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XRX - Q4 2012 Xerox Corporation Earnings Conference Call

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OVERVIEW:

XRX announced 4Q12 revenue of \$5.9b and GAAP 4Q12 EPS of \$0.26. 2012 adjusted EPS came in at \$1.03. Management provided guidance for adjusted EPS of \$0.23-0.25 in 1Q13 and \$1.09-1.15 for 2013.



CORPORATE PARTICIPANTS

Ursula Burns *Xerox Corporation - Chairman & CEO*

Luca Maestri *Xerox Corporation - Corporate EVP & CFO*

Jim Lesko *Xerox Corporation - Corporate VP, IR*

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CONFERENCE CALL PARTICIPANTS

Shannon Cross *Cross Research - Analyst*

Keith Bachman *BMO Capital Markets - Analyst*

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PRESENTATION

Operator

(audio in progress) and welcome to the Xerox Corporation fourth-quarter 2012 earnings release conference call hosted by Ursula Burns, Chairman of the Board and Chief Executive Officer. She is joined by Luca Maestri, Executive Vice President and Chief Financial Officer.

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

During this conference call, Xerox executives will make comments that contain forward-looking statements, which, by their nature, address matters that are in the future and are uncertain. Actual future financial results may be materially different than those expressed herein. At this time, I would like to turn the meeting over to Ms. Burns. Ms. Burns, you may begin.

Ursula Burns - Xerox Corporation - Chairman & CEO

Good morning and thanks for joining us today. During the fourth quarter, we delivered results that reflect consistent progress on our strategy. Our shift to a Services-led growth portfolio is paying off. Services revenue now represents 52% of our total revenue and is growing at a steady pace.

Through improved margins, our bottom line is benefiting more from this top-line growth. We have a clear understanding of the market dynamics in our Document Technology business. It remains a very profitable cash-generating operation. We are maximizing this profit by lowering the cost base and shifting investments to focused areas of growth.

And we are generating strong operating cash flow, \$2.6 billion in 2012. This gives us flexibility to invest for growth and build shareholder value. We bought back more than \$1 billion in Xerox stock in 2012. And share repurchase will remain part of our balanced approach to capital allocation.



Xerox is a company that is going through a seismic transformation. 2012 was a year of alignment -- getting our costs aligned with our Services-focused business model, getting our investments aligned with key priorities, getting our diverse portfolio aligned with market opportunities and getting our operations aligned to address these opportunities. We are doing this through a customer-centric approach that takes full advantage of our brand, innovation and global scale. I feel good about our progress and I am confident that we will deliver strong results in 2013.

Here is a closer look at Q4 results. We reported adjusted EPS of \$0.30. As planned, adjusted earnings include \$0.05 of restructuring. Adjusted EPS exclude \$0.04 related to amortization of intangibles resulting in GAAP EPS of \$0.26. Total revenue of \$5.9 billion was down 1% or flat in constant currency. Growth came from our Services business, up 7% in the quarter and reflecting solid results across the board. Business Process Outsourcing revenue grew 8%. IT Outsourcing was up 15% and Document Outsourcing was up 2%.

Segment margin also improved in Services. At 11.2%, Services margin was up 90 basis points. This is very good progress and puts our margins right in the range of our expectations.

Signings in Q4 were lower year-over-year. With the nature of our business, any 90-day cycle will bring ups and downs, especially factoring in prior-year compares and long purchasing cycles. Considering the nearly \$11 billion in total business signings during 2012, I remain confident that our pace of signings today aligns well with our future revenue growth expectations.

In our Document Technology business, revenue declined 8%. We made disciplined decisions in 2012 to be conservative in how we manage this business. Due to the economic uncertainty across most regions, we put our focus on reducing the cost base while expanding distribution through indirect channels. As a result, segment margin in Document Technology improved. At 12.3%, it is well above our target range and gives us flexibility to make important investments this year.

We are about to launch a refresh of products in the first quarter. And we are ramping up marketing investments while broadening our channel partnerships, positioning us better to pursue the growth opportunities in small and mid-sized businesses. As a result, we expect to see improving trends in install levels and equipment sale revenues this year.

Operating margin in the fourth quarter improved 30 basis points to 10.3%. Gross margin was 31.5%; selling, administrative and general expenses were down \$56 million and represent 18.5% of revenue. We generated \$1.8 billion in cash from operations during the fourth quarter, \$2.6 billion for the year, including the sale of certain finance receivables. And we allocated \$334 million of that quarterly cash to buy back shares.

The fundamentals of our strategy are delivering as expected. We are managing our Services business for growth. In Document Technology, we are maintaining leadership in the profitable growth segments while benefiting from the overall profitability of this mature business. As a result, Services now represents 52% of our total revenue, up from 48% just one year ago. This mix shift will continue with Services growing to two-thirds of our revenue by 2017. That growth then fuels our annuity stream, which is now 83% of our total revenue. It was up 3% in constant currency during the quarter and during 2012, we generated \$18.9 billion in recurring revenue.

Equipment sales are becoming a much smaller percentage of our business. Down 13% this quarter, they are the most impacted by economic and industry trends. We expect the equipment sales trend to improve modestly this year. We are launching new products and we are targeting investments that will boost our share of the digital color and SMB markets.

Summing up the quarter, the strong growth in Services and consistent profitability of our Document Technology business generated significant operating cash flow and contributed to earnings that met our expectations.

Before I turn it over to Luca, let me take a moment to offer my thanks to him. As you know, Luca is leaving Xerox on February 28. He has been a fantastic business partner and is a steadfast supporter of our business strategy. I know his contributions to Xerox will serve his successor, our Company and our shareholders well for the long term. Thank you, Luca.



Luca Maestri - Xerox Corporation - Corporate EVP & CFO

Thank you, Ursula, for the very kind words and good morning, everyone. We begin by reviewing earnings and then we cover our two segments, cash flow and capital allocation.

During the quarter and also for the full year, revenue was flat at constant currency. We continue to see good growth in Services, up 7% in Q4 and as Ursula said, now representing 52% of total revenue, while technology remains pressured and was down 8%.

An area of focus for us during Q4 was Services margin and we made really good progress. This improvement in Services also drove overall margin improvement. In total, operating margin of 10.3% was up 30 basis points year-over-year. Gross margins were lower because of the higher mix of Services revenue, but this was more than offset by continued improvement in SG&A and R&D.

As planned, restructuring in the quarter was higher year-over-year and came in at \$93 million as we initiated actions to improve the Services cost structure and maintain technology profitability. For the year, restructuring of \$153 million was \$120 million higher than in 2011. The 2012 actions have been taken in order to position us for margin improvement in 2013 and we will continue to manage our cost base proactively going forward with ongoing modest restructuring initiatives.

Equity income grew \$9 million, driven by profit growth of Fuji Xerox. An adjusted tax rate was 23% in the quarter, lower by about 3 percentage points year-over-year. Adjusted EPS of \$0.30 in Q4 was lower than 2011 by \$0.03 and full-year adjusted EPS of \$1.03 was lower by \$0.05. These results reflect the negative impact of the higher restructuring in 2012 and the pension curtailment gain of \$107 million, which we recognized in Q4 2011.

Moving onto the Services segment, revenue growth came in at 7% in Q4. BPO was up 8%. ITO was up 15% and Document Outsourcing up 2%. We have seen steady growth in BPO all year and in Q4, we had strong results in customer care, state government and transportation. ITO revenue really accelerated this quarter as we began to see the full benefit from the very strong 2011 signings. Document Outsourcing growth was somewhat lower in Q4 impacted by some decision delays in the enterprise space.

Signings in the quarter were lower year-over-year. This was fully expected as ITO had two megadeals in 2011 that made the compare extremely challenging. BPO and Document Outsourcing signings were essentially flat year-over-year and in total, Q4 had the highest new business signings of the year from an annual recurring revenue perspective. The average contract length was approximately three years for BPO and ITO, considerably lower than our historical average of approximately five years and dampened the signings number when looking at total contract value.

The BPO ITO renewal rate in Q4 was below target of 79% and reflected some timing factors and price discipline. For the year, however, renewal rate was 85%, which is in our target range and 5 points higher than 2011.

We remain confident that we will continue to see mid to high single digit Services revenue growth in 2013. As we discussed at our investor conference, our recurring revenue model provides us with good line of sight to expected revenues and even though overall signings this year have been lower, we have achieved what we expected from new business signings and renewal rates in order to support our growth plans going forward.

Turning to margins, Services segment margin of 11.2% increased 90 basis points year-over-year and 180 basis points sequentially ahead of our expectations. The sequential margin increase was driven by the initial benefit from our cost actions, the absence of negative one-offs, improvements in Document Outsourcing and some level of seasonality.

Year-over-year, the improvement came mainly from Document Outsourcing where we benefited from lower SG&A. We also had good margin improvement in a number of BPO lines of business, including state government services, customer care and transportation. We continue to expect to be in the 10% to 12% range for the full year and we expect Q1 margin to be lower than Q4, but modestly better on a year-over-year basis.

So overall a good quarter for Services with welcome progress on margins and continued strong revenue growth, which positions us well as we enter 2013.



Let's now turn to the Technology segment. Technology revenue was down 8%. The revenue decline continued to be driven by lower equipment revenue, which was down 14% and was impacted by the soft macro environment and continued focus on segment profitability. As we look ahead, we have a significant midrange and entry production color product announcement coming next month and we fully expect activity and equipment revenue to show improving trends as we move through the year.

In terms of product segments, good growth continued in entry A4 products as more purchases are moving to multifunction devices in this segment. Midrange activity was down in the quarter, partially because the upcoming product launches are centered around this category and high end continue to show good color growth driven by entry production in iGen, which offset the secular decline in black and white.

Segment margin of 12.3% was up 60 basis points from 2011, well above our target range, reflecting cost and expense control and a gain that we realized as a result of the sale of a portion of our finance receivables.

As we transition into 2013, we believe we have set reasonable expectations for technology with mid-single digits revenue declines and margins within our target range of 9% to 11%. We believe that our opportunities to support these objectives, including new product launches, recent favorable currency trends and easier compares in Europe.

Turning to the key metrics slide, I have already commented on much of this data, but, in summary, total Services signings for the year have been clearly lower, but the underlying trends are more positive than the decline would imply. We actually signed 7% more deals in BPO and ITO than in 2011, but there were fewer megadeals and contract lengths were shorter. This, combined with lower renewal opportunities, resulted in lower signings. However, as explained before, we did meet the new business annual revenue and renewal rate targets needed to support our 2013 revenue plans and our pipeline remains very strong and it is up 6% year-over-year.

Document Technology metrics remain relatively stable, in line with annuity revenue. Install growth was softer in the quarter, but should improve with the new product launches. MIF continues to grow and page volumes are still relatively in check. Color revenue was weak, driven by lower equipment revenue and mix.

If we now turn to the next slide, I will take a moment to review cash flow. Cash from operations in Q4 was strong at \$1.8 billion in line with seasonality and resulted in \$2.6 billion for the full year. This exceeded our guidance of \$2 billion to \$2.3 billion due to an additional finance receivable sale in Q4, which contributed a net \$269 million to cash flow when considering the natural runoff of the sold receivables.

Cash contributions to our global pension plans were \$54 million in Q4, \$364 million full year, a \$62 million reduction versus 2011. We expect pension contributions in 2013 to be more than \$100 million lower than in 2012 driven by the change in funding requirements brought about by recent pension legislation in the US.

Working capital was a significant contribution to cash in the quarter, in line with usual seasonality. In particular, inventory was a source of \$128 million for the quarter and flat for the year. Accounts payable was a source of \$346 million in the quarter, and a use of \$86 million for the year and accounts receivable was a source of \$365 million in Q4 and a use of \$306 million for the year, which was \$390 million worse year-over-year. This reflects lower contribution from factoring compared to 2011 and growth in our Services business.

Finance receivables generated \$947 million in 2012. \$580 million of this contribution comes from the two finance receivable sales that we did in the year, one in Q3 and one in Q4. The remaining \$367 million comes from the runoff of our finance portfolio due to the lower equipment revenue. We spent \$513 million on CapEx for the year, which is fully in line with our guidance and we deployed \$276 million towards acquisitions. Dividends paid were \$255 million for the year and we repurchased \$1.050 million of stock during the year.

For 2013, we continue to expect \$2.1 billion to \$2.4 billion in cash from operations. We expect lower pension funding requirements, but finance receivables will be a lower contributor to cash by approximately \$500 million due to fewer collections associated with the 2012 finance receivable sales and a lower natural runoff of the portfolio given our expectation of better equipment activity. We expect the rest of working capital to be essentially flat year-over-year.



The next slide covers in more detail our capital structure and capital allocations plan. We ended the year with \$8.5 billion in debt, about \$100 million lower than planned. Our cash ending balance was over \$1.2 billion, \$344 million higher than at the end of 2011. The greater debt reduction and higher cash balance from the strong cash flow in Q4 position us well to meet our capital structure objectives for 2013, which include retiring the \$400 million senior note that comes due in May.

Turning to capital allocation, we met our 2012 objectives with the largest portion of our cash flow going to share repurchase. For the year, we spent \$1.050 billion on the repurchase of 146 million shares, reducing shares by 114 million on a net basis. This represents a 9% net reduction in common shares outstanding for the year.

We are maintaining the 2013 capital allocation guidance that was provided at the investor conference in November, which includes at least \$400 million in debt reduction, up to \$500 million in acquisitions, which will be largely focused on the Services business, dividend payments of \$300 million, which reflects the planned 35% dividend increase beginning in April and share repurchases of at least \$400 million.

So in conclusion, overall, a very good quarter across the board. I have great confidence, great confidence that Xerox is very well-positioned both strategically and financially to take advantage of the growth opportunities in Services and to strengthen our leadership position in Technology during 2013. With that, I will hand it back to Ursula.

Ursula Burns - Xerox Corporation - Chairman & CEO

2012 had its share of challenges -- thank you, Luca -- but it also gave us an opportunity to refine our business model and improve operational efficiency, all while growing our Services business. This progress gives me confidence in our ability to deliver a strong 2013.

For the first quarter, we expect adjusted earnings of \$0.23 to \$0.25 per share. Our guidance for the full year remains unchanged. We expect adjusted EPS of \$1.09 to \$1.15 and our strategy remains very sound. We are shifting to a Services-led growth portfolio. You see it in our results every quarter. We are maintaining our leadership in Document Technology. Product and platform news next month will demonstrate our commitment to this profitable business.

With improving margins, cost controls and steady growth, we will consistently expand earnings and generate strong cash. With that, we will continue to take a very balanced approach to our capital allocation, which creates value for our shareholders. That is a good place for me to end. Before we open it up for questions, let me turn it over to Jim Lesko, the Head of Investor Relations.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Ursula. Joining Ursula and Luca today is Lynn Blodgett, Head of Xerox Services. Also let me point out that we have several supplemental slides at the end of our deck. They provide more financial details to support today's presentation and complement our prepared remarks. At the end of our Q&A session, I will turn it back to Ursula for closing comments. Operator, please open the line for questions now.

QUESTIONS AND ANSWERS

Operator

Shannon Cross, Cross Research.

Shannon Cross - Cross Research - Analyst

Thank you very much. Ursula and Lynn, can you talk a bit more about the Services business, sort of where you think you are with restructuring, maybe some comments about your conservative outlook on deal pricing? And then I am curious, especially, Lynn, given your history, if you think



the trend of the lack of megadeals is something that is just sort of cyclical or is this a change in how customers are thinking about things? And then I have a follow-up on Technology.

Lynn Blodgett - Xerox Corporation - Corporate EVP & President, Xerox Services

Thanks, Shannon. As far as the restructuring activity, we made some good progress in the fourth quarter. We are not finished. As we said in the investor conference, we are really focused on cost. We have a great revenue model and just need to make sure that our costs stay in line. So we have more work to do and we will see that through the balance of 2013. But we made really good progress in this quarter.

As far as deal pricing, there is always downward pressure on deals. That is just part of our model. We know that when we come up for renewal or when we are bidding a new deal that the pricing will be down. And as percentages that we have seen in the past aren't changing dramatically, so there hasn't been a significant change there.

As far as megadeals, we didn't see -- last year, we had eight megadeals -- excuse me -- in 2011, we had eight megadeals. In 2012, we had three and that was a significant change. It was primarily in the ITO business as Ursula pointed out. But we are now seeing megadeals in the pipeline. Last year, it was a little bit of an anomaly and they are starting to materialize.

So we expect that we will see strong bookings growth next year. We expect to see that where we return to plus 10% kind of bookings growth. So we are optimistic about that and some of that will be driven because we will have more megadeals.

Shannon Cross - Cross Research - Analyst

Okay, great. And then, Ursula, if you could just talk a little bit on the Technology side. I am curious as to what you're sort of thinking about for 2013 in terms of competition and especially when you factor in what is going on with the yen, do you anticipate a more competitive environment? I know several of the competitors have launches coming. You guys have a launch coming. Just if you could give any color on sort of how you think the world shapes up, especially given the yen depreciation.

Ursula Burns - Xerox Corporation - Chairman & CEO

Yes, I think our position for 2013 is very strong. We spent 2012 in a very methodical way of assuring that we positioned ourselves for what we saw were the growth areas in this business -- color, SMB, developing economies, etc. So we managed our cost base. We were very conservative about how we went after deals given that our product portfolio wasn't refreshed. We positioned ourselves for a 2013 refresh, which will come next month and so I am actually feeling pretty good about our ability to meet our expectations, improving activity levels, stabilizing of revenue from an equipment sales perspective and total perspective and I think it will continue well against the competition.

But our offerings that we will offer that we will launch next month are not just about products; they are also about the software and services surrounding the products, positioning us well to expand our Document Outsourcing business as well. So I think that it will be a reasonable year and we are positioned well against the competition.

As far as the yen goes, the good news about the yen is that it gives us a little bit of tailwind, but it also gives our competitors tailwind. So we are going to have to pay attention in the marketplace. We are going to have to price to win where it is smart for us to go after it. We have a big focus on profitability. Most of the yen benefit for us because we hedge comes in the latter half of the year. But we will keep an eye on the marketplace and make sure that we are aggressive and win where it is good for us to win.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Shannon. If we could have the next question please.



Operator

Keith Bachman, Bank of Montreal.

Keith Bachman - BMO Capital Markets - Analyst

Hi, thank you. Ursula, I wanted to ask you about leadership and I will frame it in two different ways. One, how are you thinking about filling the very big shoes of Luca, in particular the background that you are looking for? And I am not necessarily looking for internal versus external, but skillsets, particularly as you think about the benchmark of growth is Services. And then two, where do you think the leadership -- do you think you need more depth in Services given relative inconsistency in performance since the addition of ACS?

Ursula Burns - Xerox Corporation - Chairman & CEO

Thank you, Keith. So first on the CFO replacement, you are correct that the next CFO has some pretty big shoes to fill. Interestingly enough, Luca had some big shoes to fill as well and I am very, very confident that we will find a more than adequate replacement for Lucca, very confident. The search has already started. I am, in some ways, overwhelmed with the number of candidates that I have to look through. So I think that we will end up in a good place, in a very good place with a CFO.

What I am looking for is someone who has global experience, someone who is strong, fairly aggressive in their approach. We have a strategy. It is not going to change because Luca left, so I want someone who can actually implement the strategy that we have in place and then think on a go-forward basis of some of the new things that we have to do.

Keith Bachman - BMO Capital Markets - Analyst

And I guess just to tease that out for a second, Ursula. Would you tilt toward somebody with Services experience given the importance over the next three years of Services to Xerox?

Ursula Burns - Xerox Corporation - Chairman & CEO

Yes, as we look forward, we are looking for Luca, we wanted someone who had some background in a global, large global complex business, but also someone who had some Services experience. So the answer is yes, but it won't be on only a Services play. We have a big business to run. It is all around the world and I need someone who can actually play well and understand well all of those markets. Like I said, I am confident that we will get somebody very, very, good.

As far as leadership in general, whenever we replace a leader, I look for certain general tendencies. I need someone who is extremely flexible, but strong, someone who actually can implement well. I need an operator in the business and someone who is prepared for the way that the business is going on a go-forward basis. And that obviously means people who have more history or knowledge about Services.

So the answer to your general leadership question has nothing to do with inconsistency of performance; it has to do with future growth and how I see the business going on a go-forward basis. So I need people who have good Services knowledge and background and that is what I will look for across the board when we hire.



Keith Bachman - *BMO Capital Markets - Analyst*

Okay. Well, let me just sneak in a follow-up and then I will cede the floor. Just on bookings, Lynn mentioned that you thought Services bookings would be a positive number in calendar year '13, bookings growth I should say. Is that confidence driven by the fact of the pipeline or the compares or just a little bit more on why you think the bookings will turn the corner here from a negative to the positive?

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Yes, let me start and this is probably a question that will happen -- a lot of people probably have, so we will spend a little bit more time on this one. It turns out that, in 2011, we signed an ITO business, an amazing amount of business. If you look at the absolute number, we actually doubled our normal signing year in 2011. So the total TCV in '11 was about \$3.5 billion and in a normal year, it would be about \$3 billion in ITO, in ITO. This is in ITO. Obviously the rest of the business is bigger.

In 2012, we went back to a normal pace and a normal growth level. So what we are saying is that we are absolutely confident, very confident, based on the pipeline, based on the billings, based on everything that we will be able to grow over 2012 in ITO and therefore in the total Services business on a TCV basis.

So I don't want us to -- it is interesting when you look at this. This is not a point of weakness. We had a phenomenal year in one line of business and a very good year in the rest of the businesses in 2011. 2012 is back to a normal growth cycle for us and 2013 will be back to that again. So that is the short of it.

Jim Lesko - *Xerox Corporation - Corporate VP, IR*

Thanks, Keith. We will move to the next question please.

Operator

Ben Reitzes, Barclays Capital.

Ben Reitzes - *Barclays Capital - Analyst*

Yes, I wanted to ask about cash flow for next year. Your expectation for share repurchases goes down quite a bit. Is there any upside to that \$400 million and how are you looking at that? Is that something that is dependent on who succeeds Luca? Are there any puts and takes on how you look at the flexibility of that number? And then I have a follow-up.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

First of all, Luca will answer the rest, but it has nothing to do with who succeeds Luca. As I said earlier in answering the CFO question, we have a strategy and the strategy has been vetted across the management team. We've spent a lot of time on it and so I am -- it is independent of the individual that sits in the chair. And Luca, why don't you --?

Luca Maestri - *Xerox Corporation - Corporate EVP & CFO*

I would also argue it is a smart strategy, so I hope it doesn't change. On the numbers, \$2.1 billion to \$2.4 billion, it is the same number that we mentioned in November. It is a bit lower than this year because we are going to have some positives -- the pension contributions are positives and obviously earnings are going to be a bit positive because the EPS number is higher. The effect of the finance receivables will -- they are not going to be the same level of contribution that we had in 2012 for obvious reasons. So we are confident with the range, \$2.1 billion to \$2.4 billion.



In terms of capital allocation, we talked in November about having some level of flexibility in the numbers to start the year and that is why we said at least so much for repurchase -- we said at least 400 for repurchase, we said at least 400 for debt. That level of flexibility has increased a bit because cash flow was so strong in Q4.

So we come in with a bit more flexibility and how much we are going to dial up repurchase will depend frankly on two factors -- one, earnings as we go through the year and if earnings are strong, there is an opportunity and we always watch interest rates because they drive discount rate for the pension calculation. But, yes, there is a bit of flexibility and it has increased a bit with Q4.

Ben Reitzes - *Barclays Capital - Analyst*

Okay. Then just my follow-up is another way of asking the Services question. With trailing 12-month bookings down 26%, you have said that you can still grow and hit your targets for revenue growth for 2013. Another company we cover, IBM, had bookings down 2% and they are looking for Services growth next year of flat and that obviously makes intuitive sense to us just given where bookings were the year before. It's a much different business, but when we hear bookings down 26% and then hear revenues are going to be 7% or so growth, it begs the question just can you give us a little bit more math? Is there -- for example IBM again, they kind of give you the 70% of their base contracts that they know they have and the revenue growth off of that and then that kind of thing. Can you just give us a little more support so that we can go from down 25% to plus 7%? Is it duration and do you actually have that 70% visibility and then you know the duration, etc. so that we know you can do it based on the bookings trends?

Lynn Blodgett - *Xerox Corporation - Corporate EVP & President, Xerox Services*

Yes, absolutely, Ben. The things that enter into the math are the bookings number, as you pointed out and as Ursula said, this year was much more kind of a normal year, especially in the ITO business. So we have a threshold that we use to calculate sort of our minimum in order to hit the growth targets that we have and we met that number.

The second piece that factors into the growth is the renewal rate and our renewals for the year were 85%, which is 5% higher than they were in 2011. If you take the positive impact of the higher renewal rate, it offsets pretty close the lower bookings. Does that make sense? They both contribute and we also have a higher recurring revenue rate than I think what you were talking about. Ours is about 85%. So that helps us in terms of sort of the predictability of the revenue stream.

Ben Reitzes - *Barclays Capital - Analyst*

Thanks. Can I just sneak in one more and I am done? On supplies, what trends are you seeing there for channel inventory and the trends into '13?

Luca Maestri - *Xerox Corporation - Corporate EVP & CFO*

Yes, so we have -- '12 was I think a fairly typical year. When we talk about supplies, we talk about unbundled supply. It is a small percentage of our total revenue. It is less than \$2 billion a year. We have seen a development on supplies, which is very, very consistent with annuity revenue in general in 2012. So '12 was down about 3%.

We expect for 2013 something in the mid-single digit decline for supply in line with the overall technology business. So again, also on supplies, we do not have unreasonable expectations as we enter the year.

Jim Lesko - *Xerox Corporation - Corporate VP, IR*

Thanks, Ben.

Ben Reitzes - *Barclays Capital - Analyst*

Thank you, guys.

Jim Lesko - *Xerox Corporation - Corporate VP, IR*

If we could have the next question please.

Operator

Mark Moskowitz, JPMorgan.

Mark Moskowitz - *JPMorgan Chase & Co. - Analyst*

Yes, good morning. Thank you. I want to kind of follow on on the previous questioner's line of thought around just the signings of velocity. Was 2011 really just kind of the big peak, if you will, or everything coming together in terms of ACS, Xerox synergies and that's as good as it gets? Just trying to understand why we have never really seen the follow-through in terms of the potential cross-pollination.

Ursula Burns - *Xerox Corporation - Chairman & CEO*

Yes, 2011 was a good year, but you are seeing the follow-through. First of all, 2011 in one line of business, in the ITO line of business, was an exceptional year. We are seeing growth and we will continue to see growth in 2013 in BPO as well and Document Outsourcing is doing its normal thing.

So this is not the end of the line by any stretch of the imagination and it is kind of hard to downplay a 2011, which was good, but we continue to sign, we continue to sell, we continue to cross-pollinate, we continue to get new business. We had 7% more deals signed in 2012 than we did in 2011. Contract length was a little bit shorter and there were fewer megadeals, but our signing velocity continues and we have 7% more revenue in --.

So the business is -- this is not the end of the line by any stretch of the imagination. It is performing fairly well. The math that Lynn just walked you through, which is a math of renewals, a math of signings, we have a strong pipeline that continues to keep that up 6% shows and should give some confidence that the revenue numbers that we have -- we take into account price declines, everything. The revenue numbers that we have for 2013, which is mid to high single digit revenue growth for our Services business is pretty solid.

Lynn Blodgett - *Xerox Corporation - Corporate EVP & President, Xerox Services*

If I can just add also, the number -- bear in mind too that the number that we give is the annual recurring revenue number. And many times, I think people get confused with the TCV, but this is an annual recurring revenue number and so it is very predictable, the math is easy to calculate and we feel comfortable.

Mark Moskowitz - *JPMorgan Chase & Co. - Analyst*

Thank you. As a follow-up if I could, when I hear about shorter-term contracts, it does start to beg the question, are we going to see a heightened level of pricing pressures down the road. If the contracts are shorter, are they are going to be coming up for renewal faster? Maybe there are more and more vendors fighting for less and less business. How should we think about that pricing slope over time? Is it going to start to get more severe?



Ursula Burns - Xerox Corporation - Chairman & CEO

I actually -- I will take it. The contract length on average has gone from five years to three years. First of all, shorter is not a year; shorter is three years. Absolutely, you will see at the end of three years people competing for the contracts and they would normally have competed at the end of five years. And price, as Lynn said, is something that is clearly a part of the negotiations when you come up for renewal.

So the answer is will we see pressure at three years? The answer is yes. One of the questions and drives that we have, one of the things I push Lynn for is we interact with clients in a way that penetrates the account and then expands our position in the account. We intend to continue to do that. It has proven successful for us in the past and it will prove successful I think in the future.

The shorter contract and less megadeals is a sign of the times today. We had significant pressure in both government and large enterprises given a very weak macroeconomic environment. That is what I, Xerox Corporation and all our vendors are going to deal with. We will deal in the marketplace, be very aggressive and continue to win I think like we win now.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Mark. If we could (multiple speakers).

Lynn Blodgett - Xerox Corporation - Corporate EVP & President, Xerox Services

(multiple speakers). The other thing is that many of the lines of business, customer care for example, a three-year contract life is the normal contract life and if we don't sign as many ITO deals, which are longer typically and megadeals, which are longer, that doesn't mean that the entire portfolio is shrinking in contract length.

The other factor is that the discounts that we are required to give at renewal time tend to be driven by an average annual discount rate. So if we have a five-year contract, you can take what that annual discount rate is times five. If it is a three-year contract, you times it by three. So the net overall discount is not significantly different and we have a large part of our portfolio, you are seeing it, is a three-year deal. It is what -- and we are built around that. So I wouldn't say that just because we don't have as many five-year ITO deals or megadeals that the discounting pressure is going to be significantly different.

Mark Moskowitz - JPMorgan Chase & Co. - Analyst

Okay, I appreciate that. If I could real quickly just shifting gears, Ursula, I have to say as an observer you really sound pumped up today and your cadence, everything sounds very positive, but yet your guidance isn't changing for 2013. Is that just measured conservatism just because it is early in the year and you want to see how these new products roll out next month because you sound a lot more confident and upbeat versus the prior few calls?

Ursula Burns - Xerox Corporation - Chairman & CEO

I am upbeat I am hoping in every call. I am happy I sound better today than I did in the past. I am very confident in the guidance that we have. We have studied the business a lot. We are kind of on a cadence now that is a good rhythm. And so, yes, I am confident in what we have laid out for 2013. This is not going to be a walk in the park. The environment hasn't changed that dramatically to make it that much better around the world, but I think that we know how to operate it -- I think -- I know we know how to operate it. So yes, I am confident.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Mark. If we can have the next question please.

Operator

Bill Shope, Goldman Sachs.

Bill Shope - Goldman Sachs - Analyst

Okay, great. Thanks. You guys obviously had a nice recovery here in the Services margin and I think you laid out the drivers there pretty clearly. Could you just help us understand how we should think about the quarterly swing factors here throughout the year and basically how we should think about the overall drivers of the seasonality from a margin perspective within this range you have provided for the year?

Luca Maestri - Xerox Corporation - Corporate EVP & CFO

Yes, so Bill, we said a margin range 10% to 12% for Services. Clearly, you know that from a seasonality perspective Q1 and Q3 are lower than Q2 and Q4, particularly in Document Outsourcing where we have got more fixed costs attached to the business. And we have launched a number of restructuring actions. They will progress and provide more and more benefit as we go through the year. So you should be thinking about it in terms of Services margins growing sequentially from Q1 forward and clearly Q1 lower than the Q4 that we just had just because of seasonality and -- but we expect already for Q1 improvement year-over-year and I think that should give you enough.

Bill Shope - Goldman Sachs - Analyst

Okay, great. And then you mentioned hitting your targeted renewal rate range for the year. Can you talk about the renewal rate dynamics exiting the year, again sort of the unusual seasonal aspects to consider there? And then how you are thinking about your renewal rate management plans going into next year given obviously we don't want to see too many surprises there?

Lynn Blodgett - Xerox Corporation - Corporate EVP & President, Xerox Services

Yes, the renewal rates are -- they are pretty sensitive and the sensitivity is driven by the timing of particular renewals and here is why. When we calculate the renewal rate, we look at the total universe to be renewed and then take what percentage of that was renewed. If you have a large contract that you expect to renew that happens to slip from one quarter to the next quarter that lowers the overall number and therefore a loss has a more dramatic impact. Hopefully that makes sense.

Bill Shope - Goldman Sachs - Analyst

Yes.

Lynn Blodgett - Xerox Corporation - Corporate EVP & President, Xerox Services

Yes, and so in the fourth quarter, we had a couple of deals that we had expected to renew that slipped into -- we believe -- that will happen in the first quarter. We are very, very focused on -- we know what those renewals are. We are very, very focused on winning those renewals and that is why we are not overly concerned about it. We are confident that our renewal rate for 2013 will be in the range, but we can't call with absolute precision what happens from quarter-to-quarter because the timing of -- an individual customer we can really believe that we are going to get them signed and they can shift one week and that can make a big difference in the renewal rate. So that is why we are not overly concerned about it. We don't see a drastic falloff in renewals. Most of this is timing.



Luca Maestri - Xerox Corporation - Corporate EVP & CFO

What we really liked is the fact that, for the year, we were 5 points up in renewal and that is very, very important for revenue growth going forward.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Bill. Next question please.

Operator

Jim Suva, Citi.

Jim Suva - Citi - Analyst

Thank you and congratulations to you and your team there at Xerox, Ursula. A quick question, in your prepared comments, you mentioned about 2013 a much more healthier year for signings and things. Can you help us better understand about -- are these that you are already talking with companies and they are just really putting out the formal proposal and just has yet to happen or is it any type of real cement or granularity behind that as opposed to just hoping for a bigger market? And did some slip from Q4 into Q1 or just kind of help us understand those dynamics? Thank you.

Ursula Burns - Xerox Corporation - Chairman & CEO

Right. So it is a little bit of all that you said, which I know you aren't going to like that answer, but it is true. Some of the signings are things that we know. We were already engaged with clients and we are working through the details of the engagement. Until we get them, I can't count them and I don't actually feel comfortable until we actually get the signing, but, yes, some of it is that. Some of it is -- we have some lines of business, state, transportation and customer care, that have good offers out and are engaging clients. Some of it has yet to come and our pipeline grew in 2012 by 6%. So we had -- so we have more in the hopper, more engagements in the hopper.

It is kind of a normal year. 2013 we are viewing as a normal year. Also, across the portfolios, nothing too unusual, leveraging the synergies of having our two companies together and therefore growing in a fairly normal range, nothing too exciting or too special. But still good, but very good.

Lynn Blodgett - Xerox Corporation - Corporate EVP & President, Xerox Services

I think the one shift that we have seen that is different -- that was the same in '11, different in '12 is the appearance of more megadeals as we said. And we have more of those in the pipeline now than we did halfway through 2012 for example.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Jim.

Jim Suva - Citi - Analyst

Was there any slipping from Q4 to Q1?



Ursula Burns - Xerox Corporation - Chairman & CEO

Were there any -- excuse me?

Jim Lesko - Xerox Corporation - Corporate VP, IR

Slipping.

Jim Suva - Citi - Analyst

Slipping of deals?

Ursula Burns - Xerox Corporation - Chairman & CEO

Oh, for sure, for sure. Lynn talked about it a little bit. There were a couple of deals that we thought we would be able to ink in Q4. These are generally renewals -- not generally, they are generally renewals and they slipped into Q1 or whenever the customer decides to sign it. Often times, that is actually not bad news for us. If you can keep the client with the same terms and conditions, because, as you know, when you renew, you usually lower cost a little bit, price a little bit, it is not a bad thing to have it actually move. But we would prefer to have them sign, but we have to wait for the customer. We can't force them. Sometimes they are less comfortable or want to delay. Nothing unusual though.

Lynn Blodgett - Xerox Corporation - Corporate EVP & President, Xerox Services

And I think on the bookings, on the new business side, we do have deals that slip, they always slip and then the next quarter -- some slip from the next quarter. So I am waiting for the day when everything that slipped from the previous quarter gets closed in this quarter and we have no slips for the next quarter. But yes, we had a couple of deals and things were a little lighter than we expected because of that, but nothing that was grossly out of order.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Jim. If we could have the next question please.

Operator

Chris Whitmore, Deutsche Bank.

Chris Whitmore - Deutsche Bank - Analyst

Thanks very much. I wanted to approach the bookings maybe from a little bit of a different angle and specifically wanted to ask about BPO bookings. If I look at the trend line in BPO bookings over the past couple of years, it has been down two years in a row from fiscal year '10, \$10 billion to \$6 billion in fiscal year '12, understanding that ITO was strong, etc. and contract durations are changing. But nonetheless, I am trying to understand what are the implications for the mix in your revenue as you roll forward into fiscal '13 between BPO, ITO and Document Outsourcing? Do you expect a significant change in mix or rate of growth between the segments? And does that have implications on margins?



Lynn Blodgett - Xerox Corporation - Corporate EVP & President, Xerox Services

I think that right now we are expecting that ITO, because of the strong bookings from 2011, ITO is going to continue to grow and its growth rate will be a few points higher than the BPO rate. But BPO is a much larger business than the ITO business. So don't do direct math to say that is going to -- that is going to necessarily drastically change the overall growth rate.

But BPO is, if you think about it in the last year, governments have been under extreme pressure. I mean it has been as tough a time for states and local entities as I can certainly remember. And so some deals and BPO government deals are almost, not always, but 80% of them are BPO. There has been a lot of pressure and we are seeing, as Ursula mentioned, some lightning of that pressure. We are not ready to say that it has drastically changed, but we are starting to see a little bit of lightning there. So we are hopeful that that will help to spur BPO bookings. I think most of the downward pressure that you have seen over the last couple of years has really been driven through the various aspects of the government business and we are seeing some improvement there.

Chris Whitmore - Deutsche Bank - Analyst

Does that changing mix impact the profitability? In other words, are ITO margins vastly different than BPO?

Luca Maestri - Xerox Corporation - Corporate EVP & CFO

ITO margins are slightly lower than average. We've talked about it in the past, but really it is not a massive shift. Keep in mind that revenue growth, which then drives margins, right, was significantly higher in BPO in 2012 than the other lines. And so I don't see much of a mix impact from the increased growth in ITO. It is extremely manageable.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Chris. Next question please.

Operator

Kulbinder Garcha.

Kulbinder Garcha - Credit Suisse - Analyst

Thanks. I just have a question really on the direction of Services margins and more about the cost-cutting you guys are doing. In the event that let's say this is a more secular drive towards smaller deal sizes, do you have to do more restructuring to hit your margin targets? Don't you see it that way and could you remind us of what further costdowns we might see in that business segment as we go through 2013? Many thanks.

Lynn Blodgett - Xerox Corporation - Corporate EVP & President, Xerox Services

Yes, the restructuring efforts, as we said at the beginning, we made some good progress in the fourth quarter. We are not through by any stretch and we will continue to do things that we think are prudent and as aggressive as we think are prudent over 2013.

The other side of the coin relative to the deal size is that typically smaller deals have slightly larger or slightly higher margins. So even though the deal size may be coming down, that is not a downward pressure on margins. That actually helps lift them a little bit.



Kulbinder Garcha - *Credit Suisse - Analyst*

Okay, just on that point though, like how much more in terms of dollar cost would you say year-over-year you have got to yet reduce in '13? Can you give us a number around that?

Lynn Blodgett - *Xerox Corporation - Corporate EVP & President, Xerox Services*

I think what we would like to do is an amount similar to the amount that we did in the fourth quarter.

Kulbinder Garcha - *Credit Suisse - Analyst*

Okay. And just a question on acquisitions. On the \$500 million that you might spend, is that a very firm number or is there a chance for example you get to the end of this year and you spend \$100 million and the rest can be put into buybacks for shareholders or how should we think -- is that -- how should think about how firm that number is?

Luca Maestri - *Xerox Corporation - Corporate EVP & CFO*

Can you repeat the question? What number are you referring to?

Kulbinder Garcha - *Credit Suisse - Analyst*

I am referring to the amount that you might spend on acquisitions this year, how firm is your \$400 million or \$500 million and whether you could actually use that for further distribution to shareholders?

Luca Maestri - *Xerox Corporation - Corporate EVP & CFO*

I think you need to step back for a second and think about our strategy and really acquisition we have always said is an important part of our strategy and part of the growth that we are going to be experiencing in Services will be driven by acquisitions. We said up to \$500 million. It really will depend on the type of companies that are available. And so I would say the flexibility that we have is more around the fact that we have got good cash generation from Q4, some level of flexibility and it if earnings progress the way we expect them to progress, there will be an opportunity to do both, to do more repurchase and to stick to our acquisition number.

Jim Lesko - *Xerox Corporation - Corporate VP, IR*

Thanks Kulbinder. We have time for one last question.

Operator

Ananda Baruah, Brean Capital.

Ananda Baruah - *Brean Murray, Carret & Co. - Analyst*

Hi, guys. Thanks for taking the question. Hey, congrats on the solid quarter, by the way. Hey, two if I could. Luca, just a clarification. Did I hear correctly that you said selling of receivables would contribute \$500 million less in '13 than it did in '12? And if I did hear that correctly, is that a gross number or a net number?



Luca Maestri - Xerox Corporation - Corporate EVP & CFO

I mean it is a gross number I would say because it is essentially the combination of the fact that we do not expect the portfolio to run off as much as it did in 2012. We believe that equipment activity is going to be stronger in 2013, new products and so on. And the fact that, of course, we have accelerated the collection of certain receivables from '13 in 2012. So it is the amount of lower contribution that we expect from finance receivables in 2013.

Ananda Baruah - Brean Murray, Carret & Co. - Analyst

Got it. So is the comparable number to that in '12 the \$625 million or the \$502 million? (multiple speakers)

Luca Maestri - Xerox Corporation - Corporate EVP & CFO

The comparable number is \$947 million. It is the amount of cash that we generated in finance receivables during 2012, which was \$947 million.

Ananda Baruah - Brean Murray, Carret & Co. - Analyst

I got you. That was helpful. And then just a follow-up is, Ursula, did I hear you correctly that you expect equipment sales to be up or to grow in 2013?

Ursula Burns - Xerox Corporation - Chairman & CEO

No, it won't grow. I said that we expect total revenues to be, in the Technology business, to be down in the mid-single digits. We expect some softening of the decline that we saw in 2012. We saw a double-digit decline in 2012. I expect that we will see -- continue to see declines, but it will just be moderated a bit as we launch new products.

Ananda Baruah - Brean Murray, Carret & Co. - Analyst

Got it. I was asking just specifically about equipment sales, not (multiple speakers).

Ursula Burns - Xerox Corporation - Chairman & CEO

That is specifically about equipment sales. Total revenue is about the same anyway. I mean the answer can go for total revenue or equipment sales.

Ananda Baruah - Brean Murray, Carret & Co. - Analyst

Got it. And just last one on the equipment sales, any margin implications from the new product launches, positive or negative, due to mix of pricing?

Ursula Burns - Xerox Corporation - Chairman & CEO

Not really. It turns out that equipment sales are less profitable than post sales is the way the business model works. But over time, throughout the -- as this matures, as we sell in mature, I don't think there will be any margin implications. Margin implications will come from the fact that we actually are restructuring and we will continue to do that to drive costs and stay competitive.



Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks. That is all the time we have for questions today and I certainly appreciate your interest and Ursula, I would like to turn it over to you to wrap up, please.

Ursula Burns - Xerox Corporation - Chairman & CEO

We covered quite a bit of ground today and I would like to spend just a second and kind of raising it up a little a couple of levels. Here are the reasons to keep your eye on our Company -- Services-led growth, profitable leadership through Document Technology, cash-generating annuity-based business model, consistent earnings expansion and financial strength to invest in building value for Xerox and building value for you. And that is our focus and I am really confident that we will continue to deliver.

Jim Lesko - Xerox Corporation - Corporate VP, IR

Thanks, Ursula. That concludes our call today.

Operator

Thank you. This concludes today's conference call. You may now disconnect.

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