FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: September 30, 1998

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to___________

Commission File Number 1-4471

XEROX CORPORATION
(Exact Name of Registrant as specified in its charter)

New York	16-0468020
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

P.O. Box 1600
Stamford, Connecticut 06904-1600
(Address of principal executive offices)
(Zip Code)

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at October 31, 1998
Common Stock	327,918,850 shares

This document consists of 33 pages.

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-Q 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 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' purchase 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 and materials cost inflation 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 adversely 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 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 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.

Xerox Corporation
Form 10-Q
September 30, 1998

Table of Contents

For additional information about The Document Company Xerox, please visit our World-Wide Web site at www.xerox.com/investor

PART I - FINANCIAL INFORMATION

Item 1

Xerox Corporation
Consolidated Statements of Income (Unaudited)

(In millions, except per-share data)	Three months ended September 30, 1998	1997	Nine months ended September 30, 1998	1997
Revenues				
Sales	$ 2,448	$ 2,343	$ 7,243	$ 6,602
Service and rentals	1,894	1,784	5,611	5,387
Finance income	265	243	799	749
Total Revenues	4,607	4,370	13,653	12,738
Costs and Expenses				
Cost of sales	1,296	1,271	3,963	3,620
Cost of service and rentals	1,034	939	3,037	2,758
Inventory charges	-	-	113	-
Equipment financing interest	147	128	426	386
Research and development expenses	271	270	770	806
Selling, administrative and general expenses	1,278	1,287	3,770	3,744
Restructuring and asset impairments	-	-	1,531	-
Other, net	41	25	157	49
Total Costs and Expenses	4,067	3,920	13,767	11,363

Income (Loss) before Income Taxes (Benefits), Equity Income and Minorities' Interests	540	450	(114)	1,375
Income taxes (benefits)	173	153	(66)	478
Equity in net income of unconsolidated affiliates	(28)	(37)	(54)	(105)
Minorities' interests in earnings of subsidiaries	14	14	35	75
Income (Loss) from Continuing Operations	381	320	(29)	927
Discontinued Operations	-	-	(190)	-
Net Income (Loss)	$ 381	$ 320	$ (219)	$ 927
Basic Earnings (Loss) per Share				
Continuing Operations	$ 1.12	$ 0.94	$ (0.19)	$ 2.74
Discontinued Operations	-	-	(0.58)	-
Basic Earnings per Share	$ 1.12	$ 0.94	$ (0.77)	$ 2.74
Diluted Earnings (Loss) per Share				
Continuing Operations	$ 1.05	$ 0.89	$ (0.19)	$ 2.58
Discontinued Operations	-	-	(0.58)	-
Diluted Earnings per Share	$ 1.05	$ 0.89	$ (0.77)	$ 2.58

See accompanying notes.

Xerox Corporation
Consolidated Balance Sheets

(In millions, except share data in thousands)	September 30, 1998	December 31, 1997
Assets	(Unaudited)	
Cash	$ 106	$ 75
Accounts receivable, net	2,553	2,145
Finance receivables, net	4,926	4,599
Inventories	3,506	2,792
Deferred taxes and other current assets	1,130	1,155
Total Current Assets	12,221	10,766
Finance receivables due after one year, net	8,365	7,754
Land, buildings and equipment, net	2,274	2,377
Investments in affiliates, at equity	1,265	1,332
Goodwill, net	1,782	1,375
Other assets	1,822	1,103
Investment in discontinued operations	1,936	3,025
Total Assets	$ 29,665	$ 27,732
Liabilities and Equity		
Short-term debt and current portion of long-term debt	$ 4,102	$ 3,707
Accounts payable	662	776
Accrued compensation and benefit costs	728	811
Unearned income	217	205
Other current liabilities	3,212	2,193
Total Current Liabilities	8,921	7,692
Long-term debt	10,882	8,779
Postretirement medical benefits	1,090	1,079
Deferred taxes and other liabilities	2,363	2,469
Discontinued operations liabilities - policyholders' deposits and other	1,157	1,693
Deferred ESOP benefits	(434)	(434)
Minorities' interests in equity of subsidiaries	126	127
Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company	638	637
Preferred stock	692	705
Common shareholders' equity	4,230	4,985

Total Liabilities and Equity	$ 29,665	$ 27,732
Shares of common stock issued	328,598	326,241
Shares of common stock outstanding	327,724	326,241

See accompanying notes.

Xerox Corporation
Consolidated Statements of Cash Flows (Unaudited)

Nine months ended September 30, (In millions)	1998	1997
Cash Flows from Operating Activities		
Income (Loss) from Continuing Operations	$ (29)	$ 927
Adjustments required to reconcile income to cash flows from operating activities:		
Depreciation and amortization	589	517
Provisions for doubtful accounts	173	176
Restructuring and other charges	1,644	-
Provision for postretirement medical benefits, net of payments	26	30
Charges against 1998 restructuring reserve	(197)	-
Minorities' interests in earnings of subsidiaries	35	75
Undistributed equity in income of affiliated companies	(49)	(101)
Increase in inventories	(1,173)	(723)
Increase in finance receivables	(892)	(513)
Increase in accounts receivable	(390)	(166)
Decrease in accounts payable and accrued compensation and benefit costs	(256)	(126)
Net change in current and deferred income taxes	(551)	108
Other, net	(468)	(183)
Total	(1,538)	21
Cash Flows from Investing Activities		
Cost of additions to land, buildings and equipment	(337)	(311)
Proceeds from sales of land, buildings and equipment	67	25
Purchase of additional interest in Rank Xerox	-	(812)
Acquisition of XLConnect, net of cash acquired	(380)	-
Other, net	6	-
Total	(644)	(1,098)
Cash Flows from Financing Activities		
Net change in debt	2,499	249
Dividends on common and preferred stock	(398)	(356)
Proceeds from sale of common stock	99	130
Repurchase of common and preferred stock	(147)	(116)
Dividends to minority shareholders	(4)	(5)
Net proceeds from issuance of mandatorily redeemable preferred securities	-	637
Total	2,049	539
Effect of Exchange Rate Changes on Cash	6	(7)
Cash (Used) by Continuing Operations	(127)	(545)
Cash Provided by Discontinued Operations	158	503
Increase (Decrease) in Cash	31	(42)
Cash at Beginning of Period	75	104
Cash at End of Period	$ 106	$ 62

See accompanying notes.

1. The unaudited consolidated interim financial statements presented herein have been prepared by Xerox Corporation ("the Company") in accordance with the accounting policies described in its 1997 Annual Report to Shareholders and should be read in conjunction with the notes thereto.

Effective 1998, Fuji Xerox changed its reporting period from a fiscal year ending December 20 to a fiscal year ending December 31. Our share of their results of operations during the period between the end of the 1997 fiscal year and the beginning of the new fiscal year (the stub period) amounted to a loss of $6 million. The loss was debited to retained earnings.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary for a fair statement of operating results for the interim periods presented have been made.

References herein to "we" or "our" refer to Xerox and consolidated subsidiaries unless the context specifically requires otherwise.

2. Inventories consist of (in millions):

	September 30, 1998	December 31, 1997
Finished products	$ 2,051	$ 1,549
Work in process	162	97
Raw materials and supplies	570	406
Equipment on operating leases, net	723	740
Total	$ 3,506	$ 2,792

3. 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 share, $18 million, of a restructuring charge recorded by Fuji Xerox). The program will include the elimination of approximately 9,000 jobs worldwide, the closing and consolidation of facilities, and the write-down of certain assets to net realizable value. The charges associated with this action include $113 million of inventory charges recorded as cost of revenues. Key initiatives of the restructuring will include:

1) Consolidating 56 European customer support centers into one facility and implementing a shared services organization which will generate 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 will occur primarily in administrative functions, but will also impact service, research and manufacturing.

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

	Total Reserve	Charges Against Reserve	September 30, 1998 Balance
Severance and related costs	$1,017	$185	$ 832
Asset impairment	316	316	-
Lease cancellation and other costs	198	15	183
Inventory charges	113	113	-
Total	$1,644	$629	$1,015

As of September 30, 1998, approximately 3,200 employees have left the Company under the restructuring program.

4. In May 1998, we acquired XLConnect Solutions, Inc. ("XLConnect"), an information technology services company, and its parent Company, Intelligent Electronics, Inc. ("Intelligent Electronics") for $413 million in cash. The operating results of these companies, which are immaterial, have been included in our consolidated statement of income from the date of acquisition. Based on the allocation of the purchase price, this transaction resulted in goodwill of $395 million (including transaction costs), which is being amortized over 25 years.

5. Common shareholders' equity consists of (in millions):

	September 30, 1998	December 31, 1997
Common stock	$ 330	$ 327
Additional paid-in-capital	1,433	1,303
Retained earnings	3,404	4,060
Net unrealized gain (loss) on investment securities	(1)	(1)
Translation adjustments	(857)	(704)

Treasury stock	(79)	-
Total	$ 4,230	$ 4,985

Effective January 1, 1998, we adopted Statement of Financial Accounting Standards 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 is as follows (in millions):

	Three months ended September 30,		Nine months ended September 30,	
	1998	1997	1998	1997
Net income (loss)	$ 381	$ 320	$ (219)	$ 927
Fuji Xerox stub period income(loss)	-	-	(6)	8
Translation adjustments	77	(82)	(153)	(265)
Unrealized appreciation of equity investments	-	-	-	6
Comprehensive income (loss)	$ 458	$ 238	$ (378)	$ 676

6. In April 1998, we issued convertible subordinated debentures for net proceeds of $575 million. The proceeds were used to reduce commercial paper. The amount due upon maturity in April 2018 is $1,012 million, resulting in an effective interest rate of 3.625% per annum, including 1.003% payable in cash semiannually beginning in October 1998. These debentures are convertible at any time at the option of the holder into 3.904 shares of our stock per $1,000 principal amount at maturity of debentures.

7. Interest expense totaled $553 million and $450 million for the nine months ended September 30, 1998 and 1997, respectively.

8. On August 13, 1998, we closed on the previously announced sale of Crum & Forster Holdings, Inc. (CFI) to Fairfax Financial Holdings Limited of Toronto for $680 million, including the repayment of $115 million in debt. We incurred approximately $75 million in transaction-related costs.

With the completion of the CFI transaction, we have effectively completed our exit from insurance and financial services. An additional write-down of $190 million after-tax was recorded in the first quarter of 1998.

9. Litigation

Continuing Operations

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 claims 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 has 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 judgement 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. The Court's ruling did not preclude a finding of antitrust liability based upon other allegations of exclusionary conduct, including the refusal to sell unpatented parts. The District Court also granted summary judgement 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 judgement in favor of the Company with respect to some of its claims of copyright infringement. On July 17, 1997 and December 22, 1997 the Court denied CSU's motions for reconsideration. On June 16-17, 1998 a trial was held to establish copyright infringement damages to be awarded to Xerox for the unlawful copying of the Company's diagnostic software. A settlement was reached with regard to the Company's infringement claims relating to service manuals. The Court has calculated damages due to the Company in the amount of $1,039,282 for its diagnostic software copyright infringement claims. The Company intends to move for summary judgement on plaintiff's antitrust claims. In response to that motion Plaintiff has indicated it will concede, in light of the Court's prior rulings, that there are no issues of fact barring entry of summary judgement on its antitrust claims in favor of the Company but that it will argue for reversal on appeal.

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 $40,000,000. On October 1, 1998, the court entered an order which gives plaintiff the option of reducing the amount of damages to $8,000,000 or, in the alternative, request a new trial on the issue of damages. Separately, the Company has filed a notice of appeal to the Court of Appeals for the Federal Circuit with respect to the issue of whether the Company should be liable for any damages. The Company believes that the liability verdict should be set aside.

Item 2 Xerox Corporation

Management's Discussion and Analysis of Results of Operations and Financial Condition

Document Processing

Summary

Income from continuing operations increased 19 percent to $381 million in the 1998 third quarter from $320 million in the 1997 third quarter, primarily as a result of outstanding growth in digital product revenues and improved operating profit margins, including the initial benefits from the worldwide restructuring program.

Third quarter 1998 revenues of $4.6 billion were affected by weaker global economic conditions, growing 6 percent on a pre-currency basis. Weakness in Brazil and Russia alone reduced pre-currency revenue growth by 2 percentage points in the quarter.

Diluted earnings per share from continuing operations increased 18 percent to $1.05 in the third quarter.

For the first nine months of the year, excluding the restructuring charge, diluted earnings per share from continuing operations increased 16 percent to $2.98 and income from continuing operations increased 16 percent to $1,078 million. Including the restructuring charge and the loss from discontinued operations, Xerox reported a net loss of $219 million for the first nine months of 1998, or a net loss of $0.77 per share.

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 2 percent weaker in the 1998 third quarter than in the 1997 third quarter. However, the 9 percent strengthening of the U.S. dollar compared with the Canadian dollar essentially offset this impact.

Revenues denominated in currencies where the local currency is the functional currency are not hedged for purposes of translation into U.S. dollars.

Revenues

For the major product categories, the pre-currency revenue growth rates are as follows:

	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1997 FY	1998 Q1	1998 Q2	1998 Q3
Total Revenues	5%	6%	9%	10%	7%	10%	10%	6%
Digital Products	18	24	26	31	25	35	41	38
Light Lens Copiers	(2)	(3)	1	(2)	(2)	(4)	(8)	(15)

Digital product revenues grew 38 percent in the 1998 third quarter, reaching 47 percent of total revenues and again exceeding light lens revenues. In the 1997 third quarter, digital revenues represented 35 percent of total revenues. The outstanding growth of our expanding Document Centre black and white digital copier family revenues represented 25 percentage points of the year-over-year digital revenue growth. Production printing grew 11 percent in the 1998 third quarter and production publishing grew 12 percent following a strong 1997 third quarter. Color copying and printing growth slowed to 8 percent in the 1998 third quarter, with excellent growth in DocuColor 40 revenues but flat revenues in color copying due to increased competitive activity and pricing pressure. For the first nine months of 1998, digital product revenues grew 38 percent with over half the growth driven by the Document Centre digital copier family. Color copying and printing grew 24 percent, production publishing grew 17 percent and production printing grew 6 percent.

Black-and-white light lens copier revenues declined 15 percent in the 1998 third quarter as a result of some weakness in worldwide economic conditions and continued pricing pressures, as well as customer transition to the company's digital copiers. These revenues were 40 percent of total revenues in the 1998 third quarter compared with 50 percent of total revenues in the 1997 third quarter. Black-and-white light lens copier revenue declined 9 percent for the first nine months of 1998.

Geographically, the pre-currency revenue growth rates are as follows:

	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1997 FY	1998 Q1	1998 Q2	1998 Q3
Total Revenues	5%	6%	9%	10%	7%	10%	10%	6%
United States	6	3	7	11	7	7	13	10
Xerox Limited	3	6	11	10	7	13	10	5
Other Areas	3	11	11	7	8	11	6	(4)
Memo: Fuji Xerox	10	3	3	(2)	3	2	(4)	(6)

Third quarter and year to date U.S. revenue growth was driven by excellent digital equipment sales and document outsourcing.

Xerox Limited and related companies manufacture and market Xerox products principally in Europe. Xerox Limited revenue growth in the 1998 third quarter and the first nine months of 1998 was driven by excellent digital equipment sales and document outsourcing growth, and strong growth in supplies. The U.K. and Italy had strong revenue growth in the third quarter, Spain had good growth, France and Holland had essentially flat revenues, while revenue in Germany declined. In the first nine months of 1998, Holland, Italy and Spain had strong revenue growth, the UK had good growth, France had modest growth while revenue in Germany was essentially flat.

Other Areas include operations principally in Latin America, Canada, China and Russia. Revenue in Brazil declined by 10 percent in the 1998 third quarter as customers deferred purchases due to the weak economic environment, although there was modest growth in digital product revenues. Although our operations in Russia are relatively small, with full year 1997 revenues of less than $100 million, there was a very significant revenue decline in the 1998 third quarter. Canada and a number of the smaller Latin American affiliates, including Argentina and Colombia, had good revenue growth in the third quarter. Revenue in Other Areas grew 4 percent during the first nine months of 1998. Revenue growth in Canada and Mexico was strong while revenue in Brazil declined modestly.

Fuji Xerox Co., Ltd., an unconsolidated entity, jointly owned by Xerox Limited and Fuji Photo Film Company Limited, develops, manufactures and distributes document processing products in Japan, Australia, New Zealand, and other areas of the Pacific Rim. Fuji Xerox revenue declined by 6 percent in the 1998 third quarter reflecting a mid-single-digit decline in Japan and a double-digit decline in Fuji Xerox' other Asia Pacific territories. For the first nine months, revenue declined by 3 percent due to a modest decline in Japan and a double-digit-decline in Fuji Xerox' other Asia Pacific territories.

The pre-currency growth rates by type of revenue are as follows:

	1997					1998		
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3
Total Revenues	5%	6%	9%	10%	7%	10%	10%	6%
Sales	5	6	12	13	10	15	14	5
Equipment	11	12	17	16	14	17	19	7
Supplies	1	2	2	5	2	8	10	4
Paper	(9)	(1)	8	9	2	15	4	-
Service/Rentals/ Outsourcing/Other	4	5	6	6	5	4	6	6
Service	(2)	1	2	1	1	3	1	1
Rentals	(11)	(8)	(10)	(7)	(9)	(9)	(14)	(10)
Document Outsourcing *	41	36	31	33	35	24	25	26
Finance Income	2	5	-	3	2	8	7	9
Memo:								
Revenues Excluding Equipment Sales	2	3	5	5	4	6	6	5
Equipment (Excluding OEM)	10	11	21	16	15	17	19	5

*Excludes equipment in outsourcing contracts that are accounted for as sales.

Equipment sales in the 1998 third quarter grew 7 percent as revenues declined in Brazil and Russia due to their weak economies and we experienced some softness in several European countries. Excluding Brazil and Russia, equipment sales grew 12 percent. Approximately 55 percent of 1998 third quarter equipment sales was due to products introduced since 1997, including the company's expanding line of black-and-white digital copiers, the DocuTech 6180, the DocuColor Office 6, and the N series of network printers sold through indirect channels. Equipment sales in the first nine months of 1998 grew 14 percent primarily due to excellent growth in digital products.

Supplies sales growth slowed in the 1998 third quarter primarily due to paring back of inventory by our indirect sales channels customers. For the first nine months of 1998, supply sales increased 7 percent primarily due to growth in indirect channels and competitive supplies.

Paper sales: Our strategy is to charge a spread over mill wholesale prices to cover our costs and value added as a distributor. Flat revenue in the 1998 third quarter reflects slight volume increases due to expanding distribution channels, offset by moderating industry prices due to excess worldwide inventory. Good revenue growth in the first nine months of 1998 is primarily due to volume increases due to expanding distribution channels partially offset by moderating industry prices.

Combined service, rental, document outsourcing and other revenues grew 6 percent in the 1998 third quarter and 5 percent in the first nine months of 1998. Service revenues grew 1 percent as the impact of higher machine populations resulting from higher equipment sales was partially offset by customer preference for document outsourcing and competitive price pressures. Rental revenues continued to decline, due primarily to customers' preference for purchase or document outsourcing rather than rental.

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 as Equipment Sales on the income statement. All other document outsourcing revenue, including service, equipment rental, supplies, paper, and labor, are included in Service/Rentals/Outsourcing/Other on the income statement. This has the effect of diverting some revenues from supplies, paper, service and rental. The continuing excellent Document Outsourcing growth reflects the trend of customers to focus on their core businesses and outsource their document processing requirements to Xerox. The growth rate for total document outsourcing revenue is substantially higher than the growth included in Service/Rentals/Outsourcing/Other, reflecting an increase in the proportion of equipment in outsourcing contracts accounted for as 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. Good growth in finance income in the 1998 third quarter and the first nine months of 1998 is the result of strong growth in the financing of equipment sales in Latin America, good growth in the U.S., and modest growth in Europe.

Key Ratios and Expenses

The trend in key ratios was as follows:

	1997					1998		
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3
Gross Margin	46.4%	47.8%	46.5%	47.0%	46.9%	45.0%	45.6%	46.2%
SAG % Revenue	29.2	29.5	29.5	27.1	28.7	27.9	27.3	27.7

The gross margin declined by 0.3 percentage points in the 1998 third quarter from the 1997 third quarter, significantly less than the gross margin decline in the first half of the year. The modest third quarter gross margin decline was due to the increasing proportion of lower margin indirect channels and Document Outsourcing business, continued competitive price pressures, and unfavorable product mix, partially offset by manufacturing and service productivity. The 45.6 percent gross margin for the first nine months of 1998 was 1.3 percentage points lower than the first nine months of 1997 primarily due to the factors mentioned above and weaker results in Brazil. The gross margin for the first nine months of 1998, including the restructuring charge was 44.8 percent.

Selling, administrative and general expenses (SAG) declined 1 percent in the 1998 third quarter from the 1997 third quarter due to significant declines in general and administrative expenses partially offset by increased sales coverage and advertising investments. SAG was 27.7 percent of revenue in the 1998 third quarter and 27.6 percent of revenue for the first nine months of 1998, 1.8 percentage points better than the 1997 third quarter and the first nine months of 1997 due to continuing productivity initiatives and expense controls, including the initial benefits from our worldwide restructuring program, as well as the increasing proportion of our business conducted through indirect channels and Document Outsourcing.

Research and development (R&D) expense in the 1998 third quarter was essentially flat with the 1997 third quarter. We continue to invest in technological development to maintain our premier position in the rapidly changing document processing market with an added focus on increasing the effectiveness of that investment and time to market. We expect R&D spending will be relatively flat for the full year. Xerox R&D is strategically coordinated with that of Fuji Xerox which invested $612 million in R&D in the 1997 full year, for a combined total of $1.7 billion.

Worldwide employment declined by 500 in the 1998 third quarter to 92,900 as a result of 1,700 employees leaving the company under the worldwide restructuring program partially offset by the net hiring of 1,200 employees, primarily for the company's fast-growing document outsourcing business and the acquisition of an Eastern European dealer.

The increase in other expenses, net, from the 1997 third quarter and the first nine months of 1997 was due primarily to increased non-financing interest expense and the planned increase in year 2000 remediation expenses.

Income Taxes (Benefits), Equity in Net Income of Unconsolidated

Affiliates and Minorities' Interests in the Earnings of Subsidiaries

Income before income taxes increased 20 percent to $540 million in the 1998 third quarter from $450 million in the 1997 third quarter.

We estimate that the impact of currency on third quarter earnings was about neutral which follows an adverse impact of approximately $0.20 per share in the first half. If mid-October spot rates continue, we would expect currency to benefit our 1998 fourth quarter results by somewhat less than $0.05 per share compared to a year ago. Under this scenario, currency will adversely affect our earnings by about $0.15 to $0.20 per share for the full year, after an adverse impact of $0.35 per share in 1997. Assuming mid-October spot rates hold through 1999, currency could benefit our earnings by about $0.20 per share year-over-year representing the first positive impact in the past several years.

The effective tax rate was 32 percent in the 1998 third quarter, which is consistent with the first half and the full year expectation. The 2.2 percentage point decline from the 1997 third quarter is due to the worldwide mix of profits as well as a tax refund in 1998.

Equity in the net income of unconsolidated affiliates is principally the Xerox Limited share of Fuji Xerox income. Total equity in net income decreased in the 1998 third quarter due to lower Fuji Xerox income reflecting difficult economic conditions in Japan and their Asia Pacific operations and adverse currency translation. We expect the difficult economic conditions in Japan and the Pacific Rim to continue to adversely affect Fuji Xerox' operations and that their earnings, before currency translation, will be lower than 1997 for the balance of the year.

Minorities' Interests were unchanged and primarily reflect the dividends on $650 million of mandatorily redeemable preferred stock issued through a trust in January 1997 to reduce debt.

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 share of the Fuji Xerox restructuring charge). The program will include the elimination of approximately 9,000 jobs worldwide, the closing and consolidation of facilities, and the write-down of certain assets. The pre-tax charges associated with this action include $113 million of inventory charges recorded as cost of revenues. Key initiatives of the restructuring will include:

1) Consolidating 56 European customer support centers into one facility and implementing a shared services organization which will generate 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 will occur primarily in administrative functions, but will also impact service, research and manufacturing.

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

	Original Reserve	Charges Against Reserve	September30, 1998 Balance
Severance and related costs	$1,017	$185	$ 832
Asset impairment	316	316	-
Lease cancellation and other costs	198	15	183
Inventory charges	113	113	-
Total	$1,644	$629	$ 1,015

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 will be reinvested to implement 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.

As of September 30, 1998, approximately 3,200 employees had left the company under the restructuring program. The restructuring reserve balance at September 30, 1998 relates to cash expenditures to be incurred primarily during the remainder of 1998 and in 1999.

In April 1998, we announced that we were reactivating our $1 billion stock repurchase program, which was suspended last year when we acquired the remaining financial interest in Rank Xerox, now Xerox Limited. During the third quarter, the company repurchased 1.1 million shares at a cost of $100 million for an average price of $88 per share. Since the program inception, share repurchases total 10.1 million shares for $568 million.

In May 1998, the company completed the $413 million acquisition of XLConnect Solutions, Inc., an information technology services company, and its parent company, Intelligent Electronics, Inc. The results of operations for these companies have been included in our results of operations since the date of acquisition.

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 over the next year in order to render these systems Year 2000 compliant.

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 is as follows:

Applications - 60 percent of the mission critical applications are Y2K compliant, with an additional 23 percent in the process of compliance testing. The remaining balance is in the process of remediation design. We estimate that 90-95 percent of our applications will be compliant by December 31, 1998 with the balance achieving compliance by early 1999.

Compute - 76 percent of our mainframe/smaller computer environments have been upgraded to be Y2K compliant with the remainder scheduled to be upgraded by December 31, 1998.

Infrastructure - 32 percent of networks, servers, and workstations have been upgraded to be Y2K compliant with the remainder to be upgraded by mid-1999.

Telecommunications - 23 percent of internal mission critical components are Y2K compliant, 51 percent are in the implementation stage while the remaining 26 percent are in the programming stage. We anticipate achieving compliance in this area by mid-1999.

Our Y2K project requires a majority of application systems be remediated by December 31, 1998, or one year earlier than the recognized failure date of 2000. For the 90-95 percent of our applications that will be compliant by December 31, 1998, no contingency plan is necessary. In those instances where completion by the end of 1998 is not assured, appropriate and unique contingency plans are in place, in development, or yet to be determined.

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 1, 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. However, the response rate to this survey was poor. Due to the poor response rate and the low-level of confidence gained from responses to surveys, we decided to focus our efforts along two fronts. First, we have initiated efforts to evaluate the status of sole source/key proprietary suppliers of long lead components as well as non-production suppliers and to determine alternatives and contingency plan requirements. Secondly, it is our intent to acquire additional inventory by December 31, 1999 to ensure continuity of service to our customers should our vendors experience Y2K problems. A process is underway to determine the right product mix of this additional inventory. These procedures are intended to provide a means of managing risk; however, no assurance can be given that they will eliminate the potential disruption caused by third party failure.

Regarding Product Compliance, we have determined that approximately 77% of our product offerings are currently Y2K compliant. An additional 11% are not being assessed for compliance as the product has reached its end of life. The remaining 12% of our products will be made compliant by June 30, 1999.

In Facilities Management, we are currently performing an inventory and assessment of all third party components (Xerox products are being remediated as part of the Information Technology and Product Compliance sections). We expect that the remediation effort will continue through March 31, 1999.

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 the effects.

Xerox had begun, in 1993, 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, will be $85 million during 1998, of which $58 million has been expended as of September 30, 1998, and $50 million in 1999. The increase from prior estimates is primarily due to costs being incurred in the product compliance area.

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 or replacements are not completed in a timely manner, 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 Euro. On January 1, 1999, eleven of the fifteen member countries of the European Union are scheduled to establish fixed conversion rates between their existing currencies and one common currency - the euro. The euro will then trade on currency exchanges and may be used in business transactions. Xerox Limited has processes in place 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.

Discontinued Operations

The net investment in the discontinued financial services businesses which includes Insurance, Other Financial Services and Third Party Financing and Real Estate totaled $779 million at September 30, 1998 compared with $1,332 million at December 31, 1997. The decrease primarily reflects the sale of Westchester Specialty Group, Inc. (WSG) and Crum & Forster Holdings, Inc. (CFI) and a reserve increase recorded in the first quarter, somewhat offset by scheduled funding of reinsurance coverage to the present and former Talegen Holdings, Inc. (Talegen) companies and The Resolution Group, Inc. (TRG) by Ridge Reinsurance Limited (Ridge Re) and interest for the period on the assigned debt. A discussion of the discontinued businesses follows.

Insurance

In 1995, we recorded a $1,546 million after-tax charge in connection with agreements to sell all of our "Remaining" insurance companies, which included Coregis Group, Inc. (Coregis), CFI, Industrial Indemnity Holdings, Inc. (II), WSG, TRG and three insurance-related service companies.

On September 11, 1996, those transactions were terminated. No additional charges were considered necessary as a result of the termination. In September 1996, the Board of Directors of Xerox formally approved a plan of disposal under which we retained investment bankers to assist us in the simultaneous disposition of each of the Remaining insurance and service companies.

Significant progress was made during 1997 and 1998 in the disposition of the remaining companies. Specifically:

- In the first quarter of 1997, we sold certain assets of Apprise Corp., one of Talegen's insurance related service companies. The financial terms of this transaction were not material.

- In the second quarter of 1997, we completed the sale of Coregis for $375 million in cash and the assumption of $75 million in debt.

- In the third quarter of 1997, we completed the sale of II for $365 million in cash and the assumption of $79 million in debt.

- In the fourth quarter of 1997, we completed the sale of TRG for $150 million in cash and a $462 million performance-based instrument to an investor group. Ultimate recovery of the value of this instrument will be dependent on TRG's future cash flows available for dividends.

- In the first quarter of 1998, we completed the sale of WSG for $338 million in cash, less approximately $70 million in transaction-related costs.

- In the third quarter of 1998, we completed the sale of CFI for $680 million, including the repayment of $115 million in debt. In connection with the sale, we incurred approximately $75 million in transaction-related costs.

With the completion of the CFI transaction, we have effectively completed our disengagement strategy from insurance and financial services. In the first quarter of 1998 an additional write-down of $190 million after-tax was recorded.

Xerox Financial Services, Inc. (XFSI) continues to provide aggregate excess of loss reinsurance coverage to certain of the former Talegen and TRG units through Ridge Re, a wholly owned subsidiary. As of October 1998, XFSI is obligated to pay four remaining annual premium installments of $43 million, plus finance charges for coverage totaling $982 million (which is net of 15 percent coinsurance). At September 30, 1998, Ridge Re had recognized the discounted value of approximately $661 million of the available coverage.

The net investment in Insurance at September 30, 1998 totaled $533 million compared with a balance of $1,076 million at December 31, 1997. The decrease primarily reflects the sale 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 September 30, 1998 was $130 million compared with $125 million at December 31, 1997.

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. Other policies (of Immediate, Whole Life, and Variable annuities as well as a minor amount of SPDAs) were sold and are now the responsibility of the purchaser's companies.

As a result of the Coinsurance Agreements, at September 30, 1998, OakRe retained approximately $1.0 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 September 30, 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.

Third Party Financing and Real Estate

Third Party Financing and Real Estate assets at September 30, 1998 totaled $265 million compared with a balance of $298 million at December 31, 1997. The $33 million reduction from the December 31, 1997 level primarily relates to scheduled run-off in third party financing and sales of certain real estate and other investments. Debt associated with these assets totaled $149 million at September 30, 1998 and $167 million at December 31, 1997.

Capital Resources and Liquidity

Total debt, including ESOP and discontinued operations debt not shown separately in our consolidated balance sheets, was $15,134 million at September 30, 1998 or $2,231 million more than at December 31, 1997. The changes in consolidated indebtedness since year-end and versus the first nine months of 1997 are summarized as follows (in millions):

	1998	1997

	1998	1997
Total Debt as of January 1	$12,903	$12,448
Non-Financing Businesses:		
Document Processing operations	1,115	173
Discontinued Businesses	(388)	(506)
Total Non-Financing	727	(333)
Financing Businesses	647	(106)
Total Operations	1,374	(439)
Shareholder dividends	398	356
Purchase of The Rank Group's interests in Rank Xerox (now Xerox Limited)	-	1,534
Purchase of XLConnect , net of cash acquired	380	-
Mandatorily redeemable preferred stock	(1)	(637)
Equity redemption and other changes	80	(56)
Total Debt as of September 30	$15,134	$13,206

For analytical purposes, total equity includes common equity; ESOP preferred stock; mandatorily redeemable preferred securities; and minorities' interests. The following table summarizes the changes in total equity during the first nine months of 1998 and 1997 (in millions):

	1998	1997
Total equity as of January 1	$6,454	$5,931
Income (loss)from continuing operations	(29)	927
Loss from discontinued operations	(190)	-
Shareholder dividends paid	(398)	(356)
Exercise of stock options	99	130
Repurchase of common and preferred stock	(147)	(116)
Purchase of minority interest	-	(723)
Mandatorily redeemable preferred securities	1	637
Translation adjustment	(153)	(265)
All other, net	49	63
Balance as of September 30	$5,686	$6,228

Non-Financing Operations

Non-financing cash usage during the first nine months of 1998 has increased significantly compared with the first nine months of 1997 as explained below. It should be noted, however, that our non-financing operations have historically generated significant amounts of cash in the fourth quarter of the year.

The following table summarizes Document Processing non-financing operations cash generation and borrowing for the nine months ended September 30, 1998 and 1997 (in millions):

	Cash Generated/(Borrowed) September 30, 1998	September 30, 1997
Document Processing Non-Financing:		
Income / (Loss)	$(140)	$ 763
Depreciation and amortization	589	517
Restructuring charges	1,644	-
Charges against 1998 restructuring reserve	(197)	-
Net change in current and deferred income taxes	(551)	108
Increase in inventories	(1,173)	(723)
Increase in accounts receivable	(390)	(166)
Decrease in payables and accrued compensation	(256)	(126)
Capital investment, net	(270)	(286)
All other, net	(371)	(260)
Total	$(1,115)	$(173)

Cash usage was $1,115 million and $173 million during the first nine months of 1998 and 1997, respectively. Net income before depreciation and amortization, restructuring charges, and the change in deferred income taxes increased $154 million to $1,542 million for the first nine months of 1998. However, this was more than offset by cash expenditures against the 1998 restructuring reserve, increased inventory investment in support of accelerated digital product sales growth, higher accounts receivable due to stronger equipment sales growth and some increase in days sales outstanding due to the temporary effects from the reorganization and consolidation of U.S. customer administrative centers, and settlement in 1998 of compensation obligations.

Financing Businesses

Financing business debt growth of $647 million during the first nine months of 1998 contrasts with a $106 million reduction during the first nine months of 1997. The $753 million period over period change reflects strong growth in equipment sales, an increase in the length of the average contract originated in 1998 and currency translation effects due to a significant strengthening of the U.S. dollar against most major European currencies during the first nine months of 1997.

Risk Management

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 suppliers, or a forward exchange contract to fix the U.S. dollar value of a foreign currency-denominated loan. In addition, when cost-effective, currency derivatives are used to hedge balance sheet exposures.

Revenues denominated in currencies where the local currency is the functional currency are not hedged.

With regard to interest rate hedging, virtually all customer financing assets earn fixed rates of interest and, therefore, we "lock in" an interest rate spread by arranging fixed-rate liabilities with similar maturities as the underlying assets. Additionally, customer financing assets in one currency are consistently funded 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 interest margins resulting from adverse changes in the interest rate environment. Conversely, this practice effectively eliminates the opportunity to materially increase margins when interest rates are declining.

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

Our currency and interest rate hedging is 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.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth under Note 9 contained in the "Notes to Consolidated Financial Statements" on pages 10-11 of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this item.

Item 2. Changes in Securities

During the quarter ended September 30, 1998, Registrant issued the following securities in transactions which were not registered under the Securities Act of 1933, as amended (the Act):

(a) Securities Sold: On July 1, 1998, Registrant issued 1,077 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, J.D. Macomber, 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 $101.625 per share (aggregate price $108,875), 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. Exhibits and Reports on Form 8-K

(a) Exhibit 3 (a) (1) Restated Certificate of Incorporation of Registrant filed by the Department of State of the 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.

Exhibit 3 (b) By-Laws of Registrant, as amended through February 2, 1998. Incorporated by reference to Exhibit 3 (b)to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1997.

Exhibit 11 Computation of Net Income per Common Share.

Exhibit 12 Computation of Ratio of Earnings to Fixed Charges.

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

(b) No current reports on Form 8-K were filed during the quarter for which this Quarterly Report is filed.

SIGNATURES

Pursuant to the requirements 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
(Registrant)

Date: November 10, 1998

____
By Philip D. Fishbach
Vice President and Controller
(Principal Accounting Officer)

Exhibit 11

Xerox Corporation

Computation of Net Income Per Common Share
(Dollars in millions, except per-share data; shares in thousands)

	Three months ended September 30, 1998	Three months ended September 30, 1997	Nine Months ended September 30, 1998	Nine Months ended September 30, 1997
I. Basic Net Income (Loss) Per Common Share				
Income (loss) from continuing operations	$ 381	$ 320	$ (29)	$ 927
Accrued dividends on ESOP preferred stock, net	(11)	(11)	(34)	(33)
Adjusted income (loss)from continuing operations	370	309	(63)	894
Discontinued operations	-	-	(190)	-
Adjusted net income (loss)	$ 370	$ 309	$ (253)	$ 894
Average common shares outstanding during the period	327,655	325,237	327,738	324,430
Common shares issuable with respect to exchangeable shares	1,650	1,908	1,650	1,908
Adjusted average shares outstanding for the period	329,305	327,145	329,388	326,338
Basic earnings (loss) per share:				
Continuing operations	$ 1.12	$ 0.94	$ (0.19)	$ 2.74
Discontinued operations	-	-	(0.58)	-
Basic earnings per share	$ 1.12	$ 0.94	$ (0.77)	$ 2.74
II. Diluted Net Income (Loss) Per Common Share				
Income (loss) from continuing operations	$ 381	$ 320	$ (29)	$ 927
ESOP expense adjustment, net of tax	1	-	-	-
Interest on convertible debt, net of tax	4	1	-	2
Accrued dividends on ESOP preferred stock, net	-	-	(34)	-
Adjusted income (loss) from continuing operations	386	321	(63)	929
Discontinued operations	-	-	(190)	-
Adjusted net income (loss)	$ 386	$ 321	$ (253)	$ 929
Average common shares outstanding during the period	327,655	325,237	327,738	324,430
Stock options, incentive and exchangeable shares	6,535	5,841	1,650	5,841
Convertible debt	6,595	2,644	-	2,644
ESOP preferred stock	26,811	27,418	-	27,418
Adjusted average shares outstanding for the period	367,596	361,140	329,388	360,333
Diluted earnings (loss) per share:				
Continuing operations	$ 1.05	$ 0.89	$ (0.19)	$ 2.58
Discontinued operations	-	-	(0.58)	-
Diluted earnings per share	$ 1.05	$ 0.89	$ (0.77)	$ 2.58

Exhibit 12

Xerox Corporation
Computation of Ratio of Earnings to Fixed Charges

(In millions)	Nine months ended September 30, 1998*	1997	Year ended December 31, 1997	1996	1995	1994	1993**
Fixed charges:							
Interest expense	$ 553	$ 450	$ 617	$ 592	$ 603	$ 520	$ 540
Rental expense	104	92	140	140	142	170	180
Total fixed charges before capitalized interest and preferred stock dividends of subsidiaries	657	542	757	732	745	690	720
Preferred stock dividends of subsidiaries	41	37	50	-	-	-	-
Capitalized interest	-	-	-	-	-	2	5
Total fixed charges	$ 698	$ 579	$ 807	$ 732	$ 745	$ 692	$ 725
Earnings available for fixed charges:							
Earnings***	$ (60)	$1,480	$2,268	$2,067	$1,980	$1,602	$ (193)
Less undistributed income in minority owned companies	(49)	(101)	(84)	(84)	(90)	(54)	(51)
Add fixed charges before capitalized interest and preferred stock dividends of subsidiaries	657	542	757	732	745	690	720
Total earnings available for fixed charges	$ 548	$1,921	$2,941	$2,715	$2,635	$2,238	$ 476
Ratio of earnings to fixed charges (1)(2)	0.79	3.32	3.64	3.71	3.54	3.23	0.66

(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 and preferred stock dividends of subsidiaries, by total fixed charges. Fixed charges consist of interest, including capitalized interest and preferred stock dividends 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.

* Earnings for the nine months of 1998 were inadequate to cover fixed charges. The coverage deficiency was $150 million. Excluding the restructuring charge, the ratio of earnings to fixed charges would be 3.14.

** 1993 earnings were inadequate to cover fixed charges. The coverage deficiency was $249 million.

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

5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM XEROX CORPORATION'S SEPTEMBER 30, 1998 FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000,000

9-MOS
DEC-31-1998
JAN-01-1998
SEP-30-1998
106
0
16,343
499
3,506
12,221
5,161
2,887
29,665
8,921
15,133
638
692
330
3,900
29,665
7,243
13,653
3,963
7,539
6,228
173
553
(114)
(66)
(29)
(190)
0
0
(219)
(0.77)
(0.77)