



Xerox Corporation (XRX)

Updated April 27th, 2021 by Josh Arnold

Key Metrics

Current Price:	\$24	5 Year CAGR Estimate:	5.2%	Market Cap:	\$4.7 B
Fair Value Price:	\$19	5 Year Growth Estimate:	7.0%	Ex-Dividend Date:	06/30/21 ¹
% Fair Value:	130%	5 Year Valuation Multiple Estimate:	-5.1%	Dividend Payment Date:	07/29/21 ¹
Dividend Yield:	4.2%	5 Year Price Target	\$26	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	C	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 in 2017 (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 \$4.7 billion.

Xerox reported first quarter earnings on April 20th, 2021, with results for the top and bottom lines coming in ahead of expectations. The company saw increased equipment demand and IT services growth, and management stated they are confident Xerox can deliver stronger results as workers return to offices for 2021 and beyond.

Revenue was \$1.71 billion in Q1, which was down -8.1% year-over-year, and down -10.4% in constant currency. Sales revenue rose 6.5% to more than \$600 million in Q1, but services revenue was down sharply, declining -15% to \$1,053 million year-over-year. This was due to workers not being in offices, so Xerox expects services revenue will pick up in the quarters ahead.

Earnings-per-share came to 22 cents in Q1, which was up nicely from a penny in the year-ago period. Adjusted operating margin was 5.2% of revenue, which was 50bps higher than last year's Q1. Gross margins fell 260bps as services revenue declined, but SG&A costs were down 290bps to help offset that.

We now see \$1.85 in earnings-per-share for this year following Q1 earnings, which is down slightly from our prior estimate of \$2.00 per share.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$3.60	\$3.76	\$3.92	\$3.84	\$3.20	\$2.32	\$3.48	\$3.46	\$3.55	\$1.41	\$1.85	\$2.59
DPS	\$0.68	\$0.68	\$0.92	\$0.98	\$1.09	\$1.25	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00
Shares²	334	306	297	279	253	254	255	230	213	198	191	150

Xerox's earnings-per-share have not moved around much in the past decade despite the volatile environment the company operated in during that time. Xerox has had a difficult time growing revenue and profits and we do not see that changing moving forward. However, given that the new base of earnings for 2021 is just \$1.85 per share, we expect 7% growth moving forward, not because the business has necessarily improved, but because Xerox has begun the process of retracing earnings declines from 2020.

We think the revenue and margin outlooks for Xerox remain fairly weak, 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 Estimated date

² 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 \$1.00 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	10.5	8.0	9.7	13.0	14.3	16.8	8.5	8.0	9.0	15.5	13.0	10.0
Avg. Yld.	1.8%	2.3%	2.4%	2.0%	2.4%	3.2%	3.4%	3.6%	3.1%	4.6%	4.2%	3.9%

Xerox's average price-to-earnings ratio in the past decade has been 11, but we estimate fair value at 10 times earnings given continued revenue weakness, but as margins appear to have stabilized in Q1. That is below the 13 times earnings the stock trades for today, implying a moderate 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 yield around 4% for the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	19%	18%	23%	26%	34%	54%	29%	29%	28%	71%	54%	39%

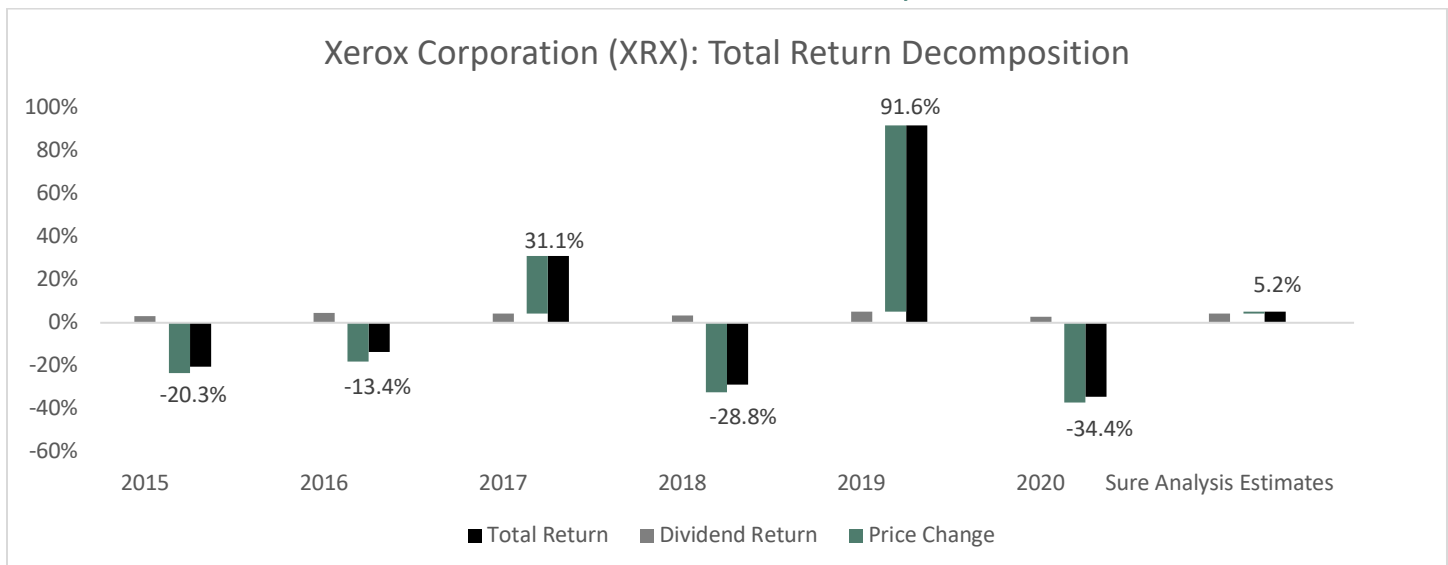
The payout ratio is 54% of earnings and we don't see any meaningful movement from that in the coming years. The dividend should thus be somewhat safe, so long as Xerox doesn't incur another huge downward move in earnings.

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 5.2% annual total returns in the coming years, which is roughly in line with projected returns from our last update. The yield will contribute 4.2%, but that could be offset by a valuation headwind. Despite the fact that we've moved our fair value estimate higher, the rally in the stock means Xerox is still overvalued in our view. However, with a yield in excess of 4% and projected returns of about 5%, we reiterate Xerox at a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	21900	20421	20006	12679	11465	10771	10265	9830	9,066	7,022
Gross Profit	7324	6787	6485	5110	4582	4261	4061	3927	3,650	2,626
Gross Margin	33.4%	33.2%	32.4%	40.3%	40.0%	39.6%	39.6%	39.9%	40.3%	37.4%
SG&A Exp.	4421	4141	4073	3133	2865	2695	2631	2458	2,097	1,851
D&A Exp.	1251	1301	1358	639	590	563	527	526	430	368
Operating Profit	1786	1690	1504	1381	1146	1032	931	1024	1,135	408
Op. Margin	8.2%	8.3%	7.5%	10.9%	10.0%	9.6%	9.1%	10.4%	12.5%	5.8%
Net Profit	1295	1195	1159	1013	448	-471	195	361	1,353	192
Net Margin	5.9%	5.9%	5.8%	8.0%	3.9%	-4.4%	1.9%	3.7%	14.9%	2.7%
Free Cash Flow	1460	2067	1948	1887	1463	957	-71	1050	1,268	474
Income Tax	377	256	253	198	193	62	481	257	179	64

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	30116	30015	29036	27658	25541	18051	15946	14874	15,056	14,741
Cash & Equivalents	902	1246	1764	1411	1228	2223	1293	1084	2,740	2,625
Acc. Receivable	2307	2639	2651	2421	741	651	1048	1276	1,347	1,051
Inventories	1021	1011	998	934	901	841	915	818	694	843
Goodwill & Int.	12940	13122	12956	11804	4291	4077	4198	4087	4,099	4,308
Total Liabilities	17742	18002	16268	16556	16075	13090	10439	9621	9,239	8,931
Accounts Payable	2016	1913	1626	1584	1342	1126	1108	1091	1,053	983
Long-Term Debt	8633	8489	8021	7741	7279	6316	5517	5230	4,282	4,444
Total Equity	11876	11521	12300	10678	9074	4709	5256	5005	5,596	5,592
D/E Ratio	0.71	0.72	0.63	0.70	0.77	1.28	1.01	1.00	0.74	0.77

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	4.3%	4.0%	3.9%	3.6%	1.7%	-2.2%	1.1%	2.3%	9.0%	1.3%
Return on Equity	10.8%	10.2%	9.7%	8.8%	4.5%	-6.8%	3.9%	7.0%	25.5%	3.4%
ROIC	6.2%	5.8%	5.6%	5.1%	2.5%	-3.4%	1.7%	3.4%	13.1%	1.9%
Shares Out.	334	306	297	279	253	254	255	230	213	198
Revenue/Share	60.67	61.45	62.84	43.29	42.61	42.08	40.01	39.06	38.88	33.60
FCF/Share	4.05	6.22	6.12	6.44	5.44	3.74	-0.28	4.17	5.44	2.27

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

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