Fourth Quarter 2017 Earnings

Non-GAAP Financial Measures

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http://www.xerox.com/investor

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Non-GAAP Financial Measures

We have reported our financial results in accordance with generally accepted accounting principles (GAAP). In addition, we have discussed our financial results using the non-GAAP measures described below. We believe these non-GAAP measures allow investors to better understand the trends in our business and to better understand and compare our results. Accordingly, we believe it is necessary to adjust several reported amounts, determined in accordance with GAAP, to exclude the effects of certain items as well as their related income tax effects.

A reconciliation of these non-GAAP financial measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are set forth below as well as on our website at www.xerox.com/investor.

These non-GAAP financial measures should be viewed in addition to, and not as a substitute for, the company's reported results prepared in accordance with GAAP.

Adjusted Earnings Measures

- Net income and Earnings per share (EPS)
- Effective tax rate
- Gross margin, RD&E and SAG (only adjusted for non-service retirement-related costs and transaction/proxy related costs)

The above measures were adjusted for the following items:

- *Amortization of intangible assets*: The amortization of intangible assets is driven by our acquisition activity which can vary in size, nature and timing as compared to other companies within our industry and from period to period. The use of intangible assets contributed to our revenues earned during the periods presented and will contribute to our future period revenues as well. Amortization of intangible assets will recur in future periods.

Non-GAAP Financial Measures

- *__Restructuring and related costs:__* Restructuring and related costs include restructuring and asset impairment charges as well as costs associated with our Strategic Transformation program beyond those normally included in restructuring and asset impairment charges. Restructuring consists of costs primarily related to severance and benefits paid to employees pursuant to formal restructuring and workforce reduction plans. Asset impairment includes costs incurred for those assets sold, abandoned or made obsolete as a result of our restructuring actions, exiting from a business or other strategic business changes. Additional costs for our Strategic Transformation program are primarily related to the implementation of strategic actions and initiatives and include third-party professional service costs as well as one-time incremental costs. All of these costs can vary significantly in terms of amount and frequency based on the nature of the actions as well as the changing needs of the business. Accordingly, due to that significant variability, we will exclude these charges since we do not believe they provide meaningful insight into our current or past operating performance nor do we believe they are reflective of our expected future operating expenses as such charges are expected to yield future benefits and savings with respect to our operational performance.

- *__Non-service retirement-related costs:__* Our defined benefit pension and retiree health costs include several elements impacted by changes in plan assets and obligations that are primarily driven by changes in the debt and equity markets as well as those that are predominantly legacy in nature and related to employees who are no longer providing current service to the company (e.g. retirees and ex-employees). These elements include (i) interest cost, (ii) expected return on plan assets, (iii) amortized actuarial gains/losses and (iv) the impacts of any plan settlements/curtailments. Accordingly, we consider these elements of our periodic retirement plan costs to be outside the operational performance of the business or legacy costs and not necessarily indicative of current or future cash flow requirements. Adjusted earnings will continue to include the elements of our retirement costs related to current employee service (service cost and amortization of prior service cost) as well as the cost of our defined contribution plans.

Non-GAAP Financial Measures

- *<u>Other discrete, unusual or infrequent items</u>:* In addition, we also excluded the following items given their discrete, unusual or infrequent nature and their impact on our results for the period:
  - Losses on early extinguishment of debt in the first and fourth quarter of 2017
  - A benefit from the remeasurement of a tax matter in the first quarter of 2017 that related to a previously adjusted item
  - Costs incurred in the fourth quarter of 2017 related to the recently announced transaction with Fujifilm as well as to our expected proxy contest. These costs are primarily for third-party investment banking, legal, accounting, consulting and other similar services.
  - An estimated non-cash charge in the fourth quarter 2017 reflecting the impact associated with the enactment of the Tax Cuts and Jobs Act (the "Tax Act") in December 2017. See our Fourth Quarter 2017 Earnings Release on Form 8-K filed with the Securities and Exchange Commission.

We believe the exclusion of these items allows investors to better understand and analyze the results for the period as compared to prior periods and expected future trends in our business.

<u>Adjusted Operating Income/Margin</u>

We also calculate and utilize adjusted operating income and margin measures by adjusting our reported pre-tax income and margin amounts. In addition to the costs and expenses noted as adjustments for our Adjusted Earnings measures, adjusted operating income and margin also exclude Other expenses, net. Other expenses, net is primarily comprised of non-financing interest expense and also includes certain other non-operating costs and expenses. We exclude these amounts in order to evaluate our current and past operating performance and to better understand the expected future trends in our business. Adjusted Operating income and margin also include Equity in net income of unconsolidated affiliates. Equity in net income of unconsolidated affiliates primarily reflects our 25% share of Fuji Xerox net income. We include this amount in our measure of operating income and margin as Fuji Xerox is our primary intermediary to the Asia/Pacific market for distribution of Xerox branded products and services.

Non-GAAP Financial Measures

Constant Currency

To better understand trends in our business, we believe that it is helpful to adjust revenue to exclude the impact of changes in the translation of foreign currencies into U.S. dollars. We refer to this adjusted revenue as "constant currency." This impact is calculated by translating current period activity in local currency using the comparable prior year period's currency translation rate. This impact is calculated for all countries where the functional currency is the local country currency. The constant currency impact for signings growth is calculated on the basis of plan currency rates. Management believes the constant currency measure provides investors an additional perspective on revenue trends. Currency impact can be determined as the difference between actual growth rates and constant currency growth rates.

Free Cash Flow

To better understand trends in our business, we believe that it is helpful to subtract amounts for capital expenditures (inclusive of internal use software) from cash flows from continuing operations. Management believes this measure gives investors an additional perspective on cash flow from operating activities in excess of amounts required for reinvestment. It provides a measure of our ability to fund acquisitions, dividends and share repurchase.

Summary:

Management believes that all of these non-GAAP financial measures provide an additional means of analyzing the current period's results against the corresponding prior period's results. However, these non-GAAP financial measures should be viewed in addition to, and not as a substitute for, the company's reported results prepared in accordance with GAAP. Our non-GAAP financial measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures and should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. Our management regularly uses our supplemental non-GAAP financial measures internally to understand, manage and evaluate our business and make operating decisions. These non-GAAP measures are among the primary factors management uses in planning for and forecasting future periods. Compensation of our executives is based in part on the performance of our business based on these non-GAAP measures.

A reconciliation of these non-GAAP financial measures and the most directly comparable measures calculated and presented in accordance with GAAP are set forth on the following tables:

Net Income and EPS reconciliation

(in millions, except per share amounts)	Three Months Ended December 31, 2017		Three Months Ended December 31, 2016		Year Ended December 31, 2017		Year Ended December 31, 2016	
	Net (Loss) Income	Diluted EPS	Net Income	Diluted EPS	Net Income	Diluted EPS	Net Income	Diluted EPS
As Reported [1]	$ (196)	**$ (0.78)**	$ 185	**$ 0.70**	$ 192	**$ 0.70**	$ 622	**$ 2.33**
Restructuring and related costs	24		92		220		264	
Amortization of intangible assets	12		14		53		58	
Non-service retirement-related costs	62		19		198		131	
Loss on extinguishment of debt	7		-		20		-	
Transaction and proxy related fees	9		-		9		-	
Income tax on adjustments [2]	(45)		(46)		(171)		(151)	
US Tax Act	400		-		400		-	
Remeasurement of unrecognized tax positions	-		-		(16)		-	
Restructuring and other charges - Fuji Xerox [3]	1		-		10		3	
Adjusted	$ 274	**$ 1.04**	$ 264	**$ 1.00**	$ 915	**$ 3.48**	$ 927	**$ 3.53**
Dividends on preferred stock used in adjusted EPS calculation [4]		$ -		$ -		$ -		$ 24
Weighted average shares for adjusted EPS [4]		264		264		263		256
Fully diluted shares at end of period [5]		264						

(1) Net (Loss) Income and EPS from continuing operations attributable to Xerox.
(2) Refer to Effective Tax Rate reconciliation.
(3) Other charges in 2017 represent audit and other fees associated with the independent investigation of Fuji Xerox's accounting practices.
(4) For those periods that exclude the preferred stock dividend the average shares for the calculations of diluted EPS include 7 million shares associated with our Series A or Series B convertible preferred stock.
(5) Represents common shares outstanding at December 31, 2017 as well as shares associated with our Series B convertible preferred stock plus dilutive potential common shares as used for the calculation of diluted earnings per share for the fourth quarter 2017.

Effective Tax Rate reconciliation

(in millions)	Three Months Ended December 31, 2017					Three Months Ended December 31, 2016					Year Ended December 31, 2017					Year Ended December 31, 2016				
	Pre-Tax Income		Income Tax Expense		Effective Tax Rate	Pre-Tax Income		Income Tax Expense		Effective Tax Rate	Pre-Tax Income		Income Tax Expense		Effective Tax Rate	Pre-Tax Income		Income Tax Expense		Effective Tax Rate
Reported (1)	**$**	**226**	**$**	**444**	**196.5%**	**$**	**179**	**$**	**18**	**10.1%**	**$**	**570**	**$**	**481**	**84.4%**	**$**	**568**	**$**	**62**	**10.9%**
Non-GAAP Adjustments (2)		114		45			125		46			500		171			453		151	
US Tax Act		-		(400)			-		-			-		(400)			-		-	
Remeasurement of unrecognized tax positions		-		-			-		-			-		16			-		-	
Adjusted (3)	**$**	**340**	**$**	**89**	**26.2%**	**$**	**304**	**$**	**64**	**21.1%**	**$**	**1,070**	**$**	**268**	**25.0%**	**$**	**1,021**	**$**	**213**	**20.9%**

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(1) Pre-Tax Income and Income Tax Expense from continuing operations.

(2) Refer to Net Income and EPS reconciliations for details.

(3) The tax impact on the Adjusted Pre-Tax Income from continuing operations is calculated under the same accounting principles applied to the As Reported Pre-Tax Income under ASC 740, which employs an annual effective tax rate method to the results.

Key Financial Ratios – Q4

(in millions)	Three Months Ended December 31, 2017			Three Months Ended December 31, 2016		
	As Reported (1)	Adjustments (2)	Adjusted	As Reported (1)	Adjustments (2)	Adjusted
Total Revenues	$ 2,747	$ -	$ 2,747	$ 2,734	$ -	$ 2,734
Total Gross Profit	1,088	23	1,111	1,094	7	1,101
Post Sale Revenue	2,065	-	2,065	2,080	-	2,080
Post Sale Gross Profit	901	23	924	889	7	896
RD&E	114	(8)	106	113	(4)	109
SAG	676	(40)	636	639	(8)	631
Total Gross Margin	39.6 %		40.4 %	40.0 %		40.3 %
Post Sale Gross Margin	43.6 %		44.7 %	42.7 %		43.1 %
RD&E as a % of Revenue	4.1 %		3.9 %	4.1 %		4.0 %
SAG as a % of Revenue	24.6 %		23.2 %	23.4 %		23.1 %

(1) Revenue and costs from continuing operations.
(2) 2017 includes adjustments for non-service retirement-related costs and transaction/proxy-related costs. 2016 includes adjustments for non-service retirement-related costs.

Key Financial Ratios – FY

(in millions)	Year Ended December 31, 2017 As Reported [1]	Year Ended December 31, 2017 Adjustments [2]	Year Ended December 31, 2017 Adjusted	Year Ended December 31, 2016 As Reported [1]	Year Ended December 31, 2016 Adjustments [2]	Year Ended December 31, 2016 Adjusted
Total Revenues	$ 10,265	$ -	$ 10,265	$ 10,771	$ -	$ 10,771
Total Gross Profit	4,061	75	4,136	4,261	49	4,310
Post Sale Revenue	8,014	-	8,014	8,352	-	8,352
Post Sale Gross Profit	3,414	75	3,489	3,513	49	3,562
RD&E	446	(25)	421	476	(25)	451
SAG	2,631	(107)	2,524	2,695	(57)	2,638
Total Gross Margin	39.6 %		40.3 %	39.6 %		40.0 %
Post Sale Gross Margin	42.6 %		43.5 %	42.1 %		42.6 %
RD&E as a % of Revenue	4.3 %		4.1 %	4.4 %		4.2 %
SAG as a % of Revenue	25.6 %		24.6 %	25.0 %		24.5 %

(1) Revenue and costs from continuing operations.
(2) 2017 includes adjustments for non-service retirement-related costs and transaction/proxy-related costs. 2016 includes adjustments for non-service retirement-related costs.

Operating Income/Margin reconciliation – Q4

(in millions)	Three Months Ended December 31, 2017 Profit	Three Months Ended December 31, 2017 Revenue	Three Months Ended December 31, 2017 Margin	Three Months Ended December 31, 2016 Profit	Three Months Ended December 31, 2016 Revenue	Three Months Ended December 31, 2016 Margin
Reported (1)	$ 226	$ 2,747	8.2%	$ 179	$ 2,734	6.5%
Adjustments:						
Restructuring and related costs	24			92		
Amortization of intangible assets	12			14		
Non-service retirement-related costs	62			19		
Transaction and proxy related fees	9			-		
Equity in net income of unconsolidated affiliates	25			27		
Restructuring and other charges - Fuji Xerox (2)	1			-		
Other expenses, net	36			57		
Adjusted	$ 395	$ 2,747	14.4%	$ 388	$ 2,734	14.2%

(1) Pre-Tax Income and revenue from continuing operations.
(2) Other charges in 2017 represent audit and other fees associated with the independent investigation of Fuji Xerox's accounting practices.

Operating Income/Margin reconciliation – FY

(in millions)	Year Ended December 31, 2017			Year Ended December 31, 2016		
	Profit	Revenue	Margin	Profit	Revenue	Margin
Reported [1]	**$ 570**	**$ 10,265**	**5.6%**	**$ 568**	**$ 10,771**	**5.3%**
Adjustments:						
Restructuring and related costs	220			264		
Amortization of intangible assets	53			58		
Non-service retirement-related costs	198			131		
Transaction and proxy related fees	9			-		
Equity in net income of unconsolidated affiliates	115			127		
Restructuring and other charges - Fuji Xerox [2]	10			3		
Other expenses, net	141			200		
Adjusted	**$ 1,316**	**$ 10,265**	**12.8%**	**$ 1,351**	**$ 10,771**	**12.5%**

(1) Pre-Tax Income and revenue from continuing operations.
(2) Other charges in 2017 represent audit and other fees associated with the independent investigation of Fuji Xerox's accounting practices.

Other expenses, net

(in millions)	Three Months Ended December 31, 2017		Three Months Ended December 31, 2016	
Other expenses, net - Reported	**$**	**36**	**$**	**57**
Adjustment:				
Loss on early extinguishment of debt		(7)		-
Other expenses, net - Adjusted	**$**	**29**	**$**	**57**

Operating Cash Flow / Free Cash Flow reconciliation

(in millions)	Q4 2017 Actual	FY 2017 Actual	FY 2018 Guidance
Operating Cash Flow [1]	**$ (28)**	**$ 122**	**$ 900 - 1,100**
Less: CAPEX (inclusive of Internal Use Software)	(35)	(105)	(150)
Free Cash Flow [1]	**$ (63)**	**$ 17**	**$ 750 - 950**

(in millions)	Q4 2017 Actual	FY 2017 Actual	FY 2017 Guidance
Operating Cash Flow [1]	**$ (28)**	**$ 122**	**$ (50) - 150**
Elimination of certain accounts receivables sales programs	350	350	350
Incremental, voluntary contributions to U.S. defined benefit pension plans	-	500	500
Adjusted Operating Cash Flow [1]	**322**	**972**	**$ 800 - 1,000**
Less: CAPEX (inclusive of Internal Use Software)	(35)	(105)	
Adjusted Free Cash Flow [1]	**$ 287**	**$ 867**	

(1) Operating Cash Flow and Free Cash Flow from continuing operations.

EPS Guidance

	FY 2018
GAAP EPS from Continuing Operations	**$2.30 - $2.50**
Non-GAAP Adjustments	1.20
Adjusted EPS from Continuing Operations	**$3.50 - $3.70**

Note: Adjusted EPS guidance excludes non-service retirement related costs, restructuring and related costs, amortization of intangibles, as well as other discretely identified adjustments.

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