



Xerox Corporation (XRX)

Updated November 3rd, 2019 by Josh Arnold

Key Metrics

Current Price:	\$33	5 Year CAGR Estimate:	6.7%	Volatility Percentile:	92.2%
Fair Value Price:	\$43	5 Year Growth Estimate:	2.5%	Momentum Percentile:	87.5%
% Fair Value:	92%	5 Year Valuation Multiple Estimate:	1.7%	Growth Percentile:	15.3%
Dividend Yield:	3.0%	5 Year Price Target	\$41	Valuation Percentile:	87.8%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	57.5%

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 now focuses on design, development and sales of document management systems. The company produces \$9+ billion in annual revenue and has a market capitalization of \$7.3 billion.

Xerox reported Q3 earnings on 10/29/19 and results were strong, leading to a guidance raise by the company's management team. Revenue was off by 6.5% against the year-ago period, but was down 5.5% in constant currency. Equipment sales fell 3.3% to \$494 million in Q3, while post sale revenue declined 7.3% to \$1.71 billion. Geographically, Americas revenue was down 3.7% to \$1.49 billion, while EMEA revenue declined 10.1% to \$641 million. Management was confident that the trend of revenue generation shifted for the better in Q3, so we'll see in the coming quarters.

On the bright side, Xerox' margin expansion efforts are bearing fruit. Gross margin declined 10bps but that was more than offset by prudent expense controls, which helped drive adjusted operating margin up 120bps to 12.1% of revenue. Xerox has been cutting its way to better profitability for several quarters, and we expect the next couple of quarters to show continued margin improvements against weaker comparables.

Adjusted earnings-per-share came in at \$1.08 in Q3, up from \$0.85 in the year-ago period. Share repurchases and margin gains are the reasons why earnings were so strong in Q3. Management guided for adjusted earnings-per-share for this year of \$4.00 to \$4.10, so we've boosted our estimate as well to \$4.05.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$2.40	\$3.16	\$3.60	\$3.76	\$3.92	\$3.84	\$3.20	\$2.32	\$3.48	\$3.46	\$4.05	\$4.58
DPS	\$0.68	\$0.68	\$0.68	\$0.68	\$0.92	\$0.98	\$1.09	\$1.25	\$1.00	\$1.00	\$1.00	\$1.00
Shares¹	217	349	334	306	297	279	253	254	255	230	225	210

Xerox's 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 despite what should be a better performance in 2019.

We see growth coming from roughly flat revenue, but continued margin expansion as Xerox improves its operating efficiency by controlling costs. Indeed, the last six quarterly reports have seen revenue fall 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, although this was not the case in Q3. In other words, actual earnings growth will

¹ Share count in millions

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likely be tough to come by; we are counting on a meaningful share reduction for the modest growth we've projected. Q3 showed some promise as margins outperformed again, but we are still cautious given it is early in the process.

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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	11.9	12.5	10.5	8.0	9.7	13.0	14.3	16.8	8.5	8.0	8.3	9.0
Avg. Yld.	2.4%	1.7%	1.8%	2.3%	2.4%	2.0%	2.4%	3.2%	3.4%	3.6%	3.0%	2.4%

Xerox's average price-to-earnings ratio in the past decade has been 11, but we are moving our estimate of fair value to 9 times earnings given continued revenue weakness. That is still higher than the 8.3 times earnings the stock trades for today, implying a modest tailwind to annual total returns should the valuation normalize over the next 5 years. We expect the stagnant dividend and rising share price to produce a lower yield over time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	28%	22%	19%	18%	23%	26%	34%	54%	29%	29%	25%	22%

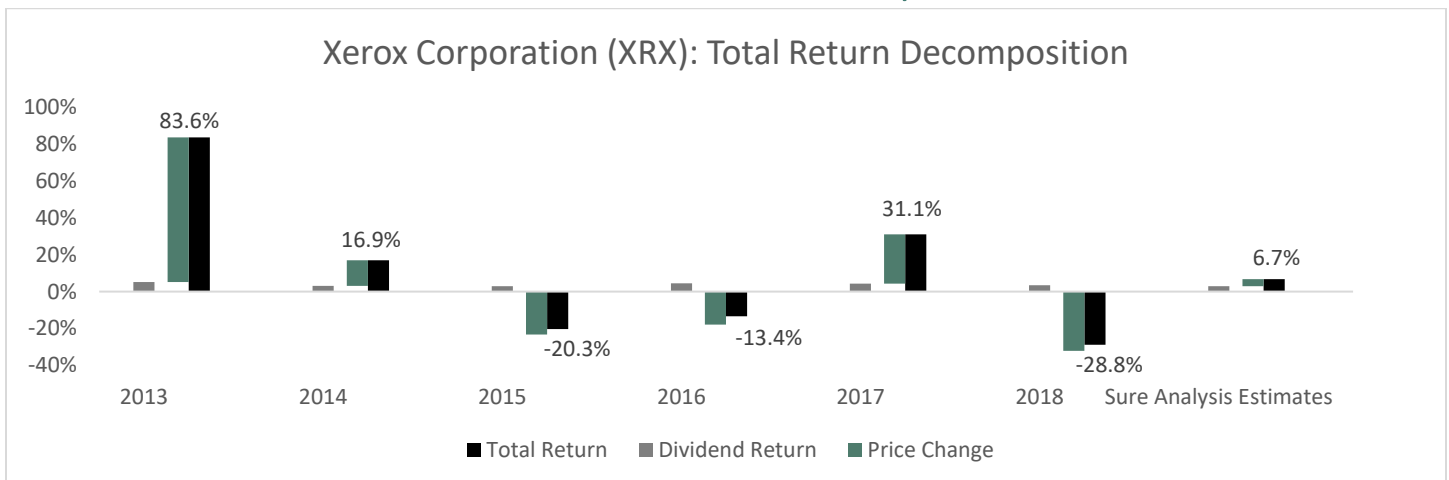
The payout ratio is just one-quarter of earnings and we don't see any meaningful movement from that in the coming years. The dividend should be fairly safe given improving profitability and a flat payout.

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 6.7% annual total returns in the coming years, although there may be significant volatility in achieving those returns. The yield will contribute 3% and earnings-per-share growth should add 2.5%. However, with the move down in fair value, the valuation is driving a smaller tailwind to total returns. While we see Xerox as trading under fair value, this is certainly not a low-risk situation. A lower estimate of fair value is causing us to reassess Xerox, moving it from buy to hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	14466	21633	21900	20421	20006	12679	11465	10771	10265	9830
Gross Profit	5312	7697	7324	6787	6485	5110	4582	4261	4061	3927
Gross Margin	36.7%	35.6%	33.4%	33.2%	32.4%	40.3%	40.0%	39.6%	39.6%	39.9%
SG&A Exp.	4149	4594	4421	4141	4073	3133	2865	2695	2631	2458
D&A Exp.	698	1097	1251	1301	1358	639	590	563	527	526
Operating Profit	263	2010	1786	1690	1504	1381	1146	1032	931	1024
Op. Margin	1.8%	9.3%	8.2%	8.3%	7.5%	10.9%	10.0%	9.6%	9.1%	10.4%
Net Profit	485	606	1295	1195	1159	1013	448	-471	195	361
Net Margin	3.4%	2.8%	5.9%	5.9%	5.8%	8.0%	3.9%	-4.4%	1.9%	3.7%
Free Cash Flow	2015	2207	1460	2067	1948	1887	1463	957	-71	1050
Income Tax	152	256	377	256	253	198	193	62	481	257

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	24032	30600	30116	30015	29036	27658	25541	18051	15946	14874
Cash & Equivalents	3799	1211	902	1246	1764	1411	1228	2223	1293	1084
Acc. Receivable	1850	2826	2307	2639	2651	2421	741	651	1048	1276
Inventories	900	991	1021	1011	998	934	901	841	915	818
Goodwill & Int.	4384	12020	12940	13122	12956	11804	4291	4077	4198	4087
Total Liabilities	16841	18441	17742	18002	16268	16556	16075	13090	10439	9621
Accounts Payable	1451	1968	2016	1913	1626	1584	1342	1126	1108	1091
Long-Term Debt	9264	8607	8633	8489	8021	7741	7279	6316	5517	5230
Total Equity	7050	12006	11876	11521	12300	10678	9074	4709	5256	5005
D/E Ratio	1.31	0.72	0.71	0.72	0.63	0.70	0.77	1.28	1.01	1.00

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.1%	2.2%	4.3%	4.0%	3.9%	3.6%	1.7%	-2.2%	1.1%	2.3%
Return on Equity	7.3%	6.4%	10.8%	10.2%	9.7%	8.8%	4.5%	-6.8%	3.9%	7.0%
ROIC	3.1%	3.3%	6.2%	5.8%	5.6%	5.1%	2.5%	-3.4%	1.7%	3.4%
Shares Out.	217	349	334	306	297	279	253	254	255	230
Revenue/Share	65.79	64.06	60.67	61.45	62.84	43.29	42.61	42.08	40.01	39.06
FCF/Share	9.16	6.54	4.05	6.22	6.12	6.44	5.44	3.74	-0.28	4.17

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

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