



Xerox Corporation (XRX)

Updated October 26th, 2018 by Josh Arnold

Key Metrics

Current Price:	\$27	5 Year CAGR Estimate:	13.5%	Volatility Percentile:	70.2%
Fair Value Price:	\$39	5 Year Growth Estimate:	2.5%	Momentum Percentile:	33.9%
% Fair Value:	70%	5 Year Valuation Multiple Estimate:	7.3%	Growth Percentile:	8.6%
Dividend Yield:	3.7%	5 Year Price Target	\$44	Valuation Percentile:	89.5%
Dividend Risk Score:	C	Retirement Suitability Score:	B	Total Return Percentile:	74.7%

Overview & Current Events

Xerox Corporation traces its lineage back to 1906 when The Haloid Photographic Company began manufacturing photographic paper and equipment. Through a series of mergers and spinoffs, the Xerox we know today was formed. Xerox spun off its business processing unit last year (now called Conduent) and today, focuses on design, development and sales of document management systems. The company produces \$10 billion in annual revenue and has a market cap of \$7 billion.

Xerox reported Q2 earnings on 7/26/18 and results were weak. Earnings-per-share fell 6 cents to 80 cents during the quarter. Revenue fell 4% on a constant currency basis, led by a decline in the International business. Q3 results came out on 10/23/18 and weren't much better. Revenue declined 4.7% on a constant currency basis led by the Post Sale business, which fell 5.2%. The International business improved sequentially but North America's revenue fell more than 4%, leading to a decline in adjusted earnings-per-share despite higher operating margins. Xerox increased its share repurchase guidance for this year to \$700 million, using the bulk of its recently-issued \$1 billion share repurchase program. Free cash flow was up to \$251 million in Q3 and Xerox has \$1.2 billion in cash on hand, which is plenty to continue its buybacks and to pay the dividend. We've slightly lowered our estimate for this year to \$3.35 after Q3.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$4.40	\$2.40	\$3.16	\$3.60	\$3.76	\$3.92	\$3.84	\$3.20	\$2.32	\$3.48	\$3.35	\$3.80
DPS	\$0.68	\$0.68	\$0.68	\$0.68	\$0.68	\$0.92	\$0.98	\$1.09	\$1.25	\$1.00	\$1.00	\$1.00
Shares	216	217	349	334	306	297	279	253	254	255	239	220

Xerox' earnings-per-share have not moved around much in the past decade despite the volatile environment the company has operated in during that time. Xerox has had a difficult time growing revenue and profits and we do not see that changing moving forward. Indeed, we are forecasting just 2.5% earnings-per-share growth for the next five years.

We see growth coming from roughly flat revenue, but continued margin expansion as Xerox improves its operating efficiency by controlling costs. Indeed, the last two quarterly reports have seen revenue fall in the low single digits while operating margins have risen. Xerox should be able to produce low single digit earnings-per-share growth, but revenue growth is a significant wildcard. Most of our earnings-per-share growth projection comes from the buyback program as revenue losses and margin gains largely offset each other. In other words, actual earnings growth will likely be tough to come by; we are counting on a meaningful share reduction for the modest growth we've projected.

The dividend is \$1 per share today and we do not see any increases coming anytime soon. The dividend was cut after the Conduent spinoff in 2017 and given the above, we do not see management taking the risk of a higher dividend.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	11.3	11.9	12.5	10.5	8.0	9.7	13.0	14.3	16.8	8.5	8.1	11.5
Avg. Yld.	1.4%	2.4%	1.7%	1.8%	2.3%	2.4%	2.0%	2.4%	3.2%	3.4%	3.7%	2.3%

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Xerox' average price-to-earnings ratio in the past decade has been 11.5 and we see that as fair value. That is much higher than the 8.1 times earnings the stock trades for today, implying a 7.3% tailwind to annual total returns should the valuation normalize. Xerox is certainly cheap today, but a recent string of weak earnings reports has investors on edge when it comes to buying this stock. Indeed, we are not the only ones revising earnings estimates downward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	34.4%	35.0%	32.5%	29.6%	27.6%	28.0%	26.2%	25.2%	39.6%	39.6%	39.5%	40.0%
Debt/A	72%	70%	60%	60%	61%	56%	61%	64%	74%	67%	70%	70%
Int. Cov.	-6.7	1.2	1.4	2.7	2.8	3.0	5.4	5.4	4.3	5.3	5.3	5.5
Payout	15%	28%	22%	19%	18%	23%	26%	34%	54%	29%	30%	26%
Std. Dev.	49%	58%	34%	30%	25%	17%	20%	17%	29%	24%	35%	30%

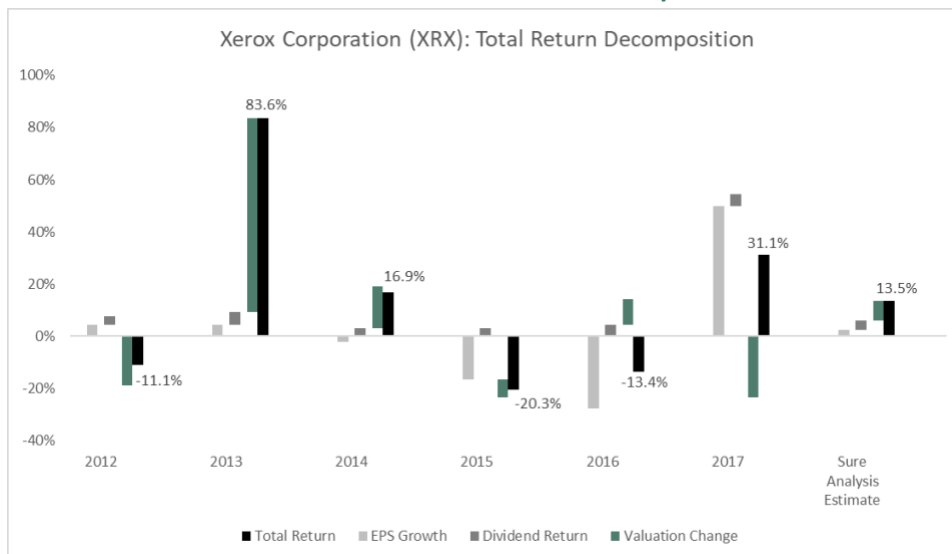
Xerox' quality metrics have generally improved in the past decade, which is partially the product of the Conduent spinoff. Margins have increased and interest coverage has improved dramatically despite higher debt totals. We think Xerox will be able to continue these positive trends in the coming years as its business remains stable.

Xerox will suffer during the next recession as it serves a global customer base, some of which will also suffer during a downturn. Its competitive advantage is in its pure-play focus on document management systems and its very long history in the industry. In addition, it has a highly diversified, global customer base.

Final Thoughts & Recommendation

In total, we see Xerox producing 13.5% annual total returns in the coming years, although there may be significant volatility in achieving those returns. The yield will contribute 3.7% and earnings-per-share growth should add 2%. However, we see roughly half of total returns – 7.3% - coming from a rising price-to-earnings ratio. While Xerox' total return projections are strong, keep in mind it may take years to achieve the result as recent earnings reports have been less than stellar. Therefore, while we see Xerox as trading significantly under fair value, this is certainly not a low-risk situation. We rate the stock a hold despite its high projected returns due to this uncertainty surrounding the earnings outlook. The yield is strong and the stock is cheap, but there is not a lot of clarity in terms of the path to higher earnings.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	16810	14466	20973	21268	19824	19523	12679	11465	10771	10265
Gross Profit	6057	5312	7037	6692	6190	6002	5110	4582	4261	4061
Gross Margin	36.0%	36.7%	33.6%	31.5%	31.2%	30.7%	40.3%	40.0%	39.6%	39.6%
SG&A Exp.	4534	4149	4594	4421	4141	4073	3133	2865	2695	2631
D&A Exp.	669	698	1097	1251	1301	1358	639	590	563	527
Operating Profit	585	263	1350	1154	1093	1021	1381	1146	1032	931
Op. Margin	3.5%	1.8%	6.4%	5.4%	5.5%	5.2%	10.9%	10.0%	9.6%	9.1%
Net Profit	230	485	606	1295	1195	1159	1013	448	-471	195
Net Margin	1.4%	3.4%	2.9%	6.1%	6.0%	5.9%	8.0%	3.9%	-4.4%	1.9%
Free Cash Flow	604	2015	2207	1460	2067	1948	1887	1463	957	-71
Income Tax	-231	152	256	377	256	253	198	193	62	481

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	22447	24032	30600	30116	30015	29036	27658	25541	18051	15946
Cash & Equivalents	1229	3799	1211	902	1246	1764	1411	1228	2223	1293
Accounts Receivable	2184	1850	2826	2600	2531	2539	2652	741	651	1048
Inventories	1232	900	991	1021	1011	998	934	901	841	915
Goodwill & Int.	3792	4384	12020	12101	11845	11708	11577	4291	4077	4198
Total Liabilities	16209	16841	18441	18091	18351	16268	16905	16424	13304	10653
Accounts Payable	1446	1451	1968	2016	1913	1626	1584	1342	1126	1108
Long-Term Debt	8384	9264	8607	8633	8489	8021	7741	7279	6316	5517
Total Equity	6238	7050	12006	11527	11172	12300	10329	9074	4709	5256
D/E Ratio	1.34	1.31	0.72	0.73	0.74	0.63	0.72	0.80	1.34	1.05

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	1.0%	2.1%	2.2%	4.3%	4.0%	3.9%	3.6%	1.7%	-2.2%	1.1%
Return on Equity	3.1%	7.3%	6.4%	11.0%	10.5%	9.9%	9.0%	4.6%	-6.8%	3.9%
ROIC	1.5%	3.1%	3.3%	6.3%	5.9%	5.7%	5.2%	2.6%	-3.4%	1.8%
Shares Out.	216	217	349	334	306	297	279	253	254	255
Revenue/Share	75.08	65.79	62.11	58.92	59.66	61.32	43.29	42.61	42.08	40.01
FCF/Share	2.70	9.16	6.54	4.05	6.22	6.12	6.44	5.44	3.74	-0.28

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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