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Xerox Holdings Corp. (XRX)

Q4 2020 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Xerox Holdings Corporation Fourth Quarter 2020 Earnings Release Conference Call hosted by John Visentin, Vice Chairman and Chief Executive Officer. He is joined by Xavier Heiss, 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 Holdings Corporation today’s conference call is being recorded. Other recording and/or rebroadcasting of this call are prohibited without the expressed permission of Xerox. And after the presentation there will be a question-and-answer session. [Operator Instructions] During this conference call Xerox executives will make comments that contain forward-looking statements, which by their nature address matters that are in the future and are uncertain. Actual future financial results may be materially different than those expressed herein.

At this time, I would like to turn the meeting over to Mr. Visentin. Mr. Visentin, you may begin.

Giovanni John Visentin  
Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Good morning, and thank you for joining the call. I hope everyone is safe and healthy. Times of adversity require working in unison and I couldn’t be prouder of the way our team came together. We put our strategy to the test in 2020, demonstrating we can deliver positive earnings per share and free cash flow while protecting our people, returning capital to shareholders and continuing to invest in our future. The team’s discipline allowed us to turn on a dime, tightly controlling expenses while steadfastly supporting clients.

To summarize the full year results, GAAP EPS from continuing operations totaled $0.84, down $1.94 from 2019, and adjusted EPS was $1.41, down $2.14 from 2019. Operating cash flow from continuing operations was $548
million, down $696 million year-over-year and free cash flow was $474 million, down $705 million year-over-year. Adjusted operating margin was 6.6%, down 650 basis points year-over-year. We generated $450 million in gross cost savings, meeting our target for the year.

Over the last two and a half years, Project Own It has generated $1.4 billion in savings, freeing up cash to reinvest in our operations, targeted adjacencies and innovation. We returned 112% of free cash flow to the shareholders in 2019. And we accomplished all of this while revenue declined to approximately $7 billion, a decrease of 22.7% in constant currency from the prior year as a result of office closures in practically every geography in which we operate.

The impact of the pandemic continues. We're optimistic about the vaccine distribution and advances in testing and treatments, though the pace of the economic recovery and office reopens remains fluid. While we saw sequential improvement over the last two quarters, we don't expect a return to growth in the first quarter. In 2021, we expect revenue to be at least $7.2 billion in constant currency, operating cash flow from continuing operations to be at least $600 million and free cash flow to be at least $500 million. We believe this is achievable even in the unlikely scenario businesses don't start reopening in a meaningful way in the first half.

The benefit of a solid strategy is it's flexible in its application yet strong in its foundation. Our four strategic initiatives, optimize operations for simplicity, drive revenue, reenergize the innovation engine and focus on cash flow and increasing capital returns remain at the center of what we do to deliver results for all stakeholders.

Let me walk through the changes we are making to the business to drive organic growth. Project Own It has been critical to fund investments by generating savings and there is more to do here. We plan to save $375 million as a result of Project Own It in 2021.

Through robotic process automation we have streamlined routine tasks including managing service tickets, updating asset data and processing customer billing and vendor invoicing. In the fourth quarter bots processed more than 1.8 million transactions, up over 300% year-over-year. RPA’s potential to deliver savings and efficiencies is now part of our go-to-market strategy.

We are piloting our RPA services with clients supporting loan application processing, targeted mail campaigns, document management for legal clients and more. There is opportunity to offer this capability to small and medium-sized businesses to help increase their efficiency and reduce cost by automating operations. By unlocking the opportunity within existing and new businesses we will increase the breadth of our offerings, reach new customers and drive organic growth.

Our printing business is second to none. IT services delivered organic growth in 2020 and is gaining traction with small to mid-sized businesses. Within the next 12 to 18 months, we plan to stand up three separate businesses; software, financing and innovation, as we continue to invest in them to support clients. The software business will bring together expanding capabilities to support clients’ digital needs and will report to Steve Bandrowczak, our President and Chief Operations Officer.

Late last year we acquired CareAR, an enterprise-augmented reality business that offers live virtual assistance technology. CareAR's initial technology is focused on modernizing field service, customer support and other IT services. Today, ServiceNow is collaborating with Deloitte to integrate the CareAR platform for ServiceNow into the operations service systems and support workflows for joint clients.
The software business will also include DocuShare, our cloud-based content management system, XMPie, our multi-channel marketing software and other software offerings such as the Xerox Content Hub we launched late last year. This new offering integrates XMPie and turns Xerox multi-function printers into content creation stations. SMBs are seeking enterprise-level content management systems that allow easy access to documents no matter where a person is working. Our newest release DocuShare Go is designed for the SMB. Its multi-tenant infrastructure offers automatic capabilities and a SaaS pay-as-you-go model for single or multiple users, also launched with a new version for enterprises offering more capability for on-premise users and addressing their need for increased controls and security.

Xerox Financial Services or XFS will become a global payment solutions business with a new leader, Nicole Torraco, reporting to me. XFS previously provided financing mostly for Xerox equipment to support our sales team. Looking ahead it will offer financing for technology, office equipment and more for third-parties as well. Fully utilized XFS will expand our customer base create potential cross-selling opportunities and position us to support SMB.

We’ve previously shared our focus on the SMB, a large and growing part of the business community whose needs for IT services increased with the shift to remote and hybrid working environments. Our IT services business now operational in the US, UK and Canada delivered organic revenue growth in 2020. We see increased opportunity here as we enhance offerings with new security and automation capabilities and leverage new and existing partnerships including expanded partnerships with Dell and Lenovo, allowing us to grow our geographical coverage and IT services offerings.

Despite global office closure and widespread economic impact of the virus, Xerox regained the top spot in total equipment sales revenue share in our territory, held the number one position in both mid and production segments and took share in entry. Demand within government accounts has been a key driver, resulting in year-over-year equipment sales growth in the US enterprise business. We believe the capability, security and broad selection of apps on Xerox devices puts them ahead of competitors, providing clients with a seamless experience that increases their efficiency.

In the fourth quarter, the production portfolio had major updates across all segments, addressing professional print shops’ needs to extend their business to new customers and enhance productivity. One example is the Baltoro’s new color accelerator add-on that allows for more applications while saving ink. The Baltoro holds the top market share in the cut sheet production inkjet class.

Digital print enhancements increased profitability, providing clients with higher margins through increased offerings. Our suite of production products offers the widest range of colors and embellishments. And we’re making it easier to take advantage of this opportunity with a new A3 device, the C8000W, introduced late last year that represents the most affordable entry point into this lucrative print market.

In 2021, we’re continuing to innovate in this portfolio, adding workflow automation, machine learning, artificial intelligence and remote services to make our clients and employees more efficient while maintaining security. For example, machine learning will enable devices to recognize individual patterns and make timesaving recommendations.

In innovation, we have made some strong progress over the last two years, developing disruptive technology that we are beginning to commercialize. That gives us the confidence to stand up a separate Innovation business that will be named PARC. This new business will include the innovation teams in Palo Alto, California; Webster, New
York; Cary, North Carolina; and Toronto, Ontario. The PARC business would be led by our Chief Technology Officer, Naresh Shanker.

Our 3D metal printer is a breakthrough technology. Localized 3D printing can improve resiliency, flexibility and responsiveness of supply chains by enabling localized production of end use parts. And our liquid metal technology uses off-the-shelf wire which is safer, more cost effective and requires less post processing than metal powders.

In December, we reached an important milestone with the first installation of our Xerox Element X 3D liquid metal printer at the Naval Postgraduate School in Monterey, California. The Xerox solution will be a key component of the school's efforts to use additive manufacturing to sustain the Navy's mission readiness, agility and reach across its sea, land and air operations. This is a strategic partnership for NPS which is looking to lead large scale adoption of additive manufacturing throughout the US Navy.

Similarly, with industrial IoT the combination of low cost sensors, cloud computing and data analytics software has the potential to advance sustainable practices, limit equipment downtime, improve safety through predictive maintenance and provide increased situational awareness.

These are the areas where PARC developed fiber optic sensors and solutions are gaining traction. PARC has worked with VicTrack, a state-owned enterprise in Victoria, Australia to pilot a new technology that remotely monitors the structural health of critical infrastructure such as bridges in real time.

The initial trial of our solution proved successful and Xerox is planning broad commercialization given the increasing risk profile and safety issue caused by aging infrastructure across the globe. Other IoT sensors built by PARC are part of a groundbreaking project by the US Defense Advanced Research Project Agency to study the oceans.

In cleantech, the team is developing a solution that has the potential to cut energy consumption of air conditioners by up to 80%, reducing greenhouse gas emissions and improving indoor air quality. At the end of 2020, the team completed a proof-of-concept prototype and validated its operational principle. Now, we are working to build the first alpha unit by the end of 2021, serving as a sample for potential partners to assess and provide product requirements for our beta units to be completed by the end of 2022.

Technology such as AI, augmented reality and virtual reality developed at PARC also will be rolled into CareAR's product roadmaps and other parts of our portfolio. To enhance our innovation ecosystem and further capitalize on the deep knowledge of experts at PARC, we are establishing a $250 million corporate venture capital fund. This fund will invest in startups and early and mid-stage growth companies aligned with our innovation towers and targeted adjacencies such as IT services, software and AI. The corporate venture capital fund will act as a bridge between internal and external innovation and commercialization efforts, building an ecosystem that drives growth through investments, commercial partnerships and co-development of new technologies.

Our strong cash position provides flexibility to explore a wide range of M&A opportunities, invest in existing business and return capital to shareholders. Over the last three years, we returned 89% of cumulative free cash flow to shareholders, exceeding a commitment to return at least 50% annually. The majority of returns came through share repurchases. In 2020, we returned over 100% of free cash flow to the shareholders. We view share repurchase as an investment in the business. We have a $500 million repurchase authorization for 2021 and plan to be opportunistic in how we use it.
We shared a lot with you today. So, let me take a moment to sum it all up. Like many others, the pandemic hit us hard. We got up, dusted ourselves, and got to work transforming Xerox for the future. We’re taking market share, investing in existing and new technologies, and regularly sourcing and evaluating M&A opportunities.

Our three-year plan and four strategic initiatives remain our roadmap. Our strategy and hard work over the last few years are paying off. We delivered positive EPS and cash flow and returned capital to shareholders. We are positioned to return to growth in 2021 and expand into new markets. We plan to stand up three separate businesses, software, financing and innovation by 2022 to provide greater focus, flexibility and visibility. We plan to identify the right long-term structure for each of these unique businesses, which may include utilizing the holding company structure. We bolstered our software offerings with the acquisition of CareAR. We are integrating existing capabilities to offer a broader suite and expand beyond existing clients.

Our RPA technology has moved from optimizing our business to doing the same for clients. Our investments are aimed at technologies targeted for double digit growth in coming years. These actions, along with the corporate venture capital fund, demonstrate the priority we are placing on building a strong future. We are confident in our strategy and our team whose tireless commitment to Xerox and its growth will always be the key to our success.

Now, let me hand it over to Xavier to cover the financial results in more detail.

Xavier Heiss
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

Thank you, John and good morning, everyone. As John mentioned, we are making changes to our business to drive organic growth and after I review our Q4 financial result, I will expand on our plan for our financing business, XFS, and our Innovation business, PARC.

In Q4, we sequentially grew revenue, adjusted EPS and cash flow versus Q3, consistent with a slightly improved economic condition we observed. But the year-over-year comparison show that our financial results continue to be impacted by business closure resulting from COVID-19. We reported $1.93 billion of revenues this past quarter, a year-over-year decline in constant currency of 19.8% when excluding the OEM licensing fee of $77 million that was paid to us by Fuji Xerox in Q4 2019 or 22.3% with it.

Adjusted operating margin of 9.5% in the quarter represent sequential improvement of 210 basis points over Q3 and a year-over-year decline of 460 basis points, excluding the 270 basis points impact of the one-time OEM fee from Fuji Xerox. The year-over-year decline in operating margin was caused by lower revenue resulting from pandemic-related business closure which was partially offset by savings from Project Own It and participation in government assistance programs, the impact of which was significantly less than in prior quarter.

Gross margin was 36.2% in the quarter, which is down 350 basis points year-over-year excluding the onetime OEM fee from Fuji Xerox or down $40 basis point with it. The year-over-year decline in gross margin was caused by lower revenue coupled with less profitable revenue, reflecting lower post sale and supplies and higher equipment sales and IT services revenue which were partially offset by benefit from Project Own It.

SAG expense of $440 million decreased $72 million year-over-year and was in line with quarter three SAG expense of $444 million. The year-over-year improvement reflect benefit from cost savings on restructuring associated with Project Own It. Bad debt expense of $13 million was $5 million higher than prior year and $3 million lower than quarter three. Current bad debt reserve for our credit and finance receivable are in line with our prediction.
RD&E as a percentage of revenue was 10 basis point higher year-over-year on lower revenue. We continue to increase investment in our innovation-focused areas while reducing spend on our print technology by simplifying our portfolio. Other expenses net of $30 million was $22 million higher year-over-year as a result of action we took to improve our long-term liquidity position in quarter three and quarter four, whereby we use proceed from new debt financing to prepaid $1.1 billion of bonds that would have matured in May 2021. The prepayment resulted in a net loss of $26 million but it satisfied virtually all our near-term bond maturities.

Our fourth quarter adjusted tax rate was 29.8% compared to 25% in the prior year. The 480 basis points year-over-year increase in adjusted tax rate result primarily from a change in the geographic core mix of our earnings. Adjusted EPS increased sequentially $0.10 over quarter three and was $0.75 lower than the same quarter last year. GAAP EPS of $0.36 was $0.81 lower year-over-year.

Non-GAAP adjustment included an increase in the amortization of intangible assets reflecting new acquisition in early 2020 on the loss of early extinguishment of debt that I referred to a moment ago. These increases were partially offset by lower restructuring on related costs. In Q4, we recorded $29 million of restructuring and related costs compared to $53 million in the fourth quarter last year.

Our focus on expense control and working capital drove positive earnings and cash flow in the fourth quarter. We generated $235 million of operating cash flow from continuing operation in the quarter, which was $129 million above quarter three and down $163 million from prior year, primarily driven by lower net income. For the year, we generated $548 million of operating cash. Cash from working capital of $123 million was $180 million higher than prior year due to inventory management and strong collection that were only partially offset by an increase in accounts payable primarily due to the timing of payment to vendor.

CapEx was $14 million in the quarter and $74 million for full year, which was slightly higher than prior year, reflecting spending in IT infrastructure and strategic core new initiative. For 2021, we expect CapEx of $100 million supporting our strategic growth program and continued investment in our IT infrastructure. We spent $203 million of cash on acquisition in 2020 including our quarter four acquisition of CareAR. For 2021, we are modeling spend of $100 million for tuck-in acquisition primarily focused on further penetrating the SMB space and our target adjacencies. We also continued to evaluate larger M&A opportunity that can accelerate growth, diversify our revenue base, and/or expand our capabilities.

Within financing cash flow and in the line with strategic action we took to improve our long-term liquidity, we prepaid $1.1 billion of bonds that would have matured in May 2021 with proceeds from a combination of senior unsecured bond issued in quarter three and a new $500 million private securitization of US financial assets that closed in December. We have no bond maturing in 2021 and only $300 million of bonds maturing in 2022. We repurchased $150 million of share in the quarter which completed the $300 million of share repurchase that we guided to for the full year.

We also paid $54 million in dividend in quarter four and $230 million in dividend full year. We generated $221 million of free cash flow in the quarter and $474 million for the full year. We are confident in our ability to generate cash and we have a strong balance sheet that supported shareholder return of $530 million in 2020, which was 112% of our total free cash flow for the year. We ended the year with $2.7 billion in cash, cash equivalents and restricted cash and our $1.8 billion revolving credit agreement is undrawn.

Turning to quarter four revenue, equipment sales of $510 million declined 18.8% in constant currency. While COVID-19 was still impacting our equipment sales and installs in the quarter, activity in government account in
both the US and EMEA was strong. Our US enterprise business had another quarter of year-over-year equipment sales growth to government customers who have sustained strong demand into 2021.

Also in the US, equipment sales to graphic communication customer grew sequentially, reflecting strong demand for our Baltoro cut-sheet inkjet system. In EMEA, large government deals helped our direct channel improve sequentially and we saw higher install of [ph] entry mono devices as well as strong demand for our recently launched PrimeLink light production mono devices.

However, SMB channel in the US and in EMEA were more challenged in quarter four compared to quarter three due to increased restrictions caused by the pandemic. Post sales revenue of $1.42 billion in quarter four declined 20.1% in constant currency, adjusting for the OEM fee impact which was in line with quarter three trend.

Including the OEM fee in the prior year, post sales was down 23.5% in constant currency. Our post sales revenue is largely contractual and most of our contracts include a minimum fixed charge and a variable charge based upon print volume.

Post sales also includes unbundled supplies, paper and other sales which are largely sold through our indirect channels and are more transactional. Strong year-over-year growth in IT services in our XBS channel in the US and sales from recently acquired dealer outside the US enable a 13.6% year-over-year revenue decline in constant currency in supplies, paper and other sales compared to a 20.2% decline in quarter three. So, growth in IT services sales was driven by demand for remote working learning solution as well as IT security reinforced requirement.

Xerox Services revenue in quarter four declined 19.4% year-over-year in constant currency compared to a 21.3% decline last quarter. While activity remained challenged as a result of COVID-19, our new business signings and our renewable win rate grew year-over-year in the quarter. On a full year basis, global enterprise signings were higher, which provides confidence in our business recovery post-COVID-19.

Looking at our profitability trend clearly shows the impact of the pandemic on our business, particularly in the first half when revenue declined 24.4% as a result of the widespread global lockdown and business closure. Nonetheless, we generated positive cash flow on earnings in every quarter due to the speed with which we were able to react to the impact of the pandemic. Our ability to react quickly come from Project Own It which has created a more flexible cost structure on disciplined expense management, allowing us to identify temporary cost savings measures to help manage through the pandemic.

Under Project Own It, we have achieved approximately $1.4 billion of gross cost savings since late 2018, including $450 million in 2020. We expect $375 million of gross cost savings from Project Own It in 2021. So progression of improvement in the second half of the year is indicative of the modest global economic recovery particularly in quarter three. Quarter four is typically our largest quarter and it was again this year. However, our business was impacted by the resumption of lockdown later in the quarter as a result of COVID-19.

Now on to capital structure. Our pension funded status is updated annually and as of December 31, 2020, our net unfunded pension liability was $905 million which include $851 million of unfunded pension liability for plan that by design are not funded. The $307 million year-over-year reduction in our net unfunded pension liability reflect contribution on strong asset return that were partially offset by decreased discount rate. In 2020 we contributed $139 million to worldwide pension plan and expect 2021 contribution to be in line with 2020.
As our debt primarily support our financing business, XFS, I will take a few minutes to discuss some of the structural announcement John spoke to earlier, which includes standing up XFS and Innovation as separated businesses. Xerox has a long history of providing financing to our customers. Supported by our strong balance sheet this is a key business enabler, providing customer a one-stop shopping experience and allowing us to maintain long-standing customer relationship.

Customer financing also provide additional post-sales revenue such as secondary market equipment sales on evergreen payment that extends beyond the initial lease and carries strong margin. We will now expand XFS activity beyond financing on lead Xerox equipment. To provide more context on XFS, as of year-end 2020 XFS balance sheet asset consisted of $3.5 billion of finance receivable on equipment and operating lease. We leverage those asset at a 7 to 1 debt to equity ratio today. Therefore, $3 billion of the $4.4 billion of our total reported debt was allocated to XFS.

The remaining debt balance which we call core debt was $1.4 billion. After netting the $2.7 billion of cash, cash equivalent and restricted cash on our balance sheet at year-end, our 2020 ending net cash position was $1.3 billion.

In order to more strategically and economically fund XFS financing activity, we raised $840 million in securitization of US finance assets in 2020 which provide match funding at attractive all-in rates. With respect to Innovation we are encouraged by the progress we have made in developing new technology within our focused area that will result in PARC becoming not only a world-class research center but a growth engine for Xerox.

We expanded our investment in Innovation in 2020 and we’ll continue to do so in 2021. Also as John mentioned, we are allocating $250 million of our excess cash to create a corporate venture capital fund. We expect to deploy those fund over the next five year to further enhance PARC’s innovation ecosystem.

We are advancing Innovation and although we are expecting modest revenue from PARC in 2021 the disruptive Innovation adds significant long-term revenue growth potential for Xerox. We expect to begin providing investor with additional financial information on both XFS and Innovation within the next 12 to 18 months.

I will wrap up by addressing our guidance. As John mentioned, we are guiding to at least $7.2 billion in revenue in 2021, and to free cash flow of at least $500 million. In our modeling, we expect a modest recovery throughout the year but we also expect quarter one to remain challenged due to the COVID-related lockdown and business closure we are seeing today. We are confident in our ability to generate cash and plan to continue our capital allocation policy of returning at least 50% of our annual free cash flow to shareholder.

Thank you. And now back to John.
QUESTION AND ANSWER SECTION


Ananda Baruah
Analyst, Loop Capital Markets LLC

Hi. Good morning, guys. Happy New Year. Thanks for taking the question. And by the way, not for nothing, you guys are consistently looking for creative ways to create value. So, I just wanted to point out that and that you’re aware but it’s worth mentioning on this call. Could you guys just walk through, and listen, you did a good job of sort of teasing out a lot of details around the business separation. But at the highest level, could you walk through, John, really what's the sort of the philosophy behind doing that is? I know you’re going to say things like operating efficiency, driving performance, optimizing potential and things like that. But like in addition to that, driving visibility, potential for sort of spinning them out, anything else you can give us there would be super helpful. And then I have a follow-up.

Giovanni John Visentin
Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Yeah. Hi, Ananda. What I would say is the revenue trajectory and the market opportunity we see in these three areas, it gives us confidence to stand them up as a separate business. And to become a separate business, it will allow each area to be more focused and flexible in responding to the demands of the market. We’re working to identify a long-term structure for each of these businesses which may include the use of the holding company structure for financing and innovation. And we’re looking to share more information in the coming quarters with you.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Okay. Great. That's helpful. And I guess this is maybe for Xavier. When we think about sort of – like the structure of what free cash flow generation will look like in a normalized fashion, so over the next couple of years, is there anything that we should keep in mind with what you guys are doing strategically that could materially alter what the cash cycle might look like as we model? You’re giving good guidance for 2021. But as we think about sort of out past 2021 in our own modeling.

Xavier Heiss
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

Hi, Ananda. Yeah. So, good question to hear. So, as you know it, [ph] Ananda (00:37:02), as we mentioned it in the call here, so we are returning to growth. So, obviously, revenue will be a key driver here. And at the same time, we want to maintain the investment that we are making currently on Innovation. So, if you look at the free cash flow here, obviously, net income driven by revenue is clearly our key area of focus on where we are currently driving and putting our effort. At the same time on working capital, obviously as you know it, we will focus on inventory and payables. Revenue with AR could drive or will drive, if the revenue trajectory is positive there, will drive a [ph] slow (00:37:40) downside on the working capital element.
Ananda Baruah
Analyst, Loop Capital Markets LLC

So, nothing on working capital that could change it will be an incremental headwind?

Xavier Heiss
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

No. At this stage, no. If you keep it simple between net income and the working capital there is no specific item. Revenue is a key item that we want to drive here.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Thank you, guys. Appreciate it.

Operator: Thank you. Our next question comes from Matt Cabral with Credit Suisse. Your line is open.

Matthew Cabral
Analyst, Credit Suisse Securities (USA) LLC

Yes. Thank you. I wanted to dig a little bit into the cost side of the equation in 2021 and I guess Project Own It, you guys are talking about $375 million of savings which I think is in line with the original target you guys gave a few years ago. I guess if we take a step back revenue dynamics have changed meaningfully versus that period of time. And you're guiding for 2021 that's about 25% below where you ended up in 2018. I guess with that in mind why not look to target costs more aggressively and maybe just talk about leverage you have to adjust the cost base both this year and maybe as we think about 2022 and beyond.

Xavier Heiss
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

Hi, Matt. And hey, Matt. As you know it, so Project Own It is a three-year program that we put in place and currently this program has delivered successfully more than $1.4 billion savings here. Project Own It was also the foundation during COVID-19 to readjust our cost base and we did it successfully as well.

So, we keep this foundation and we'll build on it there. So, if you look at next year, obviously you look at the overall margin, our margin sequentially improved quarter-over-quarter, I'm speaking about operating margin. And some of the outcome is directly related to the savings driven by Project Own It.

Next year, with more revenue coming into the base here, this is what is giving us confidence in the free cash flow guidance that we can grow it year-over-year and as you know it, we have a risk management team as evidenced and demonstrated our commitment on the cost reduction here.

Matthew Cabral
Analyst, Credit Suisse Securities (USA) LLC

Got it. And then just on the situation with Fuji, I was wondering if you could just give us an update on where that stands, if your guidance for 2021 includes them exercising the option or not? And maybe just more broadly, how we should think about your approach to the Asia-Pac region longer term?
Okay. So, Fuji relationship, we may [indiscernible] (00:40:20) so we negotiated this transaction last year. And the relationship remain a relationship where Fuji is one of our main supplier and provide some of our line of equipment. And we have good relationship on this one.

The second item on Fuji, as you know it, we have negotiated a royalty related to the usage of the brand, Fuji Xerox update to have these royalties. This will translate into a $100 million cash payment in 2020 and will depreciate it over a two-year period, which is a period that we'll use here.

So, Fuji Xerox, I will say so far in wrap up, and relationship from a supplier point of view is going as expected and our financial modeling are in line with what we're expecting.
(00:43:28) gross margin, maintenance of gross margin, I'm looking at the gross margin expansion. And the second element is to protect the investment we are making to support the future of the business.

And the last reason of the three business startups that we just mentioned before where we would have more focus, more visibility as well and the flexibility for these businesses here. So, Project Own It, the $375 million is what we have included currently in our budget. But depending on the condition on what will happen with COVID-19. But in our model currently, with Project Own It on the methodologies or tools that we are using, we are planning to ensure that we will deliver the $510 million of free cash flows that we have mentioned in our guidance.

Shannon Cross  
*Analyst, Cross Research*

Okay. Thank you very much.

Xavier Heiss  
*Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.*

Thank you.

Operator: Thank you. Our next question comes from Paul Coster with JPMorgan. Your line is open.

Paul J. Chung  
*Analyst, JPMorgan Securities LLC*

Hi. This is Paul Chung on for Coster. Thanks for taking my questions. So, first question is can you just talk about the health of your [ph] VAR (00:44:46) and distribution partners? Are you seeing any consolidation in the space? And once demand comes back, the senior partners can ramp quickly. Is this the case? And do you expect any changes in pricing? Just anything you can mention on the health of your channel partners. I know you mentioned some lean channel inventory there to kind of shore up liquidity. And then I have a follow-up.

Xavier Heiss  
*Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.*

Yeah. So, as you know it, hi Paul too, as you know it, we don't have a lot of specific concentration in distribution partner by themselves here. So, what we see currently, I will tell you, it's quite – I mean, I won't say normal but a healthy situation, our relationship with distribution partner specifically in the SMB market on the reseller had been I will say quite positive during the year.

As you know it, we went through and we leveraged XFS in order to support some of their activity at the top of the crisis last year. But at the same time, I will tell you and I was pleased with the outcome from a cash situation here, where we finished the year from a receivable cash flow positive situation and a DSO improvement as well. So, no specific tension I could mention here with our distribution partner as of now.

Paul J. Chung  
*Analyst, JPMorgan Securities LLC*

Okay. And then my follow-up is on your shareholder return guidance of at least $250 million for 2021. So I assume your dividend doesn't change kind of leaving lower pace of buybacks in 2020. Is that the right way to think about it? And then when free cash flow kind of normalizes more so in fiscal year 2022, maybe that percentage goes back to kind of historical norms.
Giovanni John Visentin  
**Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.**

Yeah. I would look at it as we’ve committed to 50%. But we’ve also been approved to acquire back $500 million of our stock opportunistically in 2021.

Paul J. Chung  
**Analyst, JPMorgan Securities LLC**

Thank you.

**Operator:** Thank you. Our next question comes from Jim Suva with Citigroup Investments. Your line is open.

Jim Suva  
**Analyst, Citigroup Global Markets, Inc.**

Thank you very much. John, you mentioned about the separation of businesses and then you mentioned the term stand-up of businesses a lot. I'm not overly familiar with that term, stand-up. I'm more familiar with like tax-free spin-outs, IPO, SPACs, distribution to shareholders like what happened with Conduent and carve-outs. But then I also realized you do have a holding company shell structure also. So, I didn't know are some of those vehicles more likely and others less or are they all on the table? I'm just trying to kind of figure out...

Giovanni John Visentin  
**Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.**

Got you. Yeah.

Jim Suva  
**Analyst, Citigroup Global Markets, Inc.**

...what do you mean, stand up? What do you mean? Thank you.

Giovanni John Visentin  
**Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.**

Yeah, Jim. We're looking to identify the right long-term structure for each of these businesses and we expect to share more information in the next few months. But as of now you could argue that they're all on the table.

Jim Suva  
**Analyst, Citigroup Global Markets, Inc.**

Got you. Okay. And heading back are you looking at like three new headquarters for all of them and board of directors and executive slates and all of that or is that just kind of a little premature to talk about?

Giovanni John Visentin  
**Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.**

I think it's premature to talk about it. Stay tuned.
Okay. Thank you very much. And the last point, this is probably a CFO question potentially ahead of the standing up of all these businesses, are there additional costs that we should be aware of or cash flow that needs to be earmarked for these actions? Or is it that will come when the decisions are kind of more put into concrete?

Xavier Heiss  
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

So, that's also something and as John mentioned it we are currently assessing what does that mean and how we will do this stand-up and the cost that will be associated to this will be communicated later on. We plan during an investor day to share with you more information.

Jim Suva  
Analyst, Citigroup Global Markets, Inc.

Got you. Okay. Well, thank you very much for the details. It's greatly appreciated.

Giovanni John Visentin  
Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Thanks, Jim.

Xavier Heiss  
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

Thank you, Jim.

Operator: Thank you. We have a question from Katy Huberty with Morgan Stanley. Your line is open.

Katy L. Huberty  
Analyst, Morgan Stanley

Thank you. Good morning. In the third quarter, I believe you've benefited from some replenishment of channel inventory. Can you comment on in 4Q whether channel inventory was a tailwind or a headwind? Then I have a follow-up.

Xavier Heiss  
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

Replenishments. Sorry, Katy. It was a replenishment of?

Giovanni John Visentin  
Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

If you can repeat the question.

Katy L. Huberty  
Analyst, Morgan Stanley

Of channel inventory.

Xavier Heiss  
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.
Okay, No, no, no. So, I will give you the sequence here. Quarter two, quarter three, what we saw is that a channel partner for cash, obvious reasons had managed our inventory. When I say channel partner, is a two-tier distribution on resellers. In quarter four, we did not see a strong improvement in the situation. And we have, I will say, a higher set of what we call weaker inventory. But well below the norm on the channel inventories currently are held by the channel partner at the I won't call the lowest level, but at a low level.

Katy L. Huberty  
Analyst, Morgan Stanley

And then just as a follow up, some businesses we speak to are saying that they're not going to ask their employees to come back until sometime between, say, July and Labor Day of this year. Does your $7.2 billion, at least, revenue forecast contemplate a scenario like that, or are you assuming some improvement in return to office in the calendar second quarter?

Xavier Heiss  
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

So, we are looking at this on when we model this, Katy. We look at, I'll call a modest improvement during the year specifically connected with the vaccine and how the vaccine will be spread and enable people to be back to work. So, this is more like a second half revenue expectation here. Quarter one, as you know, it will be certainly very similar to quarter four. The vaccine has not yet impacted and we see modest improvement in some of our leading indicator but we do not expect quarter one to be a strong improvement versus quarter four.

Katy L. Huberty  
Analyst, Morgan Stanley

Okay. And then lastly, how are you thinking about post-COVID normalized print volumes in a world where there is more remote and hybrid work? This came up in some other questions. How much flexibility is there for you to adjust the cost structure if say volumes are permanently lower by say 10% or 20% versus pre-COVID levels?

Xavier Heiss  
Executive Vice President & Chief Financial Officer, Xerox Holdings Corp.

So, two points, Katy. So first one as you know it, we have evidence that we can adjust the cost structure of the company to the situation. And we did it during COVID-19 and we'll keep this focus. So that's the motto and the driver of the team is still the same here.

So on point on print volume what we see is clearly new ways of working. And interestingly enough, we see that when people are working from home, they use as well some of our solution. So, we should not look at this by saying it's only printing from home become personal printing. They use some of the Xerox solution including software solution here.

So, we see a balance in revenue coming here. Will the print volume similar to 2018, 2019? It's very early to assess currently and we are watching this. We see the impact of COVID in 2020 and we see as well quarter-over-quarter how print volume grew sequentially.

Katy L. Huberty  
Analyst, Morgan Stanley

Great. Thank you.
Operator: Thank you. Ladies and gentlemen, that does conclude our question-and-answer session. I would like to turn the call over to John Visentin for any closing remarks.

Giovanni John Visentin
Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Thank you for your time today and I just ask that everyone be safe and be well.

Operator: Ladies and gentlemen, this concludes today’s conference call. Thank you for participating. You may now disconnect. Everyone have a great day.

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