



Xerox Corporation (XRX)

Updated February 9th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$37	5 Year CAGR Estimate:	2.6%	Market Cap:	\$7.9B
Fair Value Price:	\$33	5 Year Growth Estimate:	2.5%	Ex-Dividend Date:	03/31/20 ¹
% Fair Value:	113%	5 Year Valuation Multiple Estimate:	-2.4%	Dividend Payment Date:	04/30/20 ²
Dividend Yield:	2.7%	5 Year Price Target	\$37	Years Of Dividend Growth:	0
Dividend Risk Score:	B	Retirement Suitability Score:	D	Last Dividend Increase:	N/A

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 \$8+ billion in annual revenue and has a market capitalization of \$7.9 billion.

Xerox reported Q4 and full-year earnings on January 28th and results beat expectations on revenue and earnings. Revenue was down -2% in Q4 but gross margins rose 160bps to 41.6% of revenue. SG&A costs also declined -120bps to 20.9% of revenue, sending operating margins 270bps higher to 16.8% of revenue on an adjusted basis. Adjusted earnings-per-share soared 42% to \$1.33 in Q4 year-over-year.

Xerox expects revenue to decline -4% in 2020 and adjusted operating earnings to come in at 13% of revenue. Adjusted earnings-per-share is expected to be \$3.60 to \$3.70, and our initial estimate is the midpoint at \$3.65. Xerox also stated it would produce free cash flow of \$1.2 billion in 2020 and repurchase at least \$300 million of its own shares.

Xerox announced at the end of January that it acquired Arena Group, a company that provides office and technology solutions to small and mid-sized companies in Europe. Terms were not disclosed.

Xerox bid to buy all of HP Inc. (HPQ) late last year, a company that is nearly four times the size of Xerox. Xerox has \$24B of the needed \$30B in financing lined up, with the rest slated to come from new shares, but there is significant doubt that Xerox can make an acquisition of that size. HP said it had significant concerns after the Q4 report about Xerox' long-term viability, so we are skeptical HP shareholders would vote in favor of the transaction.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$3.16	\$3.60	\$3.76	\$3.92	\$3.84	\$3.20	\$2.32	\$3.48	\$3.46	\$3.55	\$3.65	\$4.13
DPS	\$0.68	\$0.68	\$0.68	\$0.92	\$0.98	\$1.09	\$1.25	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00
Shares³	349	334	306	297	279	253	254	255	230	213	205	190

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.

We see growth coming from roughly flat revenue, but continued margin expansion as Xerox improves its operating efficiency by controlling costs. Indeed, the last seven 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

¹ Estimated date

² Estimated date

³ Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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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. Q4 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	12.5	10.5	8.0	9.7	13.0	14.3	16.8	8.5	8.0	9.0	10.2	9.0
Avg. Yld.	1.7%	1.8%	2.3%	2.4%	2.0%	2.4%	3.2%	3.4%	3.6%	3.1%	2.7%	2.7%

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 below the 10.2 times earnings the stock trades for today, implying a modest headwind to annual total returns should the valuation normalize over the next 5 years. We expect the stagnant dividend and lower valuation to produce a flat yield over time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	22%	19%	18%	23%	26%	34%	54%	29%	29%	28%	27%	24%

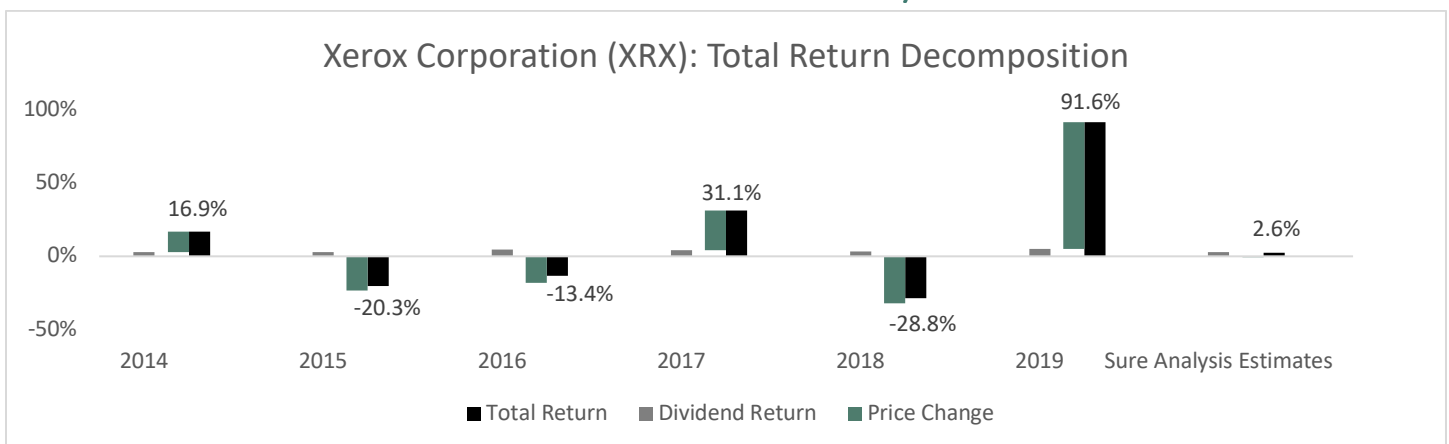
The payout ratio is just one-quarter of earnings and we don't see any meaningful movement from that in the coming years. The dividend should be fairly safe given improving profitability and a flat payout.

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 2.6% annual total returns in the coming years, although there may be significant volatility in achieving those returns. The yield will contribute nearly 3% and earnings-per-share growth should add 2.5%. However, the valuation should offset some of that. We are downgrading Xerox from hold to sell as we see the HP acquisition as a far-fetched dream and continue to have significant concerns about the company's ability to generate revenue growth over time.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	21633	21900	20421	20006	12679	11465	10771	10265	9830	9,066
Gross Profit	7697	7324	6787	6485	5110	4582	4261	4061	3927	3,650
Gross Margin	35.6%	33.4%	33.2%	32.4%	40.3%	40.0%	39.6%	39.6%	39.9%	40.3%
SG&A Exp.	4594	4421	4141	4073	3133	2865	2695	2631	2458	2,097
D&A Exp.	1097	1251	1301	1358	639	590	563	527	526	430
Operating Profit	2010	1786	1690	1504	1381	1146	1032	931	1024	1,135
Op. Margin	9.3%	8.2%	8.3%	7.5%	10.9%	10.0%	9.6%	9.1%	10.4%	12.5%
Net Profit	606	1295	1195	1159	1013	448	-471	195	361	1,353
Net Margin	2.8%	5.9%	5.9%	5.8%	8.0%	3.9%	-4.4%	1.9%	3.7%	14.9%
Free Cash Flow	2207	1460	2067	1948	1887	1463	957	-71	1050	1,268
Income Tax	256	377	256	253	198	193	62	481	257	179

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	30600	30116	30015	29036	27658	25541	18051	15946	14874	15,056
Cash & Equivalents	1211	902	1246	1764	1411	1228	2223	1293	1084	2,740
Acc. Receivable	2826	2307	2639	2651	2421	741	651	1048	1276	1,347
Inventories	991	1021	1011	998	934	901	841	915	818	694
Goodwill & Int.	12020	12940	13122	12956	11804	4291	4077	4198	4087	4,099
Total Liabilities	18441	17742	18002	16268	16556	16075	13090	10439	9621	9,239
Accounts Payable	1968	2016	1913	1626	1584	1342	1126	1108	1091	1,053
Long-Term Debt	8607	8633	8489	8021	7741	7279	6316	5517	5230	4,282
Total Equity	12006	11876	11521	12300	10678	9074	4709	5256	5005	5,596
D/E Ratio	0.72	0.71	0.72	0.63	0.70	0.77	1.28	1.01	1.00	0.74

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.2%	4.3%	4.0%	3.9%	3.6%	1.7%	-2.2%	1.1%	2.3%	9.0%
Return on Equity	6.4%	10.8%	10.2%	9.7%	8.8%	4.5%	-6.8%	3.9%	7.0%	25.5%
ROIC	3.3%	6.2%	5.8%	5.6%	5.1%	2.5%	-3.4%	1.7%	3.4%	13.1%
Shares Out.	349	334	306	297	279	253	254	255	230	213
Revenue/Share	64.06	60.67	61.45	62.84	43.29	42.61	42.08	40.01	39.06	38.88
FCF/Share	6.54	4.05	6.22	6.12	6.44	5.44	3.74	-0.28	4.17	5.44

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

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