THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

XRX - Q3 2013 Xerox Corporation Earnings Conference Call

EVENT DATE/TIME: OCTOBER 24, 2013 / 2:00PM GMT

OVERVIEW:

Management discussed 3Q13 results, reporting GAAP EPS of $0.22 on flat YoverY revenues. Guidance was for 4Q13 EPS of $0.28-0.30 on revenues down 2 percentage points from 4Q12.

CORPORATE PARTICIPANTS

Ursula Burns *Xerox Corporation - Chairman, CEO*

Kathy Mikells *Xerox Corporation - Corporate EVP, CFO*

Jim Lesko *Xerox Corporation - Corporate VP, IR*

Lynn Blodgett *Xerox Corporation - EVP, President of Xerox Services*

CONFERENCE CALL PARTICIPANTS

Shannon Cross *Cross Research - Analyst*

Ben Reitzes *Barclays - Analyst*

George Tong *Piper Jaffray - Analyst*

Keith Bachman *BMO Capital Markets - Analyst*

Bill Shope *Goldman Sachs - Analyst*

Chris Whitmore *Deutsche Bank - Analyst*

Jim Suva *Citigroup - Analyst*

Mark Moskowitz *JPMorgan - Analyst*

PRESENTATION

Operator

Good morning and welcome to the Xerox Corporation third-quarter 2013 earnings release conference call, hosted by Ursula Burns, Chairman of the Board and Chief Executive Officer. She is joined by Kathy Mikells, 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 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. Miss Burns, you may begin.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Good morning and thanks for joining us today. Before we review the third quarter, I'd like to take a moment to remind everyone that earlier this week marked the 75th anniversary of the invention of xerography. Back then, the vision was to make work simpler by automating the copying process. Since then, simplifying the way work gets done has influenced the development of our products and more recently the expansion of our business process services.

We have remained true to that purpose, and today we ensure that our strategy is linked to that original vision. It is key for moving Xerox into the next 75 years.

So let's review the strategy. The first plank is to shift our business more to Services, while enhancing our Services offerings and improving our profitability. Services revenue now represents 56% of our total revenue, up from 51% in 2012. So we have passed the tipping point on revenue, but still have work to do on margin.

To this end, we continue to focus on improving our cost structure while maintaining investments in particular areas where we see opportunities, such as healthcare.

Secondly, we are focused on maintaining our leadership in Document Technology and effectively managing this profitable business with strong cash characteristics. The past two quarters, we have shown good progress. This quarter, we saw revenue decline stabilize and very good profitability, and we continue our market share leadership with number one equipment share revenue.

Delivering on these strategies will enable us to deliver consistent earnings expansion and strong cash flow, which we are committed to deploy in a balanced way that will enhance shareholder value. During Q3, we successfully delivered on our objectives and although we still have work to do, I believe we are moving in the right direction.

So here's a closer look at our Q3 results. We reported adjusted EPS of $0.26, GAAP EPS of $0.22, which includes $0.04 related to the amortization of intangibles. Total revenue was flat year-over-year, down 1% in constant currency.

We continue to see growth in Services, which was up 3% in this quarter, although it is flattening a bit as we lap the ramp of large ITO contracts and inorganic contributions. Services operating margin was 9.9%, and although an improvement year-over-year, it's an area where we need to make more structural progress.

Our renewal rate in BPO and ITO was at the high end of our range, with continued positive pipeline growth and solid new business signings, which positions us well for the future.

In Document Technology, revenue stabilized with positive results in global imaging and the high-end business offsetting weakness in developing markets and Europe. Segment margins were above the high end of our range, reflecting both continued cost and expense management, as well as the one-time benefit from our finance receivables sale.

In total, margin was a solid 9.4% and up 50 basis points year-over-year. It's good progress, but we have more work to do and we have several initiatives underway that will deliver over time margin improvement.

Cash from operations was very strong this quarter, and we are on track to deliver at the higher end of the full-year operating cash flow range and to exceed our threshold share repurchase targets. So all up, all in, we had good results in Q3.

As we look to Q4, we face greater challenges where revenue and operating profits will face some headwinds, but we remain well-positioned in our markets and confident in our ability to expand earnings over time.

With that, let me turn it over to Kathy. Then I will wrap up and we will open this call to your questions.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

Thanks, Ursula, and good morning, everyone. Overall, we had a solid quarter. One key highlight this quarter was that we saw operating profit growth from both our Services and Technology segments. We also continue to see positive trends in leading indicators and strong cash flow.

Let's start with a look at overall earnings. Revenue was flat year-over-year, but down 1% in constant currency, with Services growth of 3% and Document Technology declines of 4%, or 5% in constant currency. We experienced a slowing in services growth, which was expected and stabilization in Document Technology declines.

Gross margin of 31.5% was flat year-over-year despite the fact that the relative growth of our Services segment naturally pressures gross margins.

RD&E and SAG were both lower year-over-year, benefiting from our ongoing productivity initiatives, as well as the greater mix of Services.

Operating margin was 9.4%. Flat gross margin and expense line performance resulted in a 50 basis point margin expansion year-over-year, driving operating profit growth of 5%.

There were specific dynamics in Services and Document Technology that contributed to this positive performance. I will cover that in more detail when I get to the individual segment slides.

Adjusted other net of $79 million was flat year-over-year, with the benefits of a building sale offsetting higher restructuring in the quarter. And equity income of $43 million was a (technical difficulty) contributor year-over-year, reflecting continued solid performance trends in Fuji Xerox.

Our adjusted tax rate came in at 28%, about 4 percentage points higher year-over-year. Adjusted EPS of $0.26 was up $0.01 from 2012 and at the high end of our guidance range of $0.24 to $0.26. Clearly, this is one blueprint for the type of operating results we want to see going forward over the long-term, recognizing that we have to overcome some near-term headwinds to consistently get there.

As we move into the segment performance slides, I will run through the drivers of the third-quarter results as well as what we are expecting in Q4.

Turning first to Services, Services revenue growth was 3% overall, with BPO up 1%, Document Outsourcing up 5% and ITO up 8%. Growth rates are playing out as expected, with Document Outsourcing showing stable mid-single digit growth, ITO growth beginning to taper and BPO growth being somewhat pressured as we begin to lose organic contributions and continue to absorb the headwinds from the runoff of the student loan business.

Looking to Q4, we expect these dynamics to continue, with Services growth closer to flat as we hit our most challenging compare on student loans, ITO growth further decelerate and we lose inorganic revenue contribution.

Additionally, we anticipate some increased volume pressure in wireless customer care.

As we look to 2014, we expect growth will begin to pick up again, driven by favorable signings and renewals, a strong new business pipeline and a richer and more mature pool of acquisition prospects.

Shifting to profitability, segment margin was 9.9% in the third quarter, up 50 basis points year-over-year, driven by margin gains in Document Outsourcing, an easier compare given the prior-year government contract writeoffs in BPO and savings from cost actions. Partially offsetting these positives were margin pressure from a less rich mix as we've grown ITO and absorbed the impact of the student loan runoff.

We've also seen increased expenses associated with the rollout of our new Medicaid platform and healthcare exchange operations. We are very pleased with the successful implementation of these platforms, with Alaska's Medicaid management information system and Nevada's health insurance exchange both launched successfully this past quarter.

As with many large new programs, there is an initial period of higher cost during rollout, including non-cash amortization of the platforms. We continue to be excited about these long-term healthcare-related opportunities and expect to gain scale and experience efficiencies over time.

Looking to the fourth quarter, we expect margin pressures to continue, with the year-over-year student loan compare being the most challenging of the year, resulting in about a $20 million decline in operating profit from that business unit. As a result, we expect Services margins will decline from the relatively strong 11.2% from the fourth quarter 2012 to about 10%, with full-year Services margin a bit lower than 10%.

So while we are seeing positive trends in key performance indicators, we are in a transition period where we are pressured by line of business mix and investments. At our November investor conference, we will walk through in detail the Services business dynamics and actions that we are taking to drive sustainable margin improvement.

I will now turn to Document Technology. Revenue in Document Technology was down 4%, or 5% in constant currency this quarter, which was in line with the second quarter as the trajectory of the business stabilized. Equipment sale revenue year-over-year was up 1% for the total Company and down 3% within Document Technology, reflecting continued good success from our recently-launched products in midrange and high-end.

Within midrange, we continue to see good activity across the ConnectKey platform. High end also experienced good growth in both entry and production color, and we continue to feel good about the improving trends and our position in this segment.

Finally, in entry, once again, color A4 MFPs had good growth, but in total, entry continues to be down, driven by weaker results in developing markets.

Overall, Document Technology margin was very strong at 12.1%, up 130 basis points year-over-year and above our target range of 9% to 11%.

On an absolute basis, this quarter's finance receivables sale resulted in a $25 million gain, boosting margin by about 100 basis points. However, the benefit year-over-year was negligible, as we had a similar gain in the prior-year period.

Contributing to the year-over-year improvement were cost and efficiency savings and a modest currency benefit from the weak yen.

Looking toward the fourth quarter, we expect Document Technology revenue growth down mid-single digits, generally consistent with the third-quarter performance, but with a bit more pressure in developing markets.

In terms of margins, we expect they will be down versus the very strong 12.3% from the fourth quarter of 2012, but at the higher end of our 9% to 11% target range. This incorporates lower finance receivable gains, as well as higher pension settlement activity and associated costs as retirees seek to cash in their benefit before a higher discount rate goes into effect next year.

So overall, good performance in Document Technology.

With that, I'd like to turn to cash flow. Cash flow from operations was strong, with $960 million in the third quarter and $1.4 billion year to date through September. Free cash flow was similarly strong at $860 million in the third quarter and $1.1 billion through the first three quarters.

While there are some timing differences coming into play year-over-year, one of the drivers of our improved performance is better contribution of cash flows from Services, which reflects improvements in working capital.

Looking specifically at the third quarter, the improvements in operating cash flow year-over-year was driven primarily by accounts receivable, which was the source of about $85 million this quarter versus a use of $319 million last year. The drivers of this improved contribution were improved DSO and a higher level of factoring versus prior year.

Finance receivables, although not much of a swing factor year-over-year, probably deserves further explanation. It was a source of a little more than $400 million this past quarter and in the third quarter of 2012, with both periods benefiting from a finance receivables sale.

Looking to the fourth quarter, we are planning another finance receivables sale, but it will be approximately $150 million or so less than the one that we did in the fourth quarter of 2012. Considering the smaller-size sale and the lower collections due to past sales, we anticipate finance receivables will likely be a modest source of cash in the fourth quarter, which compares to a $260 million source of cash in the fourth quarter of 2012.

Overall, we expect the fourth-quarter operating cash flow to be close to $1 billion, which is lower than our traditional seasonality due to the expected lower contribution from finance receivables, as well as working capital timing, which has been more smoothed out this year.

Given the strong cash flow through September, we expect to end the year toward the higher end of our $2.1 billion to $2.4 billion range.

Moving down the cash flow report, investing cash flows were an $82 million use in the quarter. We spent $102 million on CapEx, had proceeds of $41 million from asset sales, primarily the sale of our Dallas facility, and we spent $24 million on acquisitions.

Cash from financing was a use of $870 million, and included the retirement of our $600 million Senior Note in September. Also included was $77 million of common dividends and $162 million that were spent in share repurchases.

Moving to the next slide, I will walk through our capital structure and capital allocation plan. We ended the quarter with $7.5 billion in debt, which is $600 million lower than the June ending balance, driven by the Senior Note repayment, a portion of which we intend on refinancing.

Applying the 7-to-1 leverage on financing assets, our allocated financing debt is $4.5 billion, leaving core debt of $3 billion.

Our financing debt continues to decline, driven by finance receivables sales and lower origination.

Our strong year-to-date cash flow and expectation to be toward the higher end of our free cash flow guidance of $1.6 billion to $1.9 billion provides more flexibility with our capital allocation plans.

On share repurchase, given the positive cash flow trend, we expect that repurchases will be at least a couple hundred million dollars above our $400 million minimum guidance.

On acquisitions, year to date, we've spent about $160 million relative to our full-year guidance of between $300 million to $500 million. This lower pace of Services acquisitions has put a damper on Services revenue growth, but as I mentioned earlier, I continue to feel good about the quality and progression of the deals that are in our pipeline.

And finally, dividends will use about $300 million of cash, which factors in our Q1 dividend increase to $0.0575 per share a quarter.

So in summary, a good quarter. Document Technology has stabilized despite some weakening in developing markets, but it will face a difficult margin compare in Q4. Services continues to face headwinds that will knock down growth and margin in Q4, but the underlying metrics remain positive and we continue to work hard at improving our cost structure.

As a result, we expect that fourth-quarter total Company revenue will be down a couple of percentage points year-over-year and operating margin will be lower than our prior-year 10.6%, yielding an expected earnings per share of $0.28 to $0.30 for the quarter, bringing our full-year EPS guidance to the low end of the range.

Our guidance includes approximately $0.02 of restructuring, as well as $0.02 negative impact from the higher non-cash pension settlement that I highlighted earlier. Cash flow has been very strong and we are on track to meet our capital allocation objective, with an opportunity to do more on share repurchases.

And with that, I will turn it back to you, Ursula.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

So thanks, Kathy, and here's a quick wrapup. Overall, the fundamentals of our business are strong. In Q3, we overcame headwinds in Services to deliver Services profit growth. We saw stabilization in Document Technology, margins in line with expectations and strong cash flow.

That said, Q4 will be a more challenging quarter. We will face more difficult compares and continue to absorb healthcare sector investments, while not fully realizing the benefit to our longer-term margin initiatives.

For our fourth quarter, we expect, as Kathy said, adjusted EPS of $0.28 to $0.30. This includes approximately $0.02 of restructuring and $0.02 from higher pension settlement expenses. And we are narrowing our full-year adjusted EPS to $1.08 to $1.10.

Throughout 2013, we've navigated the headwinds of negative Services mix, a slowdown in developing markets and continued weakness in Europe, while continuing to make investments in areas and opportunities such as healthcare. We have delivered at the high end of our range over the last three quarters and with strong cash flow. In spite of this, Q4 is anticipated to be a weaker quarter, but I'm confident that we are taking the actions to position us better for the future.

And we look forward to sharing them with you at our investor conference on November 12th.

Before we open it up to questions, let me turn it over to Jim Lesko, who is the Head of Investor Relations.

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

Thanks, Ursula. Joining Ursula and Kathy today is Lynn Blodgett, Head of Xerox Services business.

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.

For the Q&A, I ask participants to limit yourself to one follow-on question so we can get to everyone. 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

(Operator Instructions). Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

Thank you very much. I had a question on the Services business. Specifically, looking at the operating margin, which obviously is below 10% with only about 1% of growth in BPO, can you talk more about what you are doing specifically from a restructuring standpoint, what kind of changes you are making perhaps, and how you are selling or where you are selling, balancing the mix? Just how are you working on improving that? And then I have a follow-up. Thank you.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

Sure. So, a couple different things. First, I will speak to restructuring. In the quarter, we had about $0.02 of restructuring costs, Shannon. About 40% of the restructuring costs were for the Services segment. I would say the biggest piece of restructuring that we are doing within Services is continuing to move our mix, rightshoring more offshore. And we've talked about that previously. I'd say we are making progress there, but certainly looking to accelerate that progress, which will continue to have some level of restructuring cost associated with it.

In terms of the overall mix of the business, part of what we have talked about is we've had negative mix headwinds recently. We've obviously seen over the past several quarters the fact that ITO has tended to grow at a faster pace than BPO, and ITO has a lower margin overall than BPO; and so that's been giving us a negative mix.

More recently, the additional negative mix that we're seeing is just the runoff of the student loan business. So from a top-line perspective, as I look out to the fourth quarter, that pressures top line by about 1.5 percentage points. And from a margin perspective, that's worth 60 to 70 basis point pressure in the fourth quarter year-over-year.

So that is some of the mix elements that we are seeing that are causing pressure.

But as I look out forward beyond that, I'd continue to point to just overall strong signings, really strong renewals, strong new business pipeline. So year to date, Services, our signings are up 30%. And within BPO year to date, signings are up 40%. And new business only within BPO on a year-to-date basis is up 8%.

So I think we've got really strong fundamental trends. So as we look towards 2014, I'd expect to see overall our growth rate pick up and our mix start to improve as we will begin to lap things like the student loan runoff.

Shannon Cross - *Cross Research - Analyst*

Okay. And then again on Services, perhaps -- I don't know if, Kathy or Ursula, you want to talk about it -- or whoever wants to talk about it -- the healthcare opportunity. With $2 billion of revenue from Health Care Services and the ACA starting in January, can you help to provide some color as to how we should think about benefit from this in terms of both the revenue; and then obviously this quarter, we were hit by the startup in Nevada and that. So how do we sort of balance thinking about benefits from the ACA as we look at 2014?

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

So within BPO, healthcare is our fastest-growing area. And we are clearly benefiting from our number one position in MMIS. So on the Medicare side, we are very strong.

We were incredibly pleased that we've been actually standing up the new MMIS systems successfully. I think if you look in the newspapers recently, if there's one thing that's clear, standing up these systems is not particularly easy. And so while it's certainly come with a little bit higher cost that's pressuring margin, we continue to look at our overall position in healthcare and feel very good about the fact that we are participating across a number of different sectors.

We obviously have a very strong position in MMIS in state and local government. We clearly have a strong payer position on the private side, as well as within our support that we provide to hospitals.

So we continue to look at the changes that are occurring in healthcare generally, in part driven by the Affordable Care Act, and view it as just a really great opportunity.

And the really nice thing about platforms is when you are putting a new one in place, you clearly go through some of the pain of standing it up for the first time. This becomes a pretty replicable process for us. And so we certainly think over time we are going to get scale and experience gains in that area.

So we are really excited about these opportunities. And while I mentioned Nevada specifically as a healthcare insurance exchange that we helped to stand up, we are also behind the scenes participating in at least a handful of others, and we are gaining more experience. So as more states look to put these in place, we view that as an area of incremental growth going forward. So we continue to be really bullish about this.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

I was going to add something, but there's nothing else to add. Kathy covered it all. Thank you, Shannon.

Operator

Ben Reitzes, Barclays.

Ben Reitzes - *Barclays - Analyst*

Yes, thanks a lot. I wanted to talk about cash flow. You guys mentioned several times in the (inaudible) that cash flow was really strong, and I just wanted to challenge that a bit. Without factoring and selling finance receivables, it looks to my math that cash flow is going to be much closer to $1 billion this year than something at $2.4 billion. I mean, I cover a lot of other companies; we never include factoring in their cash flow and we exclude factoring from finance receivables. And then you factor in the accounts receivable line, and that's not very well understood.

It would seem to me that once we get done with this factoring, then cash flow normalizes in like a $1 billion range, and that's below EPS. And it says something about the earnings quality as well.

How am I wrong on this? I don't count factoring. That's like a one-time gain, and it's flowing through the P&L as well. I don't really agree with this, and I want you to deconstruct it and explain how real cash flow is not really just $1 billion.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

So I am very happy to talk about that. So with respect to factoring, all the Company factors is very near-term receivables, and it's been a practice that the Company has been doing for a very long period of time. So it really has absolutely no impact on the Company's core operating cash flow performance.

So all we're factoring is near-term, call it within the next 60 days. It's a very efficient program that we have, and so the costs associated with doing that are de minimis. We view it as a very economic (multiple speakers).

Ben Reitzes - *Barclays - Analyst*

Okay, okay. The finance receivables, $850 million this year, and you just can't do that forever. I mean, you take out the $850 million from the $2.4 billion, and my math is still pretty close.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

Can you kind of give me a second to walk through my explanation? Because I'm going to go back, to start with, I think your math is completely wrong. So with respect to factoring, again, it causes absolutely no plus or minus to operating cash flow. All we're factoring is very near-term receiveables, and we are doing it because it's a very efficient form of -- I will call it near-term financing for us with de minimis cost.

If you look at what's going on year-over-year, we have a much smoother pattern of working capital this year. And so we are seeing some year-over-year changes, and that's just because we've got a much smoother pattern.

I'm then going to turn just to financing receivables sales. So we did last year finance receivables sales. We are going to do about the same amount this year. That's just a movement in terms of timing. And overall this year relative to last year, it's actually going to be a modes headwind as opposed to a gain year-over-year.

By doing those finance receivables sales, we actually kind of trigger a need to pay down debt, because our finance receivables actually get a much higher leverage factor. And so it really isn't anything that ultimately changes our overall cash profile. And I guess if I get down to the nuts and bolts at least of what some of our investors I think are focused on, which is capital allocation and how much excess capital we have to deploy against things like share repurchases, as I look out to 2014, while we may have some year-over-year differences in terms of the level of finance receivables sales the Company may do, I think we are going to have a very consistent and balanced approach in terms of overall capital allocation continuing to look to do a meaningful amount of share repurchases.

Ben Reitzes - *Barclays - Analyst*

Okay. Well, I think that you might want to change that definition to cash flow X financing so we can look at it apples-to-apples. And I don't think everybody understands it; I really don't.

Because when you put it in above the line, it makes it seem like it's real cash flow, and it's just a very unique way of portraying it. And I would highly suggest that, and thanks and I appreciate the answer.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

And certainly I'd say I think our disclosures on this have been very fulsome. And if you don't get the math right, I'd certainly encourage you talk to our IR group after the call, because I think (multiple speakers).

Ben Reitzes - *Barclays - Analyst*

No, I think I get the math right. Thanks a lot.

Operator

George Tong, Piper Jaffray.

George Tong - *Piper Jaffray - Analyst*

Good morning and thanks for taking my questions. Services signings for the past 12 months was up about 9%, but fell 7% in the quarter due to the timing of contracts eligible for renewal.

How does the renewal pipeline look like going forward? Do you have more contracts coming up for renewal in the coming quarters that can help drive improved performance in Services bookings?

Lynn Blodgett - *Xerox Corporation - EVP, President of Xerox Services*

The renewal pipeline tends to be -- it will be a little bit lumpy just based on the exact timing of a particular contract, and then three or four years later when it comes up to renewal. But in general, the renewal rates pretty much average across the average contract life. And right now, we are somewhere between three and four years.

And you are going to see a little bit of lumpiness from one quarter to the next. But overall, if you look at a year -- the accumulation of the year, it's going to be pretty consistent.

George Tong - *Piper Jaffray - Analyst*

Okay, that's helpful. And as a follow-up, the upcoming fourth quarter does pose some particularly challenging revenue and margin comps and operating environment. Could you talk about how we should think about from a Services perspective revenue growth in 2014, factoring in the headwinds from the student loan processing business and your ramping businesses with the Affordable Care Act. And how we should think about margins going forward, if we can continue to expect a stepup in margins, acknowledging that 2013 will be somewhat flat to slightly down with Services margins. Thanks.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

So I'm going to talk a little bit about what we are seeing in the fourth quarter, and then I'd say at a high level expectations for 2014. But we are going to talk a lot more in detail at our investor conference for 2014.

So if you just looked at what we are expecting to see in the fourth quarter, clearly the runoff of the student loan business is giving us a big headwind on revenue with that basically, where it is about 1.5 points of headwind on revenue growth in the fourth quarter.

Acquisitions have historically been kind of a 2% to 3% revenue growth driver for us. And so if I look at the fourth quarter in the prior-year period, 2012, it was worth about 2 points of growth, and it's going to be worth about nothing in the fourth quarter of this year. So that's a near-term headwind, but certainly as I look out to 2014, we would expect that we'd actually have more acquisitions and therefore more growth coming from that area.

And on student loan, obviously we are seeing the biggest impact in the fourth quarter. And so as we head into next year, that impact will be early on a headwind for us. And then as we get toward the end of next year, we will start to lap that.

As you mentioned in your first question, overall, we continue to have really strong signings and renewal on new business. And so as I look out into 2014, the year may start a little bit slower, but we certainly expect that new business and acquisitions will help us to then pick up overall growth.

George Tong - *Piper Jaffray - Analyst*

That's helpful. How would you think about the margin cadence playing out?

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

So in terms of the overall margin cadence as I look forward, the impact year-over-year from the student loan business runoff actually abates a little bit next year in terms of margin. So this year, it's worth on a full-year basis about 35 basis points of margin headwind. Next year, that's probably closer to 25 basis points of margin headwind.

I think really importantly, while we are starting to see some positive pickup in terms of offshoring, that obviously takes a little bit of planning and timing to implement, and we would expect a lot more gains from that as we head into next year. So I think those are some of the gives and takes.

And then in terms of overall mix, typically, acquisitions are margin accretive to us. We are obviously looking to acquire things that have significant synergies associated with them, and we tend to target businesses that would be margin accretive.

And the ITO growth slowing, that also just will help us from an overall mix perspective on margin.

So hopefully that gives you a little bit in the puts and takes, and obviously this is an area of a whole lot of focus on from our part, and I think we are going to see progress.

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

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

Operator

Keith Bachman, BMO.

Keith Bachman - *BMO Capital Markets - Analyst*

Hi, thank you. I wanted to ask about Services, please. If I think about your calendar-year EPS guidance, the pension expense wasn't in there. So it looks to me like you are taking down guidance by about $0.02 or $0.01 to $0.02. And yet the printing side of the business outperformed, so it literally seems like the variance was on the Services side.

So if I think about it, it raises the problem from investors' perspective of consistency of execution, which in my mind comes back to leadership. So I'm really trying to understand what changed to cause you to take your calendar-year guidance lower.

And specifically, student loan was known. You have talked about that since the March quarter. So was it the magnitude of the student loan? Or was it the ramp-down of BPO? Because as part of this whole, I think, disappointment in the Services side of the business, in addition, the signings were relatively weak for the quarter.

So if you could just really address what was the disappointment from 91 days ago, when you gave guidance on the Services side of the business?

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

So a couple of things I'd say just in terms of new pieces of information. So A, we had certainly expected that we were going to have more from acquisitions in the fourth quarter. And so while the pipeline looks rich, I think deals are maturing, we had hoped would be able to close things sooner than is occurring. And so that's, I'd say, a near-term headwind, but certainly one as we look out to 2014 that we don't expect is going to continue to occur.

The other thing I mentioned is on the one hand, we, I think, did a terrific job in terms of standing up MMIS systems and the Nevada health insurance exchange. That has caused some near-term pressure. Those things are not easy to stand up, and so we are making more investments there.

So those are a couple of things. I also mentioned in my prepared remarks that we are seeing a little bit of volume decline on the telecom side. And so we had a major telecom customer that got acquired by another company, and as a result of that acquisition, they are taking a little different approach. We are seeing some volume decline.

So those are specifically the things I would say if I backed up 90 days that I didn't have completely in view. And I'd also say that as I look at all of those things and I look forward into 2014 and beyond, I view them as transitionary and temporary factors.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

As far as leadership goes, we have an experienced team. We bring in on a regular basis new executives into the fold that could help us to refine our implementation and refine our approach to the business. And we are doing that every month, every day. We have two new executive that are particularly promising. I won't say their names, because then they will believe they are promising as well.

So I think that we actually have -- I have a very, very good view on weaknesses and strengths of our Services leadership team. And where we have weaknesses, we try to augment it and move forward. So I am actually confident in our Services leadership.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

(multiple speakers) One more thing I wanted to add is you mentioned kind of weak signings in the quarter. We already mentioned that on the renewals, we just had not many renewal opportunities in the quarter. And so renewals were light just because we didn't have many opportunities. But year to date, overall Services signings are up 30% and BPO signings are up 40%. So I think the underlying trajectory there is very positive.

Keith Bachman - *BMO Capital Markets - Analyst*

Okay. For my follow-up then, could you just talk a little bit about what investors should anticipate directionally or any kind of dimensions with Q4 signings? So if you have some idea how signings look for the year.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

Yes, we expect Q4 signings are going to be modestly positive year-over-year.

Keith Bachman - *BMO Capital Markets - Analyst*

Okay, all right. I will cede the floor. Thank you.

Operator

Bill Shope, Goldman Sachs.

Bill Shope - *Goldman Sachs - Analyst*

Okay, great, thanks. Digging into the Affordable Care Act a bit more, can you remind us of your exposure here across Xerox, and help us quantify it a bit better? Because we obviously get a lot of questions on this.

I'm trying to deconstruct your comments a bit. Is 2014 the year where you really start to see the steady-state net benefits from this exposure?

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

Overall, our health care business, kind of across our health care business, is about [$2.5 billion] (corrected by company after the call) in revenue, just to give you an overall sizing.

As we look forward, it's one of the fastest-growing areas that we have within BPO, and we expect that to continue to take place. We have always been in our number one in terms of MMIS. As we look at the opportunity of standing up the Nevada health insurance exchange, I think that's an

THOMSON REUTERS

area where as states look to move from the federal system and implement their own exchanges that's a great area of growth and participation for us.

We also participate in private exchanges, so as companies look to move to I'll call it more of a defined contribution approach to how they support healthcare for their employees and trying to give their employees then a lot more freedom of choice or what they choose to then purchase, we're also participating in that market, and I think that's clearly another area of growth.

And some of the things we bring to the table there is both our ability to stand up for somebody -- I will call it a portal for employees to come to and choose; an ability to go in and look at their employees' demographics and actually choose providers then that will go into that network that are a good fit for their employee base; and then we put all of the support around that as well.

So I think those are a couple of different areas where we have really good growth opportunities. And we continue to be really bullish. We participate really across this industry. We come at it from a bunch of different ways that gives us a lot of insight. I think we've been in this business for a long period of time. We've got a lot of expertise that we bring to the table. And we think it's going to be a very good area for us for years to come.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

And one of the things that a previous questioner asked is something important to note. As Kathy said, we participate across the board. If you look at our pipeline -- our signings, our pipeline, if you look at the percentage of our BPO and ITO business that is actually focused on healthcare, it's all positive signs, which is good. We kind of surround this from government payer, provider, employer. It's good participation.

It's hard to do; it's hard to stand them up. I am very pleased that we've actually been able to stand up exchanges and an MMIS system actually operating, taking customers' calls, et cetera. It costs a little bit more than we thought it would cost, and that's one of the pressures that we saw in third and we will see a little bit in fourth. But we have done it now.

So the bulk of the investment won't have to change. We have to modify it for every engagement a little bit of the system, but not as big a modification as before. And that's one of the things that we are learning. I think other people are learning it as well.

So I'm actually pleased with healthcare. It's a big piece of our business and I think we have some proof points that will show it will be good on a go-forward basis as well.

Bill Shope - *Goldman Sachs - Analyst*

If I could just have one follow-up on another area of Services. Looking at Document Outsourcing, you guys have had a leadership position here in the past, but the competition is getting pretty intense and we are seeing some pretty good numbers from some of your smaller competitors, suggesting they are starting to gain share at a fairly rapid clip.

Given that this is such an important part of the Services business, but also an important secular counter to what's going on in the technology business over time, can you talk about how you are looking at your market share momentum here and what you could possibly do to re-accelerate it from here?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

I'm just going to start and then I'll have Kathy answer some of the details. We are extremely pleased with Document Outsourcing. In the last three quarters, last two in particular, it has actually outperformed even our expectations.

The external market actually sees us as a market leader, independent assessors do, and our growth would dictate that we are market leader as well. I don't think that your statement that competitors are gaining share at a pretty rapid clip is actually true vis-a-vis us. Actually, it's not so at all.

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

I think importantly -- right -- we are the folks who invented managed print services. As a result, we have been in this business for a longer period of time. I think we are much more evolved. And we have a bigger base of business that we are growing off of.

So rather than having a business that's in its relative infancy, where in the beginning you get really big growth rates because you're growing off of very small base, we have a much more sizable business here to start with, and we've been very pleased with our growth rates.

One of the things Ursula just mentioned in terms of third parties taking a look at our offering and putting us against our competitors and really feeling like we are incredibly strong positioned, recently Gartner came out with a study showing us that in their Magic Quadrant, which is where the managed print services, Document Outsourcing resides, that we actually gained some distance on our competitors recently.

So that's in part because we have a very fulsome vision and really, really good execution in this area. And as we look at I will say the synergies between our Services business and our Document Technology business, this is really one area where we are continuing to evolve into workflow from our Document Technology side of the business through Managed (technical difficulty) Services and Document Outsourcing. And that's a natural adjacency then over to our Services business, where we have business process outsourcing.

So that's where those two businesses meet. We have been at this for a long period of time. We have got deep vertical expertise. We feel great about this area of our business.

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

Thanks, next question, please.

Operator

Chris Whitmore, Deutsche Bank.

Chris Whitmore - *Deutsche Bank - Analyst*

Thanks very much. I wanted to ask a couple follow-up questions on topics that were covered earlier, specifically around the margin impact from renewals and new business signings. How do those two factors come into play as we think about 2014 margins in Services?

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

In this area, I would say it's normal course of business. We always know as we renew business that we are typically giving some level of discount. It isn't as if the pressure that we are seeing is any more or less. And we always understand that as we are heading into this business. It's all about we stand up new business, we get more productive and efficient over the course of the contract period, preparing for the fact that we are going to have a price decrease as we renew that business. So there's nothing new or different in that.

Chris Whitmore - *Deutsche Bank - Analyst*

Because when I listen to the puts and takes around Services margins heading into next year, it sounds like there's a lot more puts than takes. So maybe can you clarify? Do you think margins will be flat or up or down in Services in 2014?

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

Certainly I would say with regard to the fourth quarter of this year, I'd agree there's more puts and takes which is why we are expecting to see a year-over-year margin decline. We are going to talk more about 2014 at our investor conference, but I would not at all conclude that we see more puts than takes as we head into 2014.

And I'd specifically refer to a big opportunity that we have, which is to shift more of our labor mix offshore. So that's a very big opportunity for us and an opportunity that from an execution basis is a bit still in its infancy today, takes some planning, takes some time to implement. But it's certainly something that we are looking to do in a very aggressive way and a way that we think will be impactful in 2014.

Another thing I would just point to that we are doing where we get secondary benefit for more offshoring is we entered into a strategic relationship with Cognizant who helps us on platform development implementation. And it's kind of a secondary way for us to get a little bit more offshoring exposure because they obviously bring a lot of that to the table, as well as great expertise that's helping us to successfully stand up some of these new platforms.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

So just so we're not confused on the puts and takes, because I'm a little bit confused on which one is a put and which one is a take or what you mean by it. I think just so we're clear on the call, I would expect we will get into significantly more detail on this in November at the investor conference. But we expect not margin expansion, margin improvement, to be in the range of 10% to 12% in 2014. I don't know if you consider that a put or a take, but that's where we expect to be.

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

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

Operator

Jim Suva, Citigroup.

Jim Suva - *Citigroup - Analyst*

Thank you very much. And a lot of the questions have been focused on the Services, which I think is very warranted, given what the stock is reacting and the big change there. So I'm going to again focus on that, because I think that's the real struggle.

I understand how you are talking about the trailing 12 months of Services. But this quarter, the signings took a real big decline year-over-year and quarter-over-quarter, and the profitability for both this quarter and the outlook appears to be materially below your expectations, now dipping below 10% compared to when you said 10% to 12% in the lower end of the range of that just a few months ago.

So can you give us one more try of clarity of how we can get assurance that this isn't a perpetual trend? And shouldn't it then just rebound pretty remarkably for signings in Q4, if you talked about timing, or was it just the first half of the year was unsustainably too high?

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

Okay, I will take a couple different pieces of it. And if I don't touch on them all, please come back with your follow-up, because you had a couple of different things.

So A, year-over-year growth in signings for the quarter was down 7%. It was down because we did not have as rich -- as high-volume renewal opportunity in the quarter. On a year-to-date basis, Services signings are up 30%. So quarter to quarter sometimes we have a big renewal opportunity, sometimes we have a smaller renewal opportunity. This particular quarter, we had a smaller renewal opportunity. But year to date, our signings overall are up.

If we look overall at some of the pressure we are seeing in margin, I would start with this quarter's margin was 9.9%. We said we expect it to be at the low end of the range of 10% to 12%. That's 10 basis points below the target.

Overall for the full year, we said we think we are going to be a little bit lower than 10%. Again, a little bit lower, we are now kind of cutting hairs a little bit. But on a year-to-date basis, our margin is 9.8% in Services.

So our margin is a little bit lower. We are not talking leaps and bounds here. We are talking a little bit of margin pressure. And as we look towards 2014, as Ursula just mentioned, we are expecting we are going to see margin expansion.

Some of the margin pressures about we are seeing are from factors that their nature is they are going to be short term and we will start to lap them in 2014. The runoff of the student loan business overall is clearly one of those factors. The fact that we haven't had any contribution from acquisitions, which are typically margin accretive, are another one of those factors.

We have had a little more pressure on margin as we have stood up some of these new platforms. That's not unusual, but these things are now going to become for us repeatable processes. We will get better because of experience and we will get better because of scale.

So as I look forward into 2014, I think we've got great opportunities in the healthcare sector. Overall, our year-to-date signings growth has been really positive. The weak quarter of signings is really just because we didn't have a big renewal opportunity.

So overall, I think the underlying factors here continue to be really solid and we are looking forward to margin expansion and our growth rate picking up next year.

Jim Suva - *Citigroup - Analyst*

Great, thanks for the color. And as a quick follow-up, with that expansion next year, I assume that also includes the additional costs of ramps, the additional costs of the Affordable Healthcare Act that's coming in. And so we are not looking at setting up for 10% to 12% range or expansion and then coming back with a justification three or six months down the road of additional costs of ramping. I want to make sure you have involved some (inaudible) costs in that.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

In a normal quarter, Jim, we would actually -- if there were ups or downs, we basically would just cover those in the range that we have. So for 2014, I would expect that we would do that like we do anything. We have some volumes up, we have volumes down, we have startup costs up, et cetera.

This quarter -- fourth quarter -- this quarter we actually came in pretty close. As Kathy said, very, very narrow differences. We came in pretty close to where we expected to come out in margin, in revenue, in earnings. Actually, a little bit higher in earnings.

Fourth quarter, we see headwinds, temporary headwinds. And then in 2014, we expect to actually just be in a regular role, like we are in most of the quarters in 2013.

It's important, Jim, as well that you understand the signings dynamic. We have had a couple of quarters -- since we've bought ACS and gotten deeper into the Services business, we've had quarters where we had low renewals. And we've been trying to be very clear about how to actually look at those. And when you have a low renewal volume, they do have an impact because of the way that we calculate this, or the industry calculates this, and it has an impact on the signings number. And that's one of the reasons why it's important to not just look at the quarter, which we actually do focus on, but to look at all of the signings for the quarter, the new business signings for the quarter, the renewals that are available and the renewal rate.

And so we try to give you all of that data. Signings, renewals, new business, et cetera, should not be a concern. All of the numbers look good from a go-forward basis from a revenue perspective in Services -- across all of the businesses, actually.

Jim Suva - *Citigroup - Analyst*

Thanks very much.

Operator

Mark Moskowitz, JPMorgan.

Mark Moskowitz - *JPMorgan - Analyst*

Thanks. Good morning. First off I want to second that end motion regarding more transparency or cleaner cash flow reporting. I think it's giving investors to really focus on that dynamic.

As far as my questions, kind of along that same line of thought, Kathy, can you just remind us in terms of what your priority is with the Services business? Going forward, is it top-line growth or is it Services margin? Because I'm just trying to figure out how you really jumpstart the Services revenue growth profile going forward.

Is it going to really be about acquisitions? And if it is acquisitions, doesn't that kind of steal from capital allocation in terms of stock buyback, which has been a big part of investor psychology right now?

Kathy Mikells - *Xerox Corporation - Corporate EVP, CFO*

So the focus is profit expansion, and I'd say that's a focus across our entire business. In terms of how we get to profit expansion, I do think that we have a very good opportunity in getting to profit expansion in the Services business by growth, as well as by market expansion. So there, I expect to actually see both things occur.

With respect to acquisitions, we have been (inaudible) on acquisitions. The reason I've been talking about the fact that acquisition as a factor is because it historically accounted for 2 to 3 points of revenue growth within Xerox Business Services, and right now, we are not getting any revenue growth or profit growth, for that matter, from acquisitions. But I don't expect it at all to take away from our balanced approach in terms of capital allocation.

Mark Moskowitz - *JPMorgan - Analyst*

Okay, thank you.

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

Operator, if we could have the next question, please.

Operator

Kulbinder Garcha, Credit Suisse.

Kulbinder, your line is open.

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

If Kulbinder is not able to pick up, I think we are close to our end time, so I think we should say that's all we have for questions today. And Ursula, do you have anything else you'd like to wrap up with?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Thanks, Jim. We covered a lot of ground this morning, so let me bring it up a couple of levels. Q3 results and our continued focus on squarely and effectively implementing a sound business strategy, which is to be Services-led and to grow, profitable leadership from our Document Technology business, cash-generating annuity-based business model, to deliver consistent EPS expansion and financial strength to invest in building value for Xerox and in building value for you, that's our focus. I am confident that we will deliver and hope that you can join us or listen in to our investor conference on November 12th.

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

Thanks, Ursula. That concludes our call today and if you have any further questions, please contact me or any member of the investor relations team. Thanks so much.

Operator

This does conclude today's conference call. You may now disconnect.