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CORPORATE PARTICIPANTS

Jeffrey Jacobson *Xerox Corporation - CEO & Director*

Jennifer Horsley

PRESENTATION

Unidentified Analyst

Okay, great. Thanks, everyone for attending the 21st Annual Crédit Suisse TMT Conference. We're right after lunch, so hoping this exciting Q&A will burn all the calories off from what you just ate. With us from the company, we have Jeff Jacobson, to my direct left, Chief Executive Officer of Xerox; as well as Jennifer Horsley from -- Director of the Investor Relations. I was going to -- and then, I have a set of Q&A, and left over that we can open to a few questions in the audience at the end.

Jennifer Horsley

Great. Thanks, David. During this meeting, Xerox executives may make comments that contain forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995, that by their nature, address matters that are in the future and are uncertain. These statements reflect management's current beliefs of functions of expectations, and are subject to a number of factors that may cause actual results to differ materially. Information concerning these factors is included in the company's most recent annual report on Form 10-K and its subsequent quarterly reports on Form 10-Q, filed with the SEC. We do not intend to update these forward-looking statements as a result of new information or future events or developments, except as required by law.

Unidentified Analyst

Great. Thanks. Jeff, we'll start off. Now that you've spun out Conduent as separate business, what do you see is the biggest advantage to Xerox, going forward?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes. Thanks, David. It's great to be here with everyone. So the biggest advantage we have certainly is focus. We come out as an independent company. We separated, and if I look at the strategy, what we said was, first, we want to become a simpler, more nimble organization. So what we call Horizon 1 is basically what we've done is we said over a 3-year period from 2016 to 2018, we're going to drive $1.5 billion plus of productivity initiatives. So in 2016, we drove $550 million. This year, we're on target for our stated goal of $600 million, and that's going to enable us to do a few things. It's going to enable us to certainly have margin accretion, continued strong cash flow, but it's going to enable us to focus and to invest in the strategic growth areas of this marketplace. We deal on a large market of $85 billion, and about half of that market are growth initiatives where we want to invest, so it's going to enable us to have focus. It's going to enable us to have our R&D 100% focused on the business and every dollar we have will be returned either to our shareholders, invested back in the business or invested with our customers.

Unidentified Analyst

Great. Moving to just some of the differentiation of the company, how do you feel Xerox is differentiated from the competition? What makes you, you think, the winner in the printing game over the long term?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

I'm fortunate in that I got to look at this when joined this company 6 years ago. Having been in the industry over 30 years, when I came to Xerox in 2012, I really took a hard look, and I said, "If you could be at any place in the industry, where would you want to be?" And for me, it was Xerox even before I became the CEO, I came in running the graphic communications business. And the reason I felt that way is when I competed against Xerox for so many years, Xerox had a certain brand recognition, permission if I can call it that, where customers felt that Xerox would always keep them at the forefront of technology. So when I looked at it, and I say right now, especially -- we just had the largest product launch in the history of our 111-year company, we have the broadest portfolio in the industry. When I look at channel, we have a large direct channel. We have an indirect channel of mono-branded resellers, multi-branded resellers. So if I look at portfolio, I look at technology, I look at innovation, I look at channel reach, I really like the position we're in today.

Unidentified Analyst

Great. How are you viewing the enterprise space, which is fairly saturated with declining pages? And how do you expect the mix of technology and services in large enterprises to change as a result of that?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

We're actually -- we like the large enterprise space. It's a place that we were really founded on, where we've had a disproportionate amount of our own share in the enterprise space, and to that point, we're going to balance it out by pivoting more to the SMB market. But when we look at the enterprise space, our business is disproportionate into the Managed Print Services arena. But when we look at the rest of the market, it's not yet. So we would see upwards of over $10 billion of what we call base non-Managed Print Services business, that over the next few years, will be ready to make their transition into Managed Print Services, and as the leader in the industry in managed print services, it's an area we're targeting. So one of the things we've talked a lot about in our company, and we talked about during our conference calls, is investing in new logo, what we call, hunters. People who can get new brands, new logos that we have not done business with before, so what we're doing is taking some of the strategic transformation, make...

Unidentified Analyst

And do you think there will be a shift in expanding managed service versus more multifunctional devices, technology versus just standalone printer?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes, I mean we've seen it. We've seen Managed Print Services expanding. So if you look at Managed Print Services today, it's a $13 billion market. In the enterprise space, it's about $6 billion, and it's growing about 1% to 2%. We've got about 1/3 of that market, Managed Print Services in the large enterprise, where our bigger opportunity is actually in the Managed Print Services SMB space, small or medium business market, which now is a market that, in Managed Print Services, that's actually larger than the large enterprise. It's at $7 billion. It's growing at about 6%, and we actually only have about a 10%, 11% share there versus our 33% enterprise. So for us, with our new product launch, with our distribution channel bringing on new multi-branded resellers, we look at that as a good opportunity, and we've been -- if you look at the last few quarters, just about double the market growth rate. So last quarter, as an example, we grew 12% in that space, where the market was growing at 6%.

Unidentified Analyst

Great, just hitting on the revenue, I guess more recently, revenues have been declining mid-single-digits. Is that what you think will be the continued expected market growth? What's the strategy, or how hard it is to improve the revenue trajectory?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes, so -- and that's been a big part of our strategy. So we are declining right now, mid-single-digits at about 5%. The industry is declining in various pockets of, let's call it, negative 2% to negative 4%. Part of what we've done with this entire strategic transformation was, as I said earlier, Horizon 1 was driving as much cost out and productivity as we can, so that we can improve margins, improve our cash flow, but invest back into those strategic growth areas. So what we want to do is we want to get to the point where about 50% of our revenues by the year 2020 are in the strategic growth areas of A4 multifunction devices, which is a $12 billion market, growing at 3%.

The SMB multi-brand channel, which is about a $15 billion market, and we are significantly under-penetrated and we have big upside there, production color, which is a market that's growing at about 5%, and as I said before, Managed Print Services, especially in the SMB market. So now that we have this new product launch, what we would expect to do is, starting in Q4, really starting to see a significant improvement in our equipment sale revenue top line, which will then drive more page volumes, and enable us to improve our revenue trajectory -- the declines in our revenue trajectory over the next few years.

Unidentified Analyst

Great. And on top of revenue in terms of margin expansion, can you talk a little bit about how project Horizon is -- or other activities will be helping that going forward?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Sure. We're a company that's always, first and foremost, said we're going to drive margins hard. We're going to drive cash hard. That's kind of been our legacy, and it's kind of our DNA and what we wake up every day and say we're going to do. So we're at about 12% -- we guided this year to 12.5% to 13.5% adjusted operating margins. Through third quarter, we were at 12.3% year-to-date, which is 30 basis points above last year. Q4 is always our strongest operating margin quarter, so we're right on track for where we felt we would be and should be, and we like the position of where we are right now.

Unidentified Analyst

Yes. One of the things that I think a lot of the investors admire, and you mentioned in the beginning, is your R&D and innovation capabilities are very significant that -- since it's primarily focused on printers, could you position, reposition some of those innovation capabilities into other areas or adjacencies? It feels like you've been through a big product cycle that you just launched, so what's next? And...

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes. So that's one of the things, David, we're excited about with this separation, if you look at our Palo Alto Research Center, for the last 7 years, that was being utilized predominantly for our Business Process Outsourcing business, which was spun off and is now called Conduent. So we've now had that pivot. As a matter fact, one of the first things I did when I was named CEO of Xerox was to take our CEO of Palo Alto Research Center, Steve Hoover, and to say, Steve, I now want to take all of our long-term research, so think of Palo Alto, and all of our shorter-term commercialization cycle, think 0 to 3 years, of development and engineering, and put that all into you because what I want to do is compress the commercialization cycle of all of our products. So I want to start marketplace back, understand where the industry's going, marketplace is going, get that into our research labs, and then drive it through our development and engineering. So if you look at the things it's starting to pivot to now, and it's going to take some time, if you look at artificial intelligence, if you look at the Internet of Things, if you look at virtual reality, what I'll call the modern-day workplace and the things that we can do, interfacing with, for example, Amazon Alexa and voice activation of our devices, those are the things that we're looking at. And if I look at the areas of packaging and printing adjacencies to where we are today, if I just look at the industrial printing market, it's probably about the same size as the $85 billion core market that we're in today. So as we look at our business, we say, let's take our core business, let's improve the revenue trajectory, the current decline's in it, and then look at these adjacencies that we have some knowledge with to deal with today.

Unidentified Analyst

Great. And a question I've heard in several of the these sessions at the conference around capital allocation, and so I want to give the investors a sense on what your philosophy is. Will 2018 potentially look any different than 2017? Will share repurchase be more in the mix? How do you balance all that with M&A, CapEx and other initiatives?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes, so we believe very much in a strong return of capital strategy. In fact, in our December -- last December Investor Conference what we said was over time, we want to be able to return at least 50% of our free cash flow back to our shareholders. If we look at it now, we have a very strong dividend in the range of 3.25% to 3.5%, which is about $300 million on an annual basis. We did not do share buybacks this year because we really wanted to get our balance sheet in order, so we took some tactical actions, such as paying down about $500 million of our pension in Q3, as well as the cessation of our accounts receivable, sales programs or factoring, which will put us in a much stronger position for 2018.

Unidentified Analyst

Excellent. And then in terms of mergers and acquisitions, what are the focus areas for tuck-in or more transformational activities there? And then secondly, just from originally buying ACS, and then ultimately, spinning it out, were there any learnings that came from that, that you'll apply going forward?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes. And I think anything we do, going forward, will certainly be related to our business. It won't be a Business Process Outsourcing type of acquisition. As I look at the things we do, it's how do we support the strategic growth areas, A4 multifunction devices, production color inkjet, anything that will help us from an SMB standpoint or Managed Print Services. So if I think of Managed Print Services, I think of things such as Workflow Automation or Professional Services. I think of things that will support our inkjet business. I look at packaging today, which is an area that we touch tangentially, but if you look at it, it's not really digital yet. It's still very much an analog world. So if you look at the packaging community, you'd say there's labels, folding carton, corrugated and flexographic. Labels will be about 25% digital, but if you look at folding carton, corrugated or flexographic, it's basically single digits digital. So those would be opportunities, but again, we're not the type of company that gets out ahead of our headlights, and we're going to look at doing things in a tactical way, and we will be looking at a continuation of our channel strategy of channel acquisitions.

Unidentified Analyst

Great. And then moving to cash flow. Your free cash flow has been very good over the last few years. Cash flow this year was impacted by some unique items of pension contribution, ceasing of accounts receivable sales, so how should the Street think about normalized operating cash flow and trajectory over time?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

So I would say our normal operating cash flow continues to be strong and has been strong. So we started this year by guiding operating cash flow at $700 million to $900 million. When we came out with our third quarter earnings, what we said was we actually increased the guidance of our operating cash flow for this year from $700 million to $900 million to $800 million to $1 billion, okay? We took 2 actions that we did to strengthen our balance sheet and benefit us for the future years. So one was we actually announced in September that when we issued some new notes -- a new note to swap some debt we had, which improved from a 6.3% interest rates to a 3.6% interest rate, at the same time, we were going to pay down $500 million on our underfunded U.S. pension plan, and we did that because this year, we had $350 million contemplated originally, and we paid an extra $500 million. But over a 2-year period, we knew we were going to have $800 million of pension contributions. At our Investor

Conference last December, what we said was we'd have $800 million over a 2-year period. So we did $350 million this year, and we knew we'd have $450 million next year. So we wanted to get ahead of that. So we paid $500 million down on our pension. We also, if you're generating $800 million to $1 billion in operating cash flow, we didn't see the need to continue to basically be factoring your receivables. So we took a one-time hit in the quarter in this year of $350 million. But if you want to look at it on a normalized basis, all other things being equal, we'd be at an operating cash flow of about $800 million to $1 billion. And instead of the $350 million in pension this year, as we said on the Q3 call, next year, we'd probably be at about $200 million to $250 million. So there'd be actually another $100 million that would go into our operating cash flow.

Unidentified Analyst

Great. And just as a follow-up, would it be fair to say that free cash flow by 2019, so maybe a little further out, could be in a range of $1 billion or higher?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

We're not giving guidance for even '18 at this point, '19. We will give guidance in January when we announce our Q4 results. But again, if you go back to our $800 million to $1 billion of operating cash flow, and if we have $100 million less of pension contributions, that would give you the order of magnitude, assuming all other things being equal, and our CapEx typically runs about $150 million a year, so that's the order of magnitude.

Unidentified Analyst

Great. Then you mentioned earlier one of the, I think, the big competitive advantages of Xerox, the brand, the global nature, given that's about 40% of your sales are non-U.S. dollar, how do you think about the weaker dollar? Is there an updated view as to currency impact to EPS?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes. So currency in the past couple of years has actually been a significant headwind. So if I look at it from a revenue standpoint, and if I go back to 2015, it was a 5-point headwind in translation currency; 2016, a 2-point headwind; and year-to-date for 2017, a 1 point on top line translation currency. If I look at last quarter, it was the first quarter, probably in the last, I think, 3 years, where translation currency actually was a benefit. If I go to transaction currency, which has been a big headwind, in 2016, it was about a 50 basis point hits us on margin. And this year, year-to-date, it was about a 70 basis point hit to our operating margin. We, actually, if you were to take the current spot rates, think that we would be neutral next year, which would be a big improvement and a big help for us.

Unidentified Analyst

Great. And do you -- how do you think as a company just about hedging or any of those strategies?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

So we don't hedge translation, but we do hedge transaction, and that tends to smooth things out on both sides.

Unidentified Analyst

Great. One final question, I guess what are you most excited about that you're almost a year or 2 in as CEO? What do you believe has been the major accomplishments? What are some of the big things left that you're looking to achieve?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

We always have more to do. What I'm excited about and proud of, David, is if I look at it, first we came out of a 2016 separation. And when you talk about separation, I mean, there's a lot of heavy lifting just to do that to take 2 -- 1 company and turn it into 2. And then if I look at the strategic transformation, we set a goal of $1.5 billion plus over a 3-year period. We're now 2 years through that. We are well on the way to that, and certainly, achieving it. If I look at rolling out the largest product launch in the 111-year history of this company, and doing it as flawlessly as the team did, very proud of that as well. And then most importantly, we made commitments to our investors of metrics, and we reaffirm those in Q3, and we're on target for that. So we feel good about that, and feel we're excited about the future.

Unidentified Analyst

That's great. We have about 5 minutes left, maybe I'll to open it up to the audience if there are any questions.

Unidentified Analyst

When you talk about different areas to try to grow beyond just the core business and looking at adjacencies, one of the things that a large peer and HP has started doing a couple of years ago is try to get into the 3D printing space and claim that that's an adjacency that they can get into. How do you think about trying to address that? Have you got any thoughts of getting into that space?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes, so we actually provide, on a relatively small basis, heads, printing heads, to the 3D market, nothing of significance. What we looked at is we're looking more at the packaging space from an adjacency standpoint. And as I said before, looking at workflow automation, we're looking at Professional Services. 3D is a good market, but I think for us, at this point, we would say production inkjet near-term and packaging are the areas that we want to focus on.

Unidentified Analyst

So Jeff, on the product cycle side, earlier in the year, you talked about, I think, 25 or 30 new products that were getting launched in 2017. I guess, where are you in that cycle? And is this something that could carry over as a growth driver into next year?

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes, so we -- the 29 new products have now been introduced as of the end of Q3. As a matter fact, we introduced the last 8 A4 products towards the end of Q3, so those 29 are done. We also introduced, in the high end, 3 inkjet products over the last year, Rialto, Brenva and Trivor. So from that standpoint, we feel really good because we believe what that will enable us to do is to change the revenue trajectory of our equipment sale revenue, where for the last 5 quarters, we've basically been declining about 10%, and obviously, the best way to change the overall revenue curve, because about 75% of our business is post sale annuity, is get more machines out there, running pages, which will then start to change the annuity as well. So short answer is from the 29 products, they're now fully introduced.

Unidentified Analyst

Okay, Jeff, maybe a follow-up. We sometimes see, where some customer is holding off, maybe buying these new products, products were coming out so they were waiting, so there may be some pent-up demand.

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Yes, I don't think there's any question about that. In fact, the good news is, as I said on the third quarter call, our pipeline for new signings is at a very healthy level. Our backlog is as high as it's been over the last year, so we know there was that pent-up demand. We also had some issues in our U.S. business from a public sector standpoint just because of where the government budgets were, but we're starting to see that ease up. So all indications are starting. As we said on the Q3 call, we expect to see significant improvements in Q4, and then following it to next year because we would expect from an equipment standpoint, to see certainly, at least 12 months of benefit there. We'll have some favorable year-over-year compares. And then the post-sale revenue will follow in the years to come.

Unidentified Analyst

Any other questions in the audience? Okay. Well, thanks, everyone, for joining. Enjoy the rest of the day.

Jeffrey Jacobson - *Xerox Corporation - CEO & Director*

Thank you very much.