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Xerox Holdings Corp. (XRX)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Xerox Holdings Corporation First Quarter 2021 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. After the presentation, there will be a question-and-answer session. [Operator Instructions]

During this conference call, Xerox executives will make comments that contain the 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 our Q1 2021 earnings call. I hope everyone is safe and healthy.

Our first quarter results were in line with our expectations. Revenue totaled $1.71 billion, down 8.1% year-over-year or 10.4% in constant currency. Free cash flow was $100 million, down $50 million from last year. Adjusted earnings per share totaled $0.22, up $0.01 year-over-year. And adjusted operating margin was 5.2%, up 50 basis points year-over-year.

In the first quarter, in an environment where many offices remained closed, we grew equipment sales and IT services revenue year-over-year. I am proud of how our employees have continued to deliver for our customers during the pandemic. With small and medium-sized businesses and enterprise clients planning to return more employees to the office, our differentiated offerings are well-positioned to serve their growing needs. The strength of our performance, portfolio and strategy gives us confidence we will return Xerox to growth in 2021.

The team remains laser-focused on our four strategic initiatives: optimize operations, drive revenue, reenergize the innovation engine, and focus on cash flow and increasing capital returns. We made progress across each of these initiatives during the quarter. Continuing to optimize operations for simplicity, improve our cost structure, and expand margins must be balanced against investing in growth. Project Own It helps us strike the right balance as does our focus on cash.

Project Own It is on track to deliver $375 million of gross cost savings this year. Part of these savings are funding investments in growth areas and transformational initiatives such as our effort to reimagine the service experience from supply chain logistics to customer care. Our investments in artificial intelligence, augmented reality, predictive analytics, robotics and workflow automation are reducing our costs and making it easier to work with Xerox.

We have now integrated these technologies to create software solutions that can transform how service teams support customers. We deploy these software solutions within our technical service organization. Our differentiated capabilities paired with our experience have allowed us to commercialize both the software solutions and a technical services offering, creating new revenue streams for Xerox. In fact, we recently signed our first competitive OEM customer for technical service. This OEM will outsource parts of their field service operations to Xerox. Our solution will help them gain efficiencies and provide quality service to their customers. We plan to introduce this offering to other OEMs and companies outside of our industry as well.

We have observed a positive correlation between vaccination distribution, people returning to the workplace, and page volumes from our equipment. For the quarter, volumes on the whole remain relatively flat versus Q4. As vaccination distribution progressed, we saw volumes in certain geographies start to increase modestly in late March. For example, in Israel, where more than half the population is vaccinated, the highest vaccination rate in the world, work from home transitioned to more of a hybrid work environment and page volumes returned to near pre-COVID levels. The return to the office and accelerating vaccine distribution, combined with strong demand for our equipment during the first quarter, are leading indicators that the improvement in our revenue trend will continue throughout the year.

Investments in our workplace A3 and A4 and production portfolios have allowed us to grow equipment sales revenue in every category year-over-year and take share in our territory according to the most recent IDC data. New capabilities in workflow automation and enhanced security are driving increased interest in our workplace products and earning Xerox industry recognition. Quocirca recently recognized the strength of our hardware and security, as well as our cloud, software and delivery capabilities by naming Xerox the leader in its worldwide managed print services market report.

Our IT service business grew for the third consecutive quarter. The team is winning increasingly sizable and comprehensive deals to manage the full IT stack for SMB customers. In the quarter, we expanded our IT services portfolio by launching Robotic Process Automation as a service, leveraging our own experience deploying this technology internally across all of Xerox. The pandemic has challenged SMBs to find sustainable cost reductions while maintaining productivity. Our offerings to automate routine tasks such as deal pricing, order processing, payroll and resource management have already gained traction with customers.

In software, the team started to integrate CareAR, an enterprise augmented reality company we acquired in late 2020, both operationally and from a portfolio perspective. CareAR makes any user an expert capable of solving issues remotely through live visual interaction, self-guided instructions, and contextual data for greater insight. This technology provides many benefits, from reducing costs and downtime to improving the customer experience and eliminating many onsite visits.

CareAR is at the center of our software solutions, which integrates PARC's artificial intelligence technology, ALTO AI; our content management system, DocuShare; and XMPie's personalization software. These solutions focus on three main areas – digital platform as a service, content creation and management, and automated workflows and intelligence – and have several industry-specific applications. Use cases include training retail associates, virtually processing claims, helping with facility-related issues, and troubleshooting data center operations.

Within a few months' time, we launched pilots with several global businesses and hospitality, high-tech and IT services. We also signed up major partners, including ServiceNow, Deloitte, and HCL. These partnerships are already helping us reach new prospective clients and build a strong and growing pipeline.

Regarding Xerox Financial Services, we signed our first OEM partner. Our strategy focuses on adding other OEMs and customers outside of our industry while increasing penetration rates of Xerox accounts, all of which should enable us to grow the portfolio. PARC Innovation has continued to make progress across our focus areas, including 3D printing, industrial IoT, and clean tech. In additive manufacturing, our solutions are designed to integrate into manufacturing operations to reduce risk in the supply chain.

Global supply chains that rely on just-in-time model are becoming increasingly more vulnerable. The recently launched Xerox ElemX 3D liquid metal printer can help alleviate some of that vulnerability. This printer provides advantages over powder-based metal 3D printing, which is predominantly deployed technology today. The ElemX printer is safer, more cost-effective, and faster.

At the end of last year, we established a product development collaboration with the US Naval Postgraduate School. This collaboration will aid NPS in pushing the adoption of 3D printing throughout the US Navy. The military supply chain is among the most complex in the world, and NPS understands firsthand the challenges manufacturers must address. Their feedback is helping us refine the ElemX's road map, which includes incorporating additional metal alloys, more complex geometries, and larger build volumes of production parts.

In IoT, we are preparing to commercialize solutions that monitor the health and critical infrastructure, such as bridges and roads. Aging infrastructure is a global challenge. We recently completed a pilot with VicTrack, a state-owned enterprise in Victoria, Australia, to monitor various infrastructure assets for structural degradation and prioritize maintenance. Public-private partnerships will be critical in solving the infrastructure challenges there and throughout the world.

Xerox has a long history of inventing technologies that make the world more sustainable, and we are now carrying forward our legacy with our clean technologies. The team continues to make progress on engineering an air conditioning solution that significantly reduces greenhouse gas emissions through greater energy efficiencies. Other research projects include batteries, green hydrogen, and environmental sensing and monitoring. These innovations will open the doors to new partnerships for PARC Innovation and can potentially have major impact on the world.

Given the progress we've made, we are accelerating our plans to stand up XFS, Xerox Software and PARC Innovation as separate businesses, which will provide greater focus, visibility and flexibility for each business. And now we expect to complete this in 2021, and we'll provide more information on each business, including financial metrics and relevant KPI such as loan originations for XFS.

Balancing investments in new and existing businesses while generating cash continues to remain a focus for this team. Our free cash flow in the first quarter was in line with our expectations. The first quarter is seasonally our smallest quarter, and the business continued to experience headwinds from the impacts of COVID-19, though we kept investing because we are managing the company to deliver long-term sustainable growth. We closed the quarter with $2.5 billion of cash, cash equivalents, and restricted cash on hand.

In the quarter, we purchased $162 million of shares, demonstrating our confidence in the company's long-term trajectory. We remain committed to our shareholders' return policy, including our current dividend rate, and plan to return at least 50% of annual free cash flow.

Before turning it over to Xavier, let me address some of the frequently asked questions we receive. We expect the improvement in our revenue trend to continue. More employees returning to offices, the acceleration of vaccine distribution, and increased demand for our equipment during the first quarter give us confidence that we will meet our full-year guidance.

We are managing modest supply constraints. The investments we have made in our portfolio of offerings are starting to pay off. IT services grew organically for the third consecutive quarter, expanding this portfolio to include Robotic Process Automation as a service will further enhance our momentum. We are seeing increased interest in our differentiated software solutions, which have the potential to transform the service experience across many industries.

We will continue to invest in our future while managing our expense profile. We are accelerating our plan to stand up XFS, Xerox Software, and PARC Innovation, positioning Xerox to return to growth and unlock value sooner.

Now, I'd like to hand it over to Xavier to cover our financial results in detail.

Xavier Heiss

Executive Vice President and Chief Financial Officer, Xerox Holdings Corp.

Thank you, John, and good morning, everyone. As John mentioned, we are pleased with quarter one performance. For revenue, we delivered a strong improvement compared to the trend over the last three quarters. Both equipment and post sales revenue improved in March, consistent with the progress of vaccinations and the gradual reopening of workplaces. Equipment revenue growth was stronger than higher margin post sales revenue, driving the 260-basis-point gross margin erosion year-over-year. I will provide more detail on revenue in the next slide.

Adjusted operating margin of 5.2% in the first quarter increased 50 basis points year-over-year. The 50-basis-point improvement in margins reflect the favorable impact from lower bad debt expense, savings from Project Own It, and discretionary spend action, partially offset by the impact of lower post sales gross profit. SAG expense of $448 million decreased $93 million year-over-year, reflecting a continuous focus on cost. The improvement includes the impact of an incremental $60 million bad debt reserve taken in the first quarter of 2020, lower selling expense, cost savings associated with Project Own It, and temporary cost reduction measure.

RD&E investment were maintained to protect innovation in future revenue streams. Investments focus on existing and new product and solution in the print business, as well as adjacencies on innovation towers. Quarter one RD&E as a percent of revenue was 4.3%, 20-basis-points lower year-over-year, reflecting continuous optimization of the print portfolio. Other expenses net of $4 million were $19 million lower year-over-year, primarily driven by reduction in non-service retirement-related costs, partially offset by higher net interest expense.

First quarter adjusted tax rate was 27.7% compared to 29.4% last year. The 170-basis-point year-over-year decrease results primarily from a change in the geographical mix of earnings. Adjusted EPS of $0.22 compared to $0.21 in the same quarter last year, reflecting a slightly lower adjusted net income, impacted by $10 million higher net non-financing interest expense, which was more than offset by a reduced share count. GAAP EPS of $0.18 was $0.21 higher year-over-year due to lower year-over-year restructuring and related costs, non-service retirement-related costs, and transaction and related costs.

Turning to revenue, trend improved across all geographies. In EMEA, the rate of revenue decline moderated more significantly than in the US, in part due to the earlier onset of COVID-19 in EMEA last year and partly due to the higher proportion of SMB customers in the region. SMB customer have been returning to workplace more rapidly than large enterprises, who are slower to return to large office building. Equipment sales of $381 million increased 17.2% year-over-year, or 14.2% in constant currency. Sales increased across entry, mid-range and high-end product and in both North America and in EMEA. We are encouraged by the increased activity indicating customers' confidence in returning to the workplace.

Indirect channel sales in EMEA and the US remained strong in entry mono. Channels' sales of mid-range products, including low-end color and black and white devices, as well as the recently launched PrimeLink light production devices grew significantly. Resellers continue to manage inventory below pre-pandemic levels, but are modestly increasing inventory based upon based upon firming demand.

In the Americas, sales in North America were in line with expectation. In the US, federal government sales remained strong, and education is starting to recover as schools prepare to reopen. Post sales revenue of $1.3 billion in quarter one declined 13.4% year-over-year, or 15.6% in constant currency. However, sequentially, the rate of decline in post sales revenue improved by 7.9% in constant currency. Post sales revenue is largely contractual, and most of our contract include a minimum fixed charge and variable charge based upon print volume.

Print volumes remained below 2019 levels (e.g. pre-COVID-19) in the quarter, primarily as a result of COVID-19-related business closures. However, we saw a modest sequential increase in page volume as the quarter progressed, consistent with the rollout of vaccination and more employees returning to offices. Post sales also include unbundled supplies, paper and other sales, which are largely sold through indirect channels and are more transactional. The rate of decline of unbundled supplies improved sequentially across all geographies, reflecting higher equipment sales and increasing page volume in the quarter.

IT services sales for the quarter, which are included in other sales, grew organically in XBS in the US and grew in the UK and Canada as a result of prior-year acquisitions. We are pleased with the traction in IT services, and we are continuing to expand the coverage of these offerings to SMB customers. While the environment remain uncertain, we are encouraged by the quarter performance, the strength of the service contract pipeline and installs backlog, which provide confidence that businesses are ready to reopen and resume investing.

Turning to cash, we closely manage cash at every level of the organization. Although COVID-19 headwinds continued to impact quarter one result, we generated $117 million of cash from operation. The continued focus on working capital management resulted in a $43 million [ph] source (20:56) of cash in the quarter, down $48 million year-over-year, with strong year-over-year improvement in cash from inventory, partially offset by lower cash from account receivable and accounts payable.

Cash from accounts receivable was impacted by a lower sequential decrease in revenue as compared to the prior year. For accounts payable, cash was impacted by the timing of payment as well as lower purchase in Q1 2021 due to inventory reduction effort and lower expenses. CapEx was $17 million in the quarter, supporting the strategic growth program and continued investment in IT infrastructure. We continue to expect CapEx of $100 million for the full year.

Within financing cash flow, we repaid $94 million of debt from securitizations. This debt amortize monthly and expect to refinance it with new securitizations in support of XFS, the global payment solution business. We also repurchased $162 million of share in the quarter and paid $54 million in dividends. We expect to repurchase share opportunistically and had $338 million of repurchase authority remaining as of March 31. Free cash flow for the quarter was $100 million. With a maniacal focus on cash, we remain confident in the guidance of generating at least $500 million of free cash flow in 2021.

Regarding profitability, we are relentless in the effort to optimize operations to drive profit and cash. Since its inception in late 2018, we have taken $1.4 billion of gross cost out of operations through the Project Own It cost transformation program. Another $375 million of gross cost savings is targeted in 2021. We generated positive cash flow and adjusted earnings in every quarter impacted by the pandemic due to a flexible cost structure and disciplined expense management. Not only do we expect margin on cash flow to improve in 2021 as the economy recover, but through continuous focused action, we expect margin to improve beyond this year.

Let's focus on XFS now. In January, we discussed plan to stand up three businesses: XFS, Software, and PARC Innovation. Looking at XFS, Xerox has provided leasing option to customer for decades. products enable customers to purchase the newest technology and office equipment while managing their cash flow. XFS' growth strategy include expanding leasing options beyond print to adjacencies like IT services and software. We are also expanding leasing beyond Xerox product and solution through OEM partner such as Lexmark, which we announced will be partnering with Xerox to provide financing for Managed Print Services engagement.

We know and understand leasing in this space. Today, XFS manage over 700,000 equipment leases across a diverse portfolio of customer and geographies. We employ a proprietary and disciplined credit approval process that drive low annualized loss rate while allowing for wide credit window. XFS lease origination increased in the quarter as compared to first quarter 2020 due to an increased level of XBS origination, in line with the strategy.

At the end of March, XFS has $3.4 billion of finance asset consisting of finance receivable and equipment on operating lease. We leverage finance asset at a 7:1 debt-to-equity ratio today. Therefore, $2.9 billion of total debt support XFS assets. XFS debt includes senior unsecured bond and securitization, and we plan to increase the amount of securitization, which provide cost-effective funding.

Looking at capital structure, net core cash was $1 billion at the end of the first quarter and $4.4 billion of debt outstanding, the majority of which, $2.9 billion, support XFS. The remaining debt of around $1.5 billion support the core business. Debt primarily consists of senior unsecured bond and securitization, and there are no bond maturing in 2021. We had $2.5 billion of cash, cash equivalent and restricted cash at the end of the quarter, which, when netted again (sic) [against] core debt, result in a net core cash position of $1 billion. The decline in cash from year-end primarily reflects the initiation of opportunistic share repurchase given the confidence in our strategy.

Now, to wrap up, we are pleased with the gradual recovery during the first quarter given the evolution of the pandemic. The pace of global rollout of the vaccinations should result in more employees returning to the workplace in the coming weeks and months. Therefore, we expect a recovery in the business throughout the year, especially in the second half. This, along with first quarter result, provide us confidence in delivering full-year revenue of at least $7.2 billion and generating at least $500 million of free cash flows in 2021.

Thank you. And now, back to John.

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Giovanni John Visentin

Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

Thank you, Xavier. Now, let's open the line for questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Ananda Baruhu (sic) [Baruah] with Loop Capital. Your line is open.

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Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

Hi. Good morning, guys, and congrats on a solid progress. Hey, a few, if I could. You guys mentioned that small, medium business is opening up faster than large enterprise makes sense. I know that small, medium business expansion in general is an important part of the structural strategy. And so, I was wondering if there was anything that you're doing there to accelerate the small, medium business expansion given that's the part of the economy that you see opening up more quickly. And then, I have two follow-ups. Thanks. Quickly.

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Giovanni John Visentin

Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

A

Yeah. Yeah. Ananda, with small and medium business, we're seeing progress in different areas. Our IT services business, so we're helping them not only open up again, but we're helping them focus on their cost reduction and managing their businesses. So, our IT services offerings, we've seen some good progression in SMB. We just announced six bot offerings that, inside of the first quarter, we already had clients that are taking it over. So, it's a full solution for SMB, and that's how we've been approaching it.

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Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

And, John, do you have a – I guess, like sort of if you dial back kind of five, six quarters ago, do you believe the revenue opportunity there over time because of the solution – some of the new solutions that have arisen? As a result of the last 12 months or so, do you think that levels up the revenue opportunity there?

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Giovanni John Visentin

Vice Chairman & Chief Executive Officer, Xerox Holdings Corp.

A

Yeah. I think what gives us confidence is, if you look back, we announced the IT services, we continue to announce offerings in SMB. We've also expanded IT services in the UK. And what gives us confidence is seeing not only our growth in these services, but also our growth in the ESR and the hardware that we saw in the first quarter.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

That's awesome. And just real quick on large enterprise or just enterprise in general [indiscernible] (29:10) from SMB, do you have any context you can share from your conversations with enterprise customers, sort of the timing of after they open up, when they may begin, like how long before they begin to put print projects on?

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

A

What we've noticed is as clients open, think of – as clients open, our clicks, as we call them, continue to increase. But I think, as we're looking at the correlation between the vaccination rates, the page volumes and our geographies, we're seeing our post sales grow as well. And more and more CEOs are talking not if they're going to reopen, but when and at what speed.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Okay. That's helpful. And then one quick one for Xavier. Xavier, any reason that long-term free cash flow should not return to the same percentage of net income as historically it's been?

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

A

So, as John mentioned it, there – as you know it, our business is based on two revenue streams, the equipment stream and the post sale stream. The post sale stream is gradually recovering, and this is the stream that has the higher margin here. So, when, over time, this mix will improve and we see that, we have seen some positive signs on sales volume coming back and also activities that we are doing for our customer, which are not directly related to print, but related to transactional volume. These volume are increasing. We see clearly the opportunity for income growing and then free cash flow growing as well.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Okay. That's helpful, guys. Thanks a lot. Appreciate it.

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

A

Thank you, Ananda.

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

Q

Yes. Thank you. Good bounce back on the equipment side this quarter. I guess as we dig underneath there, I'm curious how much you'd characterize this. Some sort of backlog or pent-up demand as employees are returning to the office versus more just the underlying demand picture that you're seeing? And just going forward, how we should think about the cadence of equipment revenue for the balance of the year.

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

A

So, Matt, what we see that, first, our equipment probably grew in every segment. So, as you have seen it, on the A4 entry segment, it was a significant growth, but also, A3 (sic) [A3 Mid] and production growth during the quarter. So, we see confidence from customer bringing back in line with vaccination and employees in the office, and acquiring or renewing some equipment, so – which will drive at the end of the day the page volume on the annuity stream. That is one of the main stream of our revenue here.

So, it's not only like a backlog. We have – we ended the quarter with a, I call that a strong backlog, but it's not only like a backlog recovery, it's literally related to confidence that the business have currently in order to bring back employees in the office.

Matthew Cabral
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks for that. And then, on XFS, on the FINCO, I'm wondering if you could expand a little more on the opportunity you see that securitizes a cheaper way to get access to financing versus – historically, you used the wider Xerox balance sheet as you've tried to get capital. And, I guess, as that securitization picks up going forward, I'm curious what that means in terms of incremental balance sheet capacity for more of the core business. And assuming that does free up some capacity, just what you'd like to do with it going forward.

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

A

Yeah. So, first on securitization, as you mentioned, it give us two benefits. The first benefit is it moderate or decrease the cost of funds that we have to support this business. And this is part of the strategy that we initiated by standing up XFS. So, as you know it, XFS is a significant part of the enablement that we bring in this business. And I'm sure you saw it as well, we are now expanded the XFS portfolio and offering not only to Xerox products but to other third-party OEM and other vendor here.

So, securitization help us from a fund point of view. Securitization help us also on our ability to expand this activity and to manage properly our free cash flow on this one. We will certainly be more, I will say, industrial, more structural in the way we approach the securitization quarter-by-quarter. And we have started last year having two main tranches of securitization and will carry on this year on securitization as well.

Matthew Cabral
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Operator: Thank you. Our next question comes from Katy Huberty with Morgan Stanley. Your line is open.

Katy L. Huberty
Analyst, Morgan Stanley

Q

Thank you. Good morning. I'm a little surprised to see the Americas revenues so weak, just given the success of the vaccine rollout here and also given all the surveys are showing that US tax spending is rebounding much faster than Europe. I know you made a few comments about SMB exposure in Europe. But can you talk a little bit more about why that is? Are European customers less likely to be on contract, so that's just a more transactional business? And then, just as a second part to that, what do you think the contribution to equipment sales was in the quarter from inventory rebuild at some of those channel partners?

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

A

Okay. So, Katy, I will take care of the North America first. The America revenue is in line with our expectation. As you mentioned it, vaccination progress here. However, large enterprise are starting slowly to bring people. And on SMB, we saw growth specifically on our SMB businesses here [indiscernible] (35:16) we saw improvement in page volume coming back here.

Europe, as you know, it has been hit last year, earlier as well. So, when you look at the year-over-year compare, you had more weeks of COVID impact in Europe compared to this year. You have seen as well that in both geography, EMEA and in Europe, after quarter four where we saw some activity coming back on page volume, December, we have seen some lockdown. And then January, February, in certain geographies, EMEA, Canada as an example, certain states in the US, certain geographies were slower.

The good sign or indicator that we have seen currently is that in March, in both geographies, both territories, we saw page volume improving and transaction improving here, which give us confidence as well added to the fact that ESR sales revenue was strong, give us confidence in the revenue trajectory.

Commenting now on the equipment sales on the building inventory there, there is no direct correlation. What we saw is that there is a progressive, I would say, rebound or a step-by-step improvement in inventory level. But these level are not the levels that we were seeing before.

Katy L. Huberty
Analyst, Morgan Stanley

Q

Okay. And if you think longer term about a more hybrid workforce, would you expect page volumes and post sales revenue to return to pre-COVID levels? Or do you think we should contemplate post sales revenue that's maybe a little bit below where we were pre-COVID once the end markets stabilize?

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

A

We have – Katy, as John mentioned it, we have one data point in a country which has a high vaccination rate, which is Israel, and we are monitoring this country specifically here. And in Israel, with more than 60% of the population being vaccinated, we observed page volume coming back to pre, very close or low – slightly lower than the pre-COVID-19 level.

What we observed as well is that even when you are in a hybrid environment and – we see hybrid being – having different definition company by company. When we are in hybrid model, where an employee returned to office, their page volume is also page volume that will cover some of the pages they are not printing at home as well here. So, so far, a little bit early to confirm all these cases here. But as I mentioned it, in March, we saw page volume increasing. We clearly monitor and track the correlation between vaccination, office presence, and page volume. And these three indicator correlate very strongly.

Katy L. Huberty
Analyst, Morgan Stanley

Q

Great. And then just lastly, the $60 million of bad debt expense, is that largely coming from your small, medium business customers? Is that from channel partners? And was there any concentration by region?

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

A

So, $60 million, Katy, was a provision we took last year across our entire XFS portfolio. And as I commented here, XFS has very strict rules and strict ways of looking at credit risk of partners. Our portfolio is diversified by geography, but also by customer type. And we have like a AAA, AA and the high-level type of ratings, rated company here.

The provision was put there in order to assess what could be the impact. We are running every quarter what we call stress test on our portfolio. And, currently, we are confident that this provision is at the correct level. Our lease contract are, in average – have, in average, a four years' period. So, it's too early at this stage to declare that the provision is, would say, overall valued. Currently, what we are just assessing is that this provision is sufficient to cover the risk we could have in the portfolio.

Katy L. Huberty
Analyst, Morgan Stanley

Q

Okay. Understood. Thank you so much.

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

A

Thank you, Katy.

Operator: [Operator Instructions] Our next question comes from Shannon Cross with Cross Research. Your line is open.

Shannon Cross
Analyst, Cross Research

Q

Thank you very much. I have a few questions as well. John, just from a big picture standpoint and some of your peers in Japan have started talking about this more. When we go out, say, three or four years, how do you envision Xerox? And what I'm trying to figure out is what kind of revenue percentages would be coming from printing versus some of your more focused areas, software, PARC, XFS, services? And then, how do you sort of – again, 50,000-foot level – see the margins shifting because, obviously, print is a very high-margin business but not growing and some of the others have more opportunities? So, I'm just trying to get an idea of maybe from a high level, how you see the business shifting. And then, I have a couple follow-ups.

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

A

Yeah. Shannon, what excites us is our four-pronged strategy. So, one of them being monetizing innovation and driving revenue. And in there, we've seen progress in our software business. We've seen progress in XFS. We've seen progress also in all our innovation. And we did just say that we're going to be standing up these businesses before the end of the year. We're doing that for a few reasons. One is focus, it's flexibility, but also to provide transparency to our investors. So, you can expect us to have an Analyst Day in the second half of the year, where we will be going through this and explaining to our investors why Xerox is a good investment for now and for the future.

Shannon Cross
Analyst, Cross Research

Q

Okay. So, we can't get it quite yet. I guess, then, in terms of cash usage, you used $216 million during the quarter. You said you'll return at least 50% to shareholders and targeting $500 million at a minimum for cash. So, clearly, there's a little more room, but if I add in what you've done so far, plus keeping the dividend, you're going to be somewhere around 75% of cash usage already or cash – sorry – free cash generation already. So, how should we think about share repurchase as you go forward? And obviously, I'm assuming the dividend is solid. Thank you.

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

A

Hey, Shannon, Xavier here. So, yeah, as we mentioned it, we will always look at the share repurchase as an opportunistic – in an opportunistic way here, as you mentioned it. We repurchased $164 million, $162 million of shares during the quarter. We mentioned in prior call there that we have an authority of $500 million. So, there is still more than $300 million, which is currently left here, and we will do that opportunistically for the year.

Shannon Cross
Analyst, Cross Research

Q

Okay. And then, my final question is just – and to some more extent, going back to Katy's, as you talk to customers these days, and now that we're a year plus through the pandemic and people are kind of revaluating how their offices are going to look and what they're going to do, what kind of changes are you hearing in terms of structure? Are people looking at more distributed printing? I would assume so, given the growth in the low end, but – and then, how are they thinking about what contract levels they're willing to sort of commit to, given there are still uncertainty in terms of who's going to be in the office and how many people are going to go hybrid? Thank you.

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

A

Yeah, Shannon. Like, if we look at just surveys that were done with CEOs last summer, you had like 69%, on a certain survey that where CEOs said they're going to downsize their real estate footprint. This was just reconducted recently, and it's down to 17%. I think the focus is going to be at what rate and pace will the employees be going back to the office. And it's a direct correlation to vaccination and to safety.

The other thing that we're starting to see a little trend on is that they go back to the office, even in a hybrid environment, the print volumes go up. For cost reasons, for security reasons, it's a lot less expensive to print at – in an office than it is to print at home for security reasons. So, we're seeing that trend, and that's what gives us confidence with our guidance, though, for this year to get back to revenue growth.

Shannon Cross
Analyst, Cross Research

Q

What's your plan for Xerox? When are you going back to the office?

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

A

April 19.

Shannon Cross
Analyst, Cross Research

Q

Thank you.

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

A

And, Shannon, just back to your question on what customer are buying currently. They buy the multifunction. As you know, it is much more than a printer. The multifunction is the core of the workflow that customer are looking at. And there is something that we learned during COVID-19 is, like, this concept of digital transformation on enabling workflow, which is much more efficient for employees, group-wide device which is able to support this process transformation. Our multifunction are chosen currently by customer as a prime device in order to drive this.

Shannon Cross
Analyst, Cross Research

Q

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

Q

Chung on for Coster. Thanks for taking our question. So, just on the OpEx side, we saw big decline on cost execution, lower discretionary spend in 2020, and 1Q run rate is pretty in line as well. Just want to get a sense for what you think about OpEx in the back half as some of those costs come back. And then, secondly, were you targeting those investments in marketing spend when it does come back? Thank you.

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

A

Okay. So, OpEx, as you know, you need to look at it by looking at last year versus last year – versus this year. We have had last year some tailwind. We declared the government subsidies, what we benefit from. We also look at the whole cost opportunity we had while the [indiscernible] (46:06) pandemic was at the highest point, specifically in quarter two, quarter three.

This year, we resumed some of [indiscernible] (46:14) the benefit of the provision we had for compensation. And also, the, I would say, tailwind with regards to risk related to government subsidies are less, as you know it here. However, what we see is, from a cost point of view, we have kept the mantra on the focus that we have with Project Own It. We declare that, therefore, this year, we will run another $375 million of growth savings driven by this program. And it is again across over the different areas of the Xerox cost base here.

We have a specific focus on the innovation. And when I say innovation, automation on improving our current processes, making customer relationship and customer transactions easier and simpler by bringing simplification here. So, you should look at this as being like a maniacal focus that we have on cost. I mentioned it in former calls. We have delivered positive EPS and positive free cash flow every quarter despite COVID-19 and this is a key driver that we have currently.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Thanks. This is very helpful

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

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Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you. I have a question probably for each of you, and I'll ask them immediately at this time so you can decide how to answer them in any order you want. But, John or Xavier, can you talk about for the services that are being offered, there's so many services out there in the world. Where is the success that Xerox is having on the type of services? Because I find it very intriguing and quite encouraging. It seems like it's on the small and midsize. But is it help desk, is it robots or bot programming, or what are some examples so we can kind of grasp and visualize it?

And then, my second question is this, has there been an impact from the semiconductor shortages? Globally, some sectors like automobiles or PCs have seen a very severe shortage of semiconductor chips. So, I'm just kind of wondering if that has replicated or found its way into the sectors you deal with or maybe it hasn't. Thank you.

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

A

Yeah. Hi, Jim. Look, our IT services is focused primarily on SMB. And, basically, our mission is to provide end-to-end professional IT solutions to them. We've introduced new offerings such as RPA as a service. But at the end of the day, we're not a VAR. Our design is to manage the IP stack of an SMB, the goal being virtual CIOs for them. And our customers are largely served by our XBS organization in the US. They're served by our channels in Europe. And these are direct sales organizations that have skills at local touch points so that we could expand on our offerings, cross sell, and into existing accounts and new customers. And we've seen a lot of good traction even with our RPA products that we've been focused on. We've seen traction on that whole area of how do we help them be more efficient as they're coming back to the office. And we've been very pleased with our results in all of that.

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

A

Semiconductor?

....

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Okay.

[indiscernible] (49:52)

....

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

A

Semiconductor.

....

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

A

Yeah. Yeah. Jim, also to other offerings where we see traction currently, everything around, I call that digital transformation, but behind Content and Capture (sic) [Capture & Content] and customer engagement services that we have as part of our global business services offerings here is currently having a lot of focus. And the customer are interested in transforming, digitalizing, or making their process leaner and by combining both print and the digital part of it.

Another, I will say, highlight I would like to flag is CareAR. John, as you reiterated here, we made the acquisition of this company in December 2020 and currently with augmented reality supporting field service management and customer service management. We see initial traction being confirmed or being developed by signings that we have with customer being interested in this technology on how we transform the way field service management and customer service management is being delivered here, yeah.

Your question regarding semiconductor shortage here is we see, like, you observe it here some shortages on certain component, also on certain raw material does not believe at this stage it is impacting us directly. We are monitoring it and we are looking at the potential backlog that we could have related to it. But it's not, at this stage, a high level or higher rate of concern for us.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Great. And then, a quick follow-up. On the bad debt reserve, is it – it sounds like it was a release in that it was a positive that you reserved a year ago a higher amount for potential uncertainty of customers if they'd be able to pay given the pandemic uncertainties. And it turns out that you're collecting better than previously thought. Am I correct on that? And is that kind of a annual assessment or quarterly assessment, where there could be some more positive releases?

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

A

So, Jim, it was not a release. So, it's different. It's a year-over-year compare. Last year, we booked around $60 million of provision for potential bad debt release across our leasing portfolio. And as you know, this portfolio has an average maturity date of around four years. So, this is regarding the current lease and the future of event that could happen to this lease this year. We did not release any provision. We kept this provision because it's very early in the cycle for us to assess if and when we should release any of these provision at this stage. Currently...

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Great.

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

A

...our assessment is that the provision level that we have is sufficient to cover the potential risk.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you so much for the details and clarifications. It's greatly appreciated.

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

A

Thank you, Jim.

Operator: Thank you. And ladies and gentlemen, that does conclude our Q&A session for today. I would now like to turn the call over to John Visentin for closing remarks.

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

Thank you for your questions. This past Sunday, we celebrated our 115-year anniversary. We believe today, our future is filled with exciting possibilities that we are working to make realities. Xerox has repeatedly redefined how the world works, and we are well on our way to doing it yet again. 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.