunction with an allegedly unlawful refusal to sell critical parts. The District Court also granted summary judgment in favor of the Company on its patent infringement claim, leaving open with respect to patent infringement only the issues of willfulness and the amount of damages, and granted partial summary judgment in favor of the Company with respect to some of its claims of copyright infringement. A judgment in the amount of $1.0 was entered in favor of the Company and against CSU on the copyright infringement counterclaim. Pursuant to a final judgment entered by the Court on January 11, 1999 CSU was granted leave to appeal the antitrust claims and copyright counterclaims without entry of final judgment on the patent claims.

On April 11, 1996, an action was commenced by Accuscan Corp. (Accuscan), in the United States District Court for the Southern District of New York, against the Company seeking unspecified damages for infringement of a patent of Accuscan which expired in 1993. The suit, as amended, was directed to facsimile and certain other products containing scanning functions and sought damages for sales between 1990 and 1993. On April 1, 1998, the jury entered a verdict in favor of Accuscan for $40. However, on September 14, 1998, the Court granted the Company's motion for a new trial on damages. The Company is also seeking to appeal the issue of liability and believes that the liability verdict should be set aside.

On December 18, 1998, three former employees of Crum & Forster Holdings, Inc. (a former subsidiary of ours) ("C&F") filed a lawsuit in the United States District Court for the District of New Jersey claiming wrongful termination of their participation in the Xerox Corporation Employee Stock Ownership Plan ("ESOP"). Xerox, the ESOP, C&F and the company that acquired C&F are named defendants. Plaintiffs purport to bring this action on behalf of themselves and a class of approximately 10,000 persons who were employed by C&F (or one of its insurance subsidiaries which also participated in the ESOP) from July 1, 1989 through December 31, 1993. Plaintiffs assert violations of the Employee Retirement Income Security Act, breach of contract, conversion, unjust enrichment and fraudulent misrepresentation. They are seeking approximately $250 in damages.

The foregoing action is related to an action previously filed in the United States District Court for the Western District of Texas. The Texas plaintiffs did not specify their damages, but they are seeking certification of a similar class of former ESOP participants. Plaintiffs' motion for class certification and our motion to dismiss the Texas action are still pending.

We deny any wrongdoing and we intend to vigorously defend both the Texas and New Jersey actions.

16 Preferred Securities

We have 22 million authorized shares of cumulative preferred stock, $1 par value. Outstanding preferred stock at December 31, 1998 and 1997 follows (shares in thousands):

	1998		1997	
	Shares	Amount	Shares	Amount
Convertible Preferred Stock	8,785	$687	9,013	$705

Convertible Preferred Stock. As more fully described in Note 13 on page 55, we sold, for $785, 10 million shares of our Series B Convertible Preferred Stock (ESOP shares) in 1989 in connection with the establishment of our ESOP. As employees with vested ESOP shares leave the Company, these shares are redeemed by us. We have the option to settle such redemptions with either shares of common stock or cash.

Preferred Stock Purchase Rights. We have a shareholder rights plan designed to deter coercive or unfair takeover tactics and to prevent a person or persons from gaining control of us without offering a fair price to all shareholders.

Under the terms of the plan, one-half of one preferred stock purchase right (Right) accompanies each share of outstanding common stock (giving effect to the two-for-one stock split in February 1999). Each full Right entitles the holder to purchase from us one three-hundredth of a new series of preferred stock at an exercise price of $250.

Within the time limits and under the circumstances specified in the plan, the Rights entitle the holder to acquire either our common stock, the surviving company in a business combination, or the purchaser of our assets, having a value of two times the exercise price.

The Rights may be redeemed prior to becoming exercisable by action of the Board of Directors at a redemption price of $.01 per Right. The Rights expire in April 2007.

The Rights are non-voting and, until they become exercisable, have no dilutive effect on the earnings per share or book value per share of our common stock.

Deferred Preferred Stock. In October 1996, a subsidiary of ours issued 2 million deferred preferred shares for Canadian (Cdn.) $50 million. The U.S. dollar value was $37 and is included in Minorities' interests in equity of subsidiaries in

the consolidated balance sheet. These shares are mandatorily redeemable on February 28, 2006 for Cdn. $90 million. The difference between the redemption amount and the proceeds from the issue is being amortized, through the redemption date, to minorities' interests in earnings of subsidiaries in the consolidated statements of income. We have guaranteed the redemption value.

Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company. On January 29, 1997, a trust sponsored and wholly owned by the Company issued $650 aggregate liquidation amount preferred securities (the "Original Preferred Securities") to investors and 20,103 shares of common securities to the Company, the proceeds of which were invested by the trust in $670.1 aggregate principal amount of the Company's newly issued 8 percent Junior Subordinated Debentures due 2027 ("the Original Debentures"). On June 13, 1997, pursuant to a registration statement filed by the Company and the trust with the Securities and Exchange Commission, Original Preferred Securities with an aggregate liquidation preference amount of $644.2 and Original Debentures with a principal amount of $644.2 were exchanged for a like amount of preferred securities (together with the Original Preferred Securities, the "Preferred Securities") and 8 percent Junior Subordinated Debentures due 2027 (together with the Original Debentures, the "Debentures") which were registered under the Securities Act of 1933. The Debentures represent all of the assets of the trust. The proceeds from the issuance of the Original Debentures were used by the Company for general corporate purposes. The Debentures and related income statement effects are eliminated in the Company's consolidated financial statements.

The Preferred Securities accrue and pay cash distributions semi-annually at a rate of 8 percent per annum of the stated liquidation amount of $1,000 per

Preferred Security. The Company has guaranteed (the "Guarantee"), on a subordinated basis, distributions and other payments due on the Preferred Securities. The Guarantee and the Company's obligations under the Debentures and in the indenture pursuant to which the Debentures were issued and the Company's obligations under the Amended and Restated Declaration of Trust governing the trust, taken together, provide a full and unconditional guarantee of amounts due on the Preferred Securities.

The Preferred Securities are mandatorily redeemable upon the maturity of the Debentures on February 1, 2027, or earlier to the extent of any redemption by the Company of any Debentures. The redemption price in either such case will be $1,000 per share plus accrued and unpaid distributions to the date fixed for redemption.

17 Common Stock

We have 1.05 billion authorized shares of common stock, $1 par value. At December 31, 1998 and 1997, 45.3 and 41.5 million shares, respectively, were reserved for issuance under our incentive compensation plans. In addition, at December 31, 1998, 13.2 million common shares were reserved for the conversion of $628 of convertible debt and 52.7 million common shares were reserved for conversion of ESOP-related Convertible Preferred Stock.

Treasury Stock. The Board of Directors has authorized us to repurchase up to $1 billion of our common stock. The stock will be repurchased from time to time on the open market depending on market conditions. During 1998 and 1997, we repurchased 3.7 and 4.0 million shares for $172 and $116, respectively. Since inception of the program we have repurchased 20.6 million shares for $594. Common shares issued for stock option exercises, conversion of convertible securities and other exchanges were partially satisfied by reissuances of treasury shares.

Put Options. In connection with the share repurchase program, during 1998, 1997 and 1996, we sold 1.0 million, 8.0 million and 5.6 million put options, respectively, that entitle the holder to sell one share of our common stock to us at a specified price. These put options are exercisable only at maturity and can be settled in cash at our option. The put options had original maturities ranging from six months to two years.

At December 31, 1998, 1.0 million put options remain outstanding with a strike price of $47.93 per share.

Stock Option and Long-Term Incentive Plans. We have a long-term incentive plan whereby eligible employees may be granted nonqualified stock options and performance unit rights. Subject to vesting and other requirements, performance unit rights are typically paid in our common stock, beginning with the 1998 awards and are typically paid in cash for units awarded prior to 1998. The value of each performance unit was typically based upon the level of return on assets during the year in which granted. Performance units ratably vest in the three years after the year awarded.

Stock options and rights are settled with newly issued or treasury shares of our common stock. Stock options granted prior to December 31, 1995 normally vest in two years and normally expire five years from the date of grant. Stock options granted subsequent to December 31, 1995 vest in three years and generally will expire eight years from the date of grant. The exercise price of the options is equal to the market value of our common stock on the effective date of grant.

At December 31, 1998 and 1997, 6.4 and 8.5 million shares, respectively, were available for grant of options or rights. The following table provides information relating to the status of, and changes in, options granted:

Employee Stock Options	1998		1997		1996	
(Options in thousands)	Stock Options	Average Option Price	Stock Options	Average Option Price	Stock Options	Average Option Price
Outstanding at January 1	27,134	$ 26	22,206	$ 19	21,588	$ 17
Granted	8,980	47	12,201	34	7,376	22
Cancelled	(199)	37	(300)	24	(730)	19
Exercised	(5,571)	20	(6,973)	17	(5,878)	16
Surrendered for SARs	-	-	-	-	(150)	8
Outstanding at December 31	30,344	33	27,134	26	22,206	19
Exercisable at end of year	9,622		8,850		8,888	

Options outstanding and exercisable at December 31, 1998 are as follows:

Thousands except per share data	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$13.18 to $19.63	4,972	1.75	$ 17.94	4,972	$ 17.94
19.77 to 28.91	4,939	4.88	22.09	2,806	22.10
30.97 to 44.16	16,477	6.31	37.06	1,844	31.96
46.88 to 54.86	3,956	6.98	49.64	-	-
$13.18 to $54.86	30,344	5.42	$ 33.13	9,622	$ 21.84

We do not recognize compensation expense relating to employee stock options because the exercise price of the option equals the fair value of the stock on the effective date of grant. If we had determined the compensation based on the value as determined by the modified Black-Scholes option pricing model, in accordance with SFAS No. 123, the pro forma net income and earnings per share would be as follows:

	1998	1997	1996
Net income - as reported	$ 395	$1,452	$1,206
Net income - pro forma	350	1,429	1,189
Basic earnings per share - as reported	0.53	2.16	1.78
Basic earnings per share - pro forma	0.46	2.12	1.75
Diluted earnings per share - as reported	0.52	2.02	1.66
Diluted earnings per share - pro forma	0.45	1.99	1.64

The effects of applying SFAS No. 123 in this pro forma disclosure are not necessarily indicative of future amounts.

As reflected in the pro forma amounts in the table above, the fair value of each option granted in 1998, 1997 and 1996 was $13.31, $9.03 and $5.25, respectively. The fair value of each option granted was estimated on the date of grant using the following weighted average assumptions:

	1998	1997	1996
Risk-free interest rate	5.2%	6.1%	5.7%
Expected life in years	5.3	5.0	5.5
Expected volatility	24.9%	23.5%	22.0%
Expected dividend yield	1.4%	1.9%	2.6%

18 Earnings per Share

A reconciliation of the numerators and denominators of the basic and diluted EPS calculation follows:

(Shares in thousands)	1998 Income (Numerator)	1998 Shares (Denominator)	1998 Per Share Amount	1997 Income (Numerator)	1997 Shares (Denominator)	1997 Per Share Amount	1996 Income (Numerator)	1996 Shares (Denominator)	1996 Per Share Amount
Basic EPS									
Income from continuing operations	$585			$1,452			$1,206		
Accrued dividends on preferred stock	(46)			(44)			(44)		
Basic EPS	539	658,956	$0.82	1,408	653,371	$2.16	1,162	654,388	$1.78
Diluted EPS									
Stock options and other incentives		9,811			7,929			10,642	
ESOP Adjustment, net of tax				44	54,686		40	55,962	
Convertible debt, net of tax	3	5,287		3	5,287		3	5,287	
Diluted EPS	$542	674,054	$0.80	$1,455	721,273	$2.02	$1,205	726,279	$1.66

Note: Recalculation of per share amounts may be off by $0.01 in certain instances due to rounding.

Quarterly Results of Operations (Unaudited)

In millions, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
1998					
Revenues	$ 4,304	$ 4,742	$4,607	$5,796	$ 19,449
Costs and Expenses	3,859	5,841	4,067	4,919	18,686
Income (Loss) before Income Taxes, Equity Income and Minorities' Interests	445	(1,099)	540	877	763
Income Taxes	147	(385)	173	272	207
Equity in Net Income of Unconsolidated Affiliates	14	12	28	20	74
Minorities' Interests in Earnings of Subsidiaries	11	10	14	10	45
Income (Loss) from Continuing Operations	301	(712)	381	615	585
Discontinued Operations	(190)	-	-	-	(190)
Net Income (Loss)(1)	$ 111	$ (712)	$ 381	$ 615	$ 395
Basic Earnings (Loss) per Share					
Continuing Operations	$ 0.44	$ (1.10)	$ 0.56	$ 0.92	$ 0.82
Discontinued Operations	(0.29)	-	-	-	(0.29)
Basic Earnings per Share	$ 0.15	$ (1.10)	$ 0.56	$ 0.92	$ 0.53
Diluted Earnings (Loss) per Share(2)					
Continuing Operations	$ 0.42	$ (1.10)	$ 0.53	$ 0.84	$ 0.80
Discontinued Operations	(0.26)	-	-	-	(0.28)
Diluted Earnings per Share(2)	$ 0.16	$ (1.10)	$ 0.53	$ 0.84	$ 0.52
1997					
Revenues	$ 4,017	$ 4,351	$4,371	$5,405	$ 18,144
Costs and Expenses	3,589	3,854	3,921	4,639	16,003
Income before Income Taxes, Equity Income and Minorities' Interests	428	497	450	766	2,141
Income Taxes	150	175	153	250	728
Equity in Net Income of Unconsolidated Affiliates	22	46	37	22	127
Minorities' Interests in Earnings of Subsidiaries	30	31	14	13	88
Income from Continuing Operations	270	337	320	525	1,452
Discontinued Operations	-	-	-	-	-
Net Income	$ 270	$ 337	$ 320	$ 525	$ 1,452
Basic Earnings per Share					
Continuing Operations	$ 0.40	$ 0.50	$ 0.47	$ 0.79	$ 2.16
Discontinued Operations	-	-	-	-	-
Basic Earnings per Share	$ 0.40	$ 0.50	$ 0.47	$ 0.79	$ 2.16
Diluted Earnings per Share(3)					
Continuing Operations	$ 0.37	$ 0.47	$ 0.44	$ 0.73	$ 2.02
Discontinued Operations	-	-	-	-	-

Diluted Earnings per Share(3)	$ 0.37	$ 0.47	$ 0.44	$ 0.73	$ 2.02

(1) 1998 second quarter includes a restructuring charge of $1,644 ($1,107 after taxes and including our $18 share of a restructuring charge recorded by Fuji Xerox).
(2) 1998 quarterly diluted earnings per share differ from the full year amount because certain antidilutive securities are excluded from the earnings per share calculations.
(3) 1997 quarterly diluted earnings per share differ from the full year amount by $.01 due to rounding.

Reports of Management and Independent Auditors

Report of Management

Xerox Corporation management is responsible for the integrity and objectivity of the financial data presented in this annual report. The consolidated financial statements were prepared in conformity with generally accepted accounting principles and include amounts based on management's best estimates and judgments.

The Company maintains an internal control structure designed to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and that financial records are adequate and can be relied upon to produce financial statements in accordance with generally accepted accounting principles. This structure includes the hiring and training of qualified people, written accounting and control policies and procedures, clearly drawn lines of accountability and delegations of authority. In a business ethics policy that is communicated annually to all employees, the Company has established its intent to adhere to the highest standards of ethical conduct in all of its business activities.

The Company monitors its internal control structure with direct management reviews and a comprehensive program of internal audits. In addition, KPMG LLP, independent auditors, have audited the consolidated financial statements and have reviewed the internal control structure to the extent they considered necessary to support their report, which follows.

The Audit Committee of the Board of Directors, which is composed solely of outside directors, meets regularly with the independent auditors, the internal auditors and representatives of management to review audits, financial reporting and internal control matters, as well as the nature and extent of the audit effort. The Audit Committee also recommends the engagement of independent auditors, subject to shareholder approval. The independent auditors and internal auditors have free access to the Audit Committee.

/s/ Paul A. Allaire

Paul A. Allaire
Chairman of the Board and
Chief Executive Officer

/s/ Barry D. Romeril

Barry D. Romeril
Executive Vice President and
Chief Financial Officer

Report of Independent Auditors

To the Board of Directors and Shareholders of
Xerox Corporation:

We have audited the consolidated balance sheets of Xerox Corporation and consolidated subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, cash flows and shareholders' equity for each of the years in the three-year period ended December 31, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements appearing on pages 23, 33, 36 and 40-61 present fairly, in all material respects, the financial position of Xerox Corporation and consolidated subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles.

/s/ KPMG LLP

KPMG LLP
Stamford, Connecticut
January 25, 1999

NOTES

Eleven Years in Review

(Dollars in millions, except per-share data)	1998	1997	1996	1995
Per-Share Data				
Earnings (loss) from continuing operations				
Basic	$ 0.82	$ 2.16	$ 1.78	$ 1.73
Diluted	0.80	2.02	1.66	1.61
Dividends declared	0.72	0.64	0.58	0.50
Operations				
Revenues	$ 19,449	$ 18,144	$ 17,378	$ 16,588
Research and development expenses	1,043	1,065	1,044	949
Income (loss) from continuing operations	585	1,452	1,206	1,174
Net income (loss)	395	1,452	1,206	(472)
Financial Position				
Accounts and finance receivables, net	$ 16,984	$ 14,498	$ 13,394	$ 12,389
Inventories	3,269	2,792	2,676	2,656
Land, buildings and equipment, net	2,366	2,377	2,256	2,105
Investment in discontinued operations	1,670	3,025	4,398	4,810
Total assets	30,024	27,732	26,818	26,008
Consolidated capitalization				
Short-term debt	4,104	3,707	3,536	3,274
Long-term debt	11,003	8,946	8,697	8,148
Total debt	15,107	12,653	12,233	11,422
Deferred ESOP benefits	(370)	(434)	(494)	(547)
Minorities' interests in equity of subsidiaries	124	127	843	755
Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company	638	637	-	-
Preferred stock	687	705	721	763
Common shareholders' equity	4,857	4,985	4,367	3,878
Total capitalization	21,043	18,673	17,670	16,271
Selected Data and Ratios				
Common shareholders of record at year-end	52,048	54,689	55,908	54,262
Book value per common share (1)	$ 7.35	$ 7.59	$ 6.71	$ 5.92
Year-end common stock market price	$ 59.00	$ 36.94	$ 26.31	$ 22.84
Employees at year-end	92,700	91,500	86,700	85,900
Working capital	$ 3,968	$ 3,074	$ 2,948	$ 2,843
Current ratio	1.5	1.4	1.4	1.4
Additions to land, buildings and equipment	$ 566	$ 520	$ 510	$ 438
Depreciation on land, buildings and equipment	$ 362	$ 400	$ 372	$ 376

(*) Data that conform with the 1998 basis of presentation were not available.

(1) Book value per common share is computed by dividing common shareholders' equity by outstanding common shares plus common shares reserved for the conversion of the Xerox Canada Inc. Exchangeable Class B Stock.

1994	1993	1992	1991	1990	1989	1988
$ 1.14	$ (0.42)	$ 0.87	$ 0.63	$ 0.91	$ 0.74	$ 0.19
1.07	(0.42)	0.77	0.62	0.87	0.73	0.19
0.50	0.50	0.50	0.50	0.50	0.50	0.50
$ 15,084	$ 14,229	$ 14,298	$ 13,438	$ 13,210	$ 12,095	$ 11,354
895	883	922	890	848	809	794
794	(193)	562	436	599	488	148
794	(126)	(1,020)	454	243	704	388
$ 11,759	$ 10,565	$ 10,250	$ 8,952	$ 8,016	$ 7,272	$ 6,109
2,294	2,162	2,257	2,091	2,148	2,413	2,558
2,108	2,219	2,150	1,950	1,851	1,781	1,803
7,904	8,841	8,652	9,164	9,695	(*)	(*)
27,278	26,999	25,792	24,342	24,116	(*)	(*)
3,159	2,698	2,533	2,038	1,828	1,482	1,174
7,355	7,386	8,105	7,825	8,726	9,247	6,675
10,514	10,084	10,638	9,863	10,554	10,729	7,849
(596)	(641)	(681)	(720)	(756)	(785)	-
1,021	844	885	818	832	715	806
-	-	-	-	-	-	-
832	1,066	1,072	1,078	1,081	1,081	296
4,177	3,972	3,875	5,140	5,051	5,035	5,371
15,948	15,325	15,789	16,179	16,762	16,775	14,322
56,414	65,820	68,877	71,213	74,994	78,876	84,864
$ 6.48	$ 6.28	$ 6.70	$ 9.07	$ 8.96	$ 8.93	$ 8.71
$ 16.50	$ 14.69	$ 13.21	$ 11.42	$ 5.92	$ 9.54	$ 9.73
87,600	97,000	99,300	100,900	99,000	99,000	100,000
$ 2,411	$ 2,357	$ 2,578	$ 2,282	$ 2,537	(*)	(*)
1.4	1.4	1.5	1.5	1.6	(*)	(*)
$ 389	$ 470	$ 582	$ 467	$ 405	$ 390	$ 418
$ 446	$ 437	$ 418	$ 397	$ 372	$ 370	$ 369

Where to Find Us

Xerox Corporation
800 Long Ridge Road
P.O. Box 1600
Stamford, CT 06904
203 968-3000

Developing Markets Operations
800 Long Ridge Road
P.O. Box 1600
Stamford, CT 06904
203 968-3000

Industry Solutions Operations
800 Long Ridge Road
P.O. Box 1600
Stamford, CT 06904
203 968-3000

Xerox Europe
Parkway, Marlow
Buckinghamshire Sl7 1YL
England
44 1628-890000

General Markets Operations
800 Long Ridge Road
P.O. Box 1600
Stamford, CT 06904
203 968-3000

Fuji Xerox Co., Ltd.
2-17-22 Akasaka
Minato-ku, Tokyo 107
Japan
81 3 3585-3211

Products and Services
www.xerox.com or by phone:

- 800 ASK-XEROX (800 275-9376) for any product or service
- 800 TEAM-XRX (800 832-6979) for any small office or home office product
- 800 34-XEROX (800 349-3769) for networked products sold through resellers

Additional Information
The Xerox Foundation and Community Involvement Program: 203 968-3333

Xerox diversity programs and EEO-1 reports: 203 968-3144

Environmental, Health and Safety Progress Report: 800 828-6571

Questions from Students and Educators:
800 594-5015 or 716 423-4828
E-mail: Nancy_Dempsey@mc.xerox.com

Auditors
KPMG LLP
Certified Public Accountants
Stamford Square
3001 Summer Street
Stamford, CT 06905
203 356-9800

Consecutive Dividends Paid to Shareholders

On January 25, 1999, the Company's Board of Directors approved a two-for-one split of the Company's common stock. Additionally, the Board declared an 11 percent increase in the quarterly common stock dividend to $.20 per share effective April 1, 1999. Xerox has declared dividends to its shareholders for 69 consecutive years and has paid consecutive quarterly dividends since 1948.

At its February 1, 1999 meeting, the Company's Board of Directors declared the regular quarterly $1.5625 per share dividend on the Company's preferred stock. The Series B Convertible Preferred stock was issued in July 1989 in connection with the formation of a Xerox Employee Stock Ownership Plan.

Both the common and preferred stock dividends are payable April 1 to shareholders of record March 5.

Xerox Common Stock Prices and Dividends

New York Stock Exchange Composite Prices		First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1998	High	$53.38	$57.50	$58.25	$60.81
	Low	33.09	45.16	39.00	40.91
	Dividends Paid	.16	.18	.18	.18
1997	High	$31.63	$39.69	$42.56	$44.00
	Low	25.75	27.38	36.34	34.00
	Dividends Paid	.15	.16	.16	.16

During 1998, Xerox common stock reached an all-time high of $60.81 on December 29 and closed at $59.00 on December 31.

Stock Listed and Traded

Xerox common stock (XRX) is listed on the New York Stock Exchange and the Chicago Stock Exchange. It is also traded on the Boston, Cincinnati, Pacific Coast, Philadelphia, London and Switzerland exchanges.

Xerox Corporation

Our paper is Potlatch, Northwest Gloss. The text contains 50 percent recycled fibers with 20 percent post-consumer fiber content.

EXHIBIT 21

Subsidiaries of Xerox Corporation

The following companies are subsidiaries of Xerox Corporation as of February 1, 1999. The names of a number of other subsidiaries have been omitted as they would not, if considered in the aggregate as a single subsidiary, constitute a significant subsidiary:

Name of Subsidiary	Incorporated In
1247461 Ontario Inc.	Ontario
AMTX, Inc.	Delaware
Bradley Company	Ohio
Carmel Valley, Inc.	Delaware
ChannelBind Corporation	Delaware
Chrystal Software, Inc.	Delaware
Copiadores Nacionales, S.A.	Peru
Copicentro N.V.	Netherlands Antilles
Copicentros, S.A.	Venezuela
Delphax Systems, Inc.	Delaware
Docucentro S.A.	Colombia
Document Sciences Corporation	Delaware
dpiX, Inc.	Delaware
FairCopy Services Inc.	Canada
InConcert, Inc.	Delaware
Institute for Research on Learning	Delaware
Intelligent Electronics, Inc.	Pennsylvania
E-C Computer Technical Services, Inc.	Texas
Intellinet, Ltd.	Pennsylvania
R C K Computers, Inc.	Texas
RNTS, Inc.	Colorado
Xerox Connect, Inc.	Pennsylvania
InXight Software, Inc.	Delaware
Jeremiad Co.	Delaware
Leeroit S.A.	Ecuador
LiveWorks, Inc.	Delaware
Low-Complexity Manufacturing Group, Inc.	Delaware
Pacific Services and Development Corporation	Delaware
Inversiones San Simon, S.A.	Venezuela
Estacionamiento Bajada III, C.A.	Venezuela
Panama Services and Development Corporation	Panama
PixelCraft, Inc.	Delaware
Proyectos Inverdoco, C.A.	Venezuela
Securities Information Center, Inc.	Delaware
SCC Burton Corporation	Delaware
Servicios Xerograficos del Peru S.A.	Peru
79861 Ontario Inc.	Ontario
Terabank Systems, Inc.	Delaware
The Xerox Foundation	Delaware
Uppercase, Inc.	Delaware
Via Xerox Relocation Company, Inc.	New York
XDI, Inc.	Delaware
XEG Business Services, Inc.	Delaware
Xerox Antilliana N.V.	Netherlands Antilles
Xerox Antilliana (Aruba) N.V.	Aruba
Xerox Antilliana (St. Maarten) N.V.	Netherlands Antilles
Xerox Argentina, I.C.S.A.	Argentina

Name of Subsidiary	Incorporated In
Xerox Canada Capital Ltd.	Ontario
Xerox Canada Inc.	Ontario
832666 Ontario Inc.	Ontario

832667 Ontario Inc.	Ontario
973859 Ontario Inc.	Ontario
1192990 Ontario Inc.	Ontario
Xerox (Barbados) SRL	Barbados
Xerox Capital de Mexico, S.A. de C.V.	Mexico
Xerox Canada Acceptance Inc.	Canada
Xerox Canada Facilities Management Ltd.	Ontario
Xerox Canada Finance Inc.	Ontario
Xerox Canada Ltd.	Canada
DS Holdings, Inc.	Canada
Xerox Canada Manufacturing & Research Inc.	Ontario
Xerox Capital, LLC	Turks & Caicos Islands
Xerox Capital Trust I	Delaware
Xerox de Chile S.A.	Chile
Xerox China Investments (Bermuda) Limited	Bermuda
Xerox (China) Limited	China
Xerox Engineering Copy Systems Suzhou Co. Limited	China
Xerox Shanghai Limited	China
Xerox de Colombia S.A.	Colombia
Xerox ColorgrafX Systems, Inc.	California
Xerox de Costa Rica, S.A.	Costa Rica
Xerox Dominicana, C. por A.	Dominican Republic
Xerox del Ecuador, S.A.	Ecuador
Xerox de El Salvador, S.A. de C.V.	El Salvador
Xerox Financial Services, Inc.	Delaware
OakRe Life Insurance Company	Missouri
LKN-1, Inc.	Illinois
Ridge Reinsurance Limited	Bermuda
Talegen Holdings, Inc.	Delaware
VRN Inc.	Delaware
Xerox Credit Corporation	Delaware
MultiLease, Ltd.	Delaware
XCC/AFG, Inc.	Delaware
XCC Holdings, Inc.	Delaware
XCC Investment Corporation	Delaware
XFS Merchant Partner, Inc.	Delaware
Xerox Foreign Sales Corporation	Barbados
Xerox Funding Corporation	Delaware
Xerox de Guatemala, S.A.	Guatemala
Xerox d'Haiti, S.A.	Haiti
Xerox de Honduras, S.A.	Honduras
Xerox Imaging Systems, Inc.	Delaware
ScanSoft, Inc.	Delaware
Formmat Limited	United Kingdom
Xerox Imaging Systems UK Limited	United Kingdom
Xerox International Joint Marketing, Inc.	Delaware
Xerox International Partners	California
Xerox International Realty Corporation	Delaware
Xerox Canada Realty Inc.	Ontario
Xerox Investments (Nederland) BV	Netherlands
Xerox Holdings (Ireland) Limited	Ireland
Xerox (Europe) Limited	Ireland
Cantaloupe Limited	Ireland

Name of Subsidiary	Incorporated In
Oriel Star Limited	Ireland
Pirrip Limited	Ireland
Toblersong Limited	Ireland
Topspeed Limited	Ireland
Xerox XF Holdings (Ireland) Limited	Ireland
Xerox UK Holdings Limited	United Kingdom
Triton Business Finance Limited	United Kingdom
Xerox Business Equipment Limited	United Kingdom
Xerox Computer Services Limited	United Kingdom
Xerox Mailing Systems Limited	United Kingdom

Xerox Engineering Systems Europe Limited	United Kingdom
Xerox Research (UK) Limited	United Kingdom
Xerox Trading Enterprises Limited	United Kingdom
Xerox Overseas Holdings Limited	United Kingdom
Xerox Capital (Europe) plc	United Kingdom
XRO Limited	United Kingdom
Nemo (AKS) Limited	United Kingdom
XRI Limited	United Kingdom
RRXH Limited	United Kingdom
RRXO Limited	United Kingdom
RRXIL Limited	United Kingdom
Xerox Holding (Nederland) B.V.	Netherlands
Xerox Limited	Hong Kong
Xerox Manufacturing (Nederland) B.V.	Netherlands
Tefea B.V.	Netherlands
Xerox Holdings (Bermuda) Limited	Bermuda
Xerox Investments (Bermuda) Limited	Bermuda
Xerox Limited	United Kingdom
City Paper Limited	United Kingdom
Continua Limited *	United Kingdom
Fuji Xerox Co., Ltd. *	Japan
Aichi Xerox Co., Ltd. **	Japan
Aichi-Higashi Xerox Co., Ltd. **	Japan
Akita Xerox Co., Ltd. ***	Japan
Assist V Co., Ltd. **	Japan
Chiba Xerox Co., Ltd. **	Japan
Fuji Xerox Asia Pacific Pte Ltd. *	Singapore
College Hill Properties Limited *	New Zealand
Fuji Xerox Australia Pty. Limited *	Australia
Fuji Xerox Finance Limited *	Australia
Fuji Xerox Finance Limited *	New Zealand
Fuji Xerox (Myanmar) Limited *	Bermuda
Fuji Xerox New Zealand Limited *	New Zealand
Fuji Xerox (Sales) Pty. Limited *	Australia
Fuji Xerox Singapore Pte Ltd. *	Singapore
Philipine Fuji Xerox Corporation ***	Philippines
Taiwan Fuji Xerox Corporation ***	Taiwan
Taiwan Fuji Xerox System Service Corporation ***	Taiwan
Thai Fuji Xerox Co., Ltd. ***	Thailand
Fuji System Brain Co. Ltd. **	Japan
Fuji Xerox Career Net Co., Ltd. *	Japan
Fuji Xerox Distribution Co., Ltd. *	Japan
Fuji Xerox Engineering Co., Ltd. *	Japan
Fuji Xerox Far East Limited *	Hong Kong
Fuji Xerox General Business Co., Ltd. *	Japan
Fuji Xerox Information Systems Co., Ltd. *	Japan
Fuji Xerox Learning Institute Inc. *	Japan

Name of Subsidiary	Incorporated In
Fuji Xerox Office Supply Co., Ltd. *	Japan
Fuji Xerox System Service Co., Ltd. *	Japan
Fukui Xerox Co. Ltd. ***	Japan
Fukuoka Xerox Co., Ltd. **	Japan
Fukushima Xerox Co., Ltd. **	Japan
FX Global, Inc. *	Delaware
FX Palo Alto Laboratory, Inc. *	Delaware
Gifu Xerox Co., Ltd. *	Japan
Gunma Xerox Co., Ltd. **	Japan
Hiroshima Xerox Co., Ltd. **	Japan
Hokkaido Xerox Co., Ltd. **	Japan
Hokuriku Xerox Co., Ltd. **	Japan
Hyogo Xerox Co., Ltd. **	Japan
Ibaraki Xerox Co., Ltd. *	Japan
Iwate Xerox Co., Ltd. *	Japan
Japan Image Communications Co., Ltd. ***	Japan
Kagoshima Xerox Co., Ltd. **	Japan

Kanagawa Xerox Co., Ltd. **	Japan
Kita Kyushu Xerox Co., Ltd. **	Japan
K-O-A Co., Ltd. ***	Japan
Korea Xerox Company Limited **	S. Korea
Korea Xerox Information System Co., Ltd. **	S. Korea
Kumamoto Xerox Co., Ltd. **	Japan
Kyoto Xerox Co., Ltd. **	Japan
MCM Asia Pacific Co., Ltd. ***	Japan
M-I-C Co., Ltd. ***	Japan
Mie Xerox Co., Ltd. **	Japan
Miyagi Network Inc. ***	Japan
Miyagi Xerox Co., Ltd. **	Japan
Nagano Xerox Co., Ltd. **	Japan
Nagasaki Xerox Co., Ltd. **	Japan
Nara Xerox Co., Ltd. *	Japan
Niigata Xerox Co., Ltd. **	Japan
NTT Learning Systems Corp. ***	Japan
Okayama Xerox Co., Ltd. **	Japan
Oita Xerox Co. Ltd. ***	Japan
Okinawa Xerox Co. Ltd. ***	Japan
Osaka Xerox Co., Ltd. **	Japan
Protex Co. Ltd. **	Japan
Saitama Xerox Co., Ltd. **	Japan
Shikoku Xerox Co., Ltd. **	Japan
Shizuoka Xerox Co., Ltd. **	Japan
SOAR Co., Ltd. ***	Japan
Sogetsu Art Planning Co., Ltd. ***	Japan
Suzuka Fuji Xerox Co., Ltd. *	Japan
Tama Xerox Co., Ltd. **	Japan
Technol Co. Ltd. ***	Japan
Tochigi Xerox Co., Ltd. **	Japan
Tokyo Xerox Co., Ltd. **	Japan
Yamaguchi Xerox Co., Ltd. *	Japan
Wakayama Xerox Co. Ltd. ***	Japan
Xerox High-Technology Company of Shenzhen Ltd. **	China
Xoo GraphiX Co., Ltd. **	Japan
Yamagata Xerox Co., Ltd. ***	Japan
GS Xerox Electronics **	S. Korea
Mitcheldean Enterprise Workshops Limited	United Kingdom

Name of Subsidiary	Incorporated In
Modi Xerox Limited ****	India
Modi Xerox Financial Services Limited ****	India
Multilingual Technology Limited ****	United Kingdom
MX Software Services Limited	India
NV Xerox Credit S.A.	Belgium
NV Xerox Management Services S.A.	Belgium
N.V. Xerox S.A.	Belgium
The Limited Liability Company Xerox (Ukraine) Limited	Ukraine
The Xerox (UK) Trust	United Kingdom
Westbourne Limited	United Kingdom
Xerox AB	Sweden
Xerox AG	Switzerland
Xerox Office Supplies AG	Switzerland
Xerox A/S	Denmark
Xerox AS	Norway
Xerox Austria GmbH	Austria
Xerox Business Services GmbH	Austria
Xerox Leasing GmbH	Austria
Xerox Beograd d.o.o.	Yugoslavia
Xerox Bulgaria	Bulgaria
Xerox Buro Araciari Ticaret ve Servis A.S.	Turkey
Xerox Channels Limited	United Kingdom
Xerox (C.I.S.)	Russia

Xerox Credit AB	Sweden
XEROX CZECH Republic s r.o.	Czech Republic
Xerox Direct Nord GmbH	Germany
Xerox Direct Ost GmbH	Germany
Xerox Direct Rheinland GmbH	Germany
Xerox Direct Rhein-Main GmbH	Germany
Xerox Direct Sud GmbH	Germany
Xerox Direct Sud-West GmbH	Germany
Xerox Direct Westfalen GmbH	Germany
Xerox Espana-The Document Company, S.A.U.	Spain
Xerox Renting S.A.U.	Spain
Xerox Exports Limited	United Kingdom
Xerox Fabricacion S.A.U.	Spain
Xerox Finance AG	Switzerland
Xerox Finance (Nederland) BV	Netherlands
Xerox de Financiacion S.A.U., E.F.C.	Spain
Xerox GmbH	Germany
Xerox Dienstleistungsgesellschaft GmbH	Germany
Xerox Leasing Deutschland GmbH	Germany
Xerox Service GmbH	Germany
Xerox Reprographische Services GmbH	Germany
Xerox Hellas AEE	Greece
Xerox (Hong Kong) Limited	Hong Kong
Xerox Industry Development (Shanghai) Co., Ltd.	China
Xerox Hungary Trading Company Ltd.	Hungary
Xerox (Ireland) Limited	Ireland
Xerox Kenya Limited	Kenya
Xerox Leasing (Europe) Limited	United Kingdom
Xerox (Nederland) BV	Netherlands
"Veco" Beheer Onroerend Goed BV	Netherlands
Xerox Document Supplies BV	Netherlands
Xerox Rentalease BV	Netherlands
Xerox Services BV	Netherland

Name of Subsidiary	Incorporated In
Xerox (Nigeria) Limited	Nigeria
Xerox Office Supplies S.A.U.	Spain
Xerox Office Supplies GmbH	Austria
Xerox Oy	Finland
Asunto Oy Kristiinanvalli	Finland
Xerox Pensions Limited	United Kingdom
Xerox Polska Sp.zo.o	Poland
Xerox Portugal Equipamentos de Escritorio, Limitada	Portugal
CREDITEX - Aluguer de Equipamentos S.A.	Portugal
Xerox Professional Services Limited	United Kingdom
Xerox (Romania) Echipmante Si Servich S.A.	Romania
Xerox (Romania) SRL	Romania
Xerox Slovenia d.o.o.	Slovenia
Xerox South Africa (Proprietary) Limited	South Africa
University Document Management Services (Proprietary) Limited	South Africa
Xerox S.p.A.	Italy
Xerox Noleggi S.p.A.	Italy
Xerox - THE DOCUMENT COMPANY S.A.	France
Network Services SA	France
Office de Transformation Papetiere S.N.C.	France
Xerobail S.A.	France
Xerbail Gestion (SNC)	France
Xerox Business Services Sarl	France
Xerox Document Services SNC	France
Xerox Uganda Limited	Uganda
Xerox (UK) Limited	United Kingdom
Bessemer Trust Limited	United Kingdom
Inserco Manufacturing Limited	United Kingdom
Xerox Finance Limited	United Kingdom

Xerox Finance (Ireland) Limited	United Kingdom
Xerox Office Supplies Limited	United Kingdom
Xerox (R & S) Limited	United Kingdom
Xexco Trading Limited	United Kingdom
Xerox West Africa Limited	United Kingdom
Xerox (Jamaica) Limited	Jamaica
Xerox Latinamerican Holdings, Inc.	Delaware
Xerox Mexicana, S.A. de C.V.	Mexico
Xerox Middle East Investments (Bermuda) Limited	Bermuda
Bessemer Insurance Limited	Bermuda
Investissements Xerographiques Marocains S.A.	Morocco
Reprographics Egypt Limited	Egypt
Xerox Egypt S.A.E.	Egypt
Xerox Finance Leasing S.A.E.	Egypt
Xerox Equipment Limited	Bermuda
Xerox Maroc S.A.	Morocco
Xerox Products Limited	Bermuda
Xerox de Nicaragua, S.A.	Nicaragua
Xerox de Panama, S.A.	Panama
Xerox del Paraguay SRL	Paraguay
Xerox Participacoes Ltda.	Brazil
Xerox do Brasil Ltda.	Brazil
Astor Administracao de Bens e Participacoes	Brazil
Centro de Desenvolvimiento de Sistemas Vitoria S.A.	Brazil
J.D.R. Vitoria Equipamentos S.A.	Brazil

Name of Subsidiary	Incorporated In
Xerox Comercio e Industria Ltda	Brazil
Xerox del Peru, S.A.	Peru
Xerox Real Estate Services, Inc.	New York
Xerox Realty Corporation	Delaware
Xerox Realty Corp. (California)	California
XRC Realty Corp. West	California
Xerox Servicios Tecnicos, C.A.	Venezuela
Xerox Technologies Limited	Ireland
Xerox Trinidad Limited	Trinidad
Xerox Uruguay S.A.	Uruguay
Xerox Zona Libre, S.A.	Panama
XESystems, Inc.	Delaware
XE Holdings, Inc.	Delaware
Xerox Engineering Systems AG	Switzerland
Xerox Engineering Systems Espanola SA	Spain
Xerox Engineering Systems SpA	Italy
Xerox Engineering Systems N.V.	Belgium
Xerox Engineering Systems S.A.	France
Xerox Engineering Systems GmbH	Germany
Xerox Engineering Systems B.V.	Netherlands
XESystems Canada Inc.	Ontario
XESystems UK Limited	United Kingdom
Xerox Engineering Systems Limited	United Kingdom
Xtended Memory Systems	California

*   Indicates only 50% is owned, directly or indirectly, by Xerox Corporation.

**   Indicates 50% or more is owned, directly or indirectly, by Fuji Xerox Co., Ltd.

*** Indicates less than 50% is owned, directly or indirectly, by Fuji Xerox Co., Ltd.

**** Indicates less than 50% is owned by Xerox Corporation.

EXHIBIT 23

Consent of Independent Auditors

To the Board of Directors and Shareholders of Xerox Corporation

We consent to the incorporation by reference in the Registration Statements of Xerox Corporation on Form S-3 (Nos. 333-34333, 333-59355 and 333-73173) of our reports dated January 25, 1999 relating to the consolidated balance sheets of Xerox Corporation and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, cash flows, and shareholders' equity and related financial statement schedule for each of the years in the three-year period ended December 31, 1998, which reports appear in or are incorporated by reference in the 1998 Annual Report on Form 10-K of Xerox Corporation.

KPMG LLP

Stamford, Connecticut
March 22, 1999

<ARTICLE> 5
<LEGEND>
THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM XEROX CORPORATION'S DECEMBER 31, 1998 FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.
</LEGEND>
<MULTIPLIER> 1,000,000

<PERIOD-TYPE>	YEAR	
<FISCAL-YEAR-END>		DEC-31-1998
<PERIOD-END>		DEC-31-1998
<CASH>		79
<SECURITIES>		0
<RECEIVABLES>		17,527
<ALLOWANCES>		543
<INVENTORY>		3,269
<CURRENT-ASSETS>		12,475
<PP&E>		5,246
<DEPRECIATION>		2,880
<TOTAL-ASSETS>		30,024
<CURRENT-LIABILITIES>		8,507
<BONDS>		15,107
<PREFERRED-MANDATORY>		638
<PREFERRED>		687
<COMMON>		660
<OTHER-SE>		4,197
<TOTAL-LIABILITY-AND-EQUITY>		30,024
<SALES>		10,752
<TOTAL-REVENUES>		19,449
<CGS>		5,724
<TOTAL-COSTS>		10,547
<OTHER-EXPENSES>		8,139
<LOSS-PROVISION>		301
<INTEREST-EXPENSE>		748
<INCOME-PRETAX>		763
<INCOME-TAX>		207
<INCOME-CONTINUING>		585
<DISCONTINUED>		(190)
<EXTRAORDINARY>		0
<CHANGES>		0
<NET-INCOME>		395
<EPS-PRIMARY>		0.53
<EPS-DILUTED>		0.52