



Xerox Corporation (XRX)

Updated November 24th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$23	5 Year CAGR Estimate:	1.3%	Market Cap:	\$4.4 B
Fair Value Price:	\$20	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	12/30/20
% Fair Value:	118%	5 Year Valuation Multiple Estimate:	-3.2%	Dividend Payment Date:	01/29/21
Dividend Yield:	4.3%	5 Year Price Target	\$20	Years Of Dividend Growth:	0
Dividend Risk Score:	D	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 about \$7 billion in annual revenue and has a market capitalization of \$4.4 billion.

Xerox reported third quarter earnings on October 27th, 2020 producing a huge beat on the top and bottom lines, albeit on very low expectations. Revenue came to \$1.8 billion, down -20% in constant currencies, but easily beating estimates that called for a worse decline. Revenue was up \$302 million from the second quarter, so sequential improvement was massive.

Gross margins came to 36.8%, down 320bps year-over-year. The company managed to save a bit on R&D and SG&A costs, but it wasn't enough to stop the decline in operating income, which fell by half year-over-year to \$131 million on an adjusted basis. Adjusted operating margin was 7.4% of revenue, down a staggering 460bps year-over-year, but up 320bps from the second quarter of 2020.

Operating cash flow was \$106 million, down \$242 million year-over-year but up \$72 million sequentially. Similarly, free cash flow was \$88 million, down \$243 million year-over-year, but up \$73 million sequentially.

Adjusted earnings-per-share came to \$0.48, down \$0.32 year-over-year but up \$0.33 from Q2. We've moved our estimate of earnings-per-share for this year to \$1.45 following Q3 results and continue to use an earnings power estimate of \$2.60 per share for our valuation calculations to account for transitory weakness.

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	\$1.45	\$2.60
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
Shares¹	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 no earnings-per-share growth for the next five years on the normalized earnings base of \$2.60 per year. We're using this number for our fair value and valuation calculations as we believe COVID-19-related weakness should be transitory.

We think the revenue and margin outlooks for Xerox have deteriorated, but its buyback program should be able to help alleviate some of the burden when it comes to growth. 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 coming years.

¹ 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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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	8.8	7.5
Avg. Yld.	1.7%	1.8%	2.3%	2.4%	2.0%	2.4%	3.2%	3.4%	3.6%	3.1%	4.3%	5.1%

Xerox's average price-to-earnings ratio in the past decade has been 11, but we are reiterating our estimate of fair value of 7.5 times earnings given continued revenue weakness, and because margins plummeted again in Q3. That is now below the 8.8 times earnings power the stock trades for today following a huge rally, implying a headwind to annual total returns should the valuation normalize over the next five years. We expect the stagnant dividend and lower valuation to produce a higher yield near 5%.

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%	39%	39%

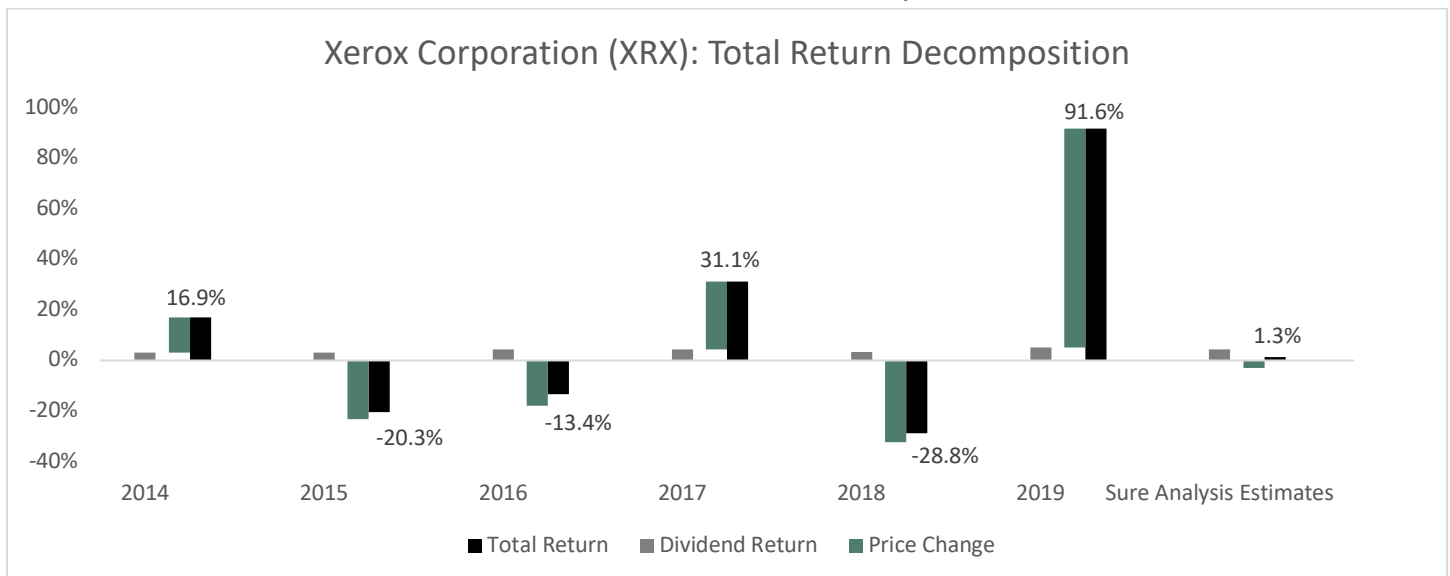
The payout ratio is just 39% of normalized earnings and we don't see any meaningful movement from that in the coming years. The dividend should thus be somewhat safe, assuming the payout survives a very tough 2020, which appears to be the case after Q3 results.

Xerox is suffering during this 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 1.3% annual total returns in the coming years, as the recent rally looks to be pricing in a lot of growth. The yield will contribute 4.3%, but that could be partially offset by a valuation headwind. Given that the valuation has worsened thanks to a large rally, we are moving Xerox from hold to sell.

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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