



Xerox Corporation (XRX)

Updated January 30th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$21	5 Year CAGR Estimate:	6.3%	Market Cap:	\$3.3 B
Fair Value Price:	\$16	5 Year Growth Estimate:	8.0%	Ex-Dividend Date:	03/29/22 ¹
% Fair Value:	131%	5 Year Valuation Multiple Estimate:	-5.3%	Dividend Payment Date:	04/30/22
Dividend Yield:	4.8%	5 Year Price Target	\$24	Years Of Dividend Growth:	0
Dividend Risk Score:	F	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 \$3.3 billion.

Xerox reported fourth quarter and full-year earnings on January 25th, 2022, and results were somewhat mixed. Earnings came to 34 cents per share on an adjusted basis, which was four cents better than expected. On the other hand, revenue was \$1.78 billion, off 8% year-over-year, and missing expectations by \$40 million. Revenue was down -7.4% in constant currency. For the year, revenue of \$7.04 billion was up fractionally, but down -1.4% in constant currency.

Xerox guided for \$7.1 billion in revenue or better for 2022, which was ahead of expectations, and the company also guided for no less than \$400 million in free cash flow.

Adjusted operating margin was 4.8% of revenue for the fourth quarter, down 470 basis points year-over-year. For the year, adjusted operating margin was 5.3% of revenue, down 130 basis points from 2020. Xerox delivered \$375 million of 2021 gross cost savings, coming to \$1.8 billion since the program's inception.

Xerox returned more than a billion dollars to shareholders during the year, which was about double what it produced in free cash flow. The vast majority of that was share repurchases, which reduced the float by nearly -20% in 2021 alone.

We forecast earnings at \$1.60 per share for this year, driven by share repurchases, principally.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$3.76	\$3.92	\$3.84	\$3.20	\$2.32	\$3.48	\$3.46	\$3.55	\$1.41	\$1.51	\$1.60	\$2.35
DPS	\$0.68	\$0.92	\$0.98	\$1.09	\$1.25	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00
Shares²	306	297	279	253	254	255	230	213	198	159	145	100

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 2022 is just \$1.60 per share, we expect 8% growth moving forward, not because the business has necessarily improved, but because Xerox continued to buy back huge amounts of its own stock. Given recent guidance, it appears that weakness is going to drag on longer than initially expected, and into 2022.

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. That view

¹ Estimated date

² Share count in millions

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is supported by the new buyback program. Xerox' free cash flow yield is well into the double-digits, so it can spend heavily on share repurchases.

The dividend is \$1.00 per share today and we do not forecast 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. The company clearly favors share repurchases.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	8.0	9.7	13.0	14.3	16.8	8.5	8.0	9.0	15.5	15.1	13.1	10.0
Avg. Yld.	2.3%	2.4%	2.0%	2.4%	3.2%	3.4%	3.6%	3.1%	4.6%	4.4%	4.8%	4.3%

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 and volatile margins. That is below the 13.1 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 4.3% in the future and note that the 4.8% yield today is quite strong.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	18%	23%	26%	34%	54%	29%	29%	28%	71%	66%	63%	43%

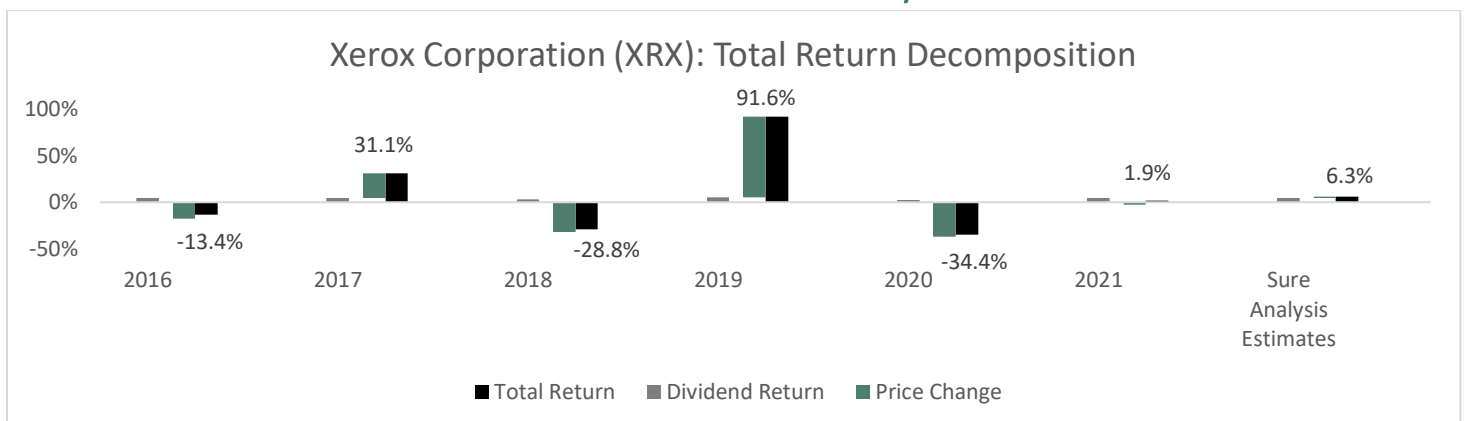
The payout ratio is 63% of earnings. The dividend should thus be somewhat safe, so long as Xerox doesn't incur another huge downward move in earnings. We continue to think that Xerox will have a difficult time raising the payout anytime soon given earnings weakness and heavy share repurchase activity.

Xerox is suffering from aftereffects of the COVID recession as it serves a global customer base, some of which 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 forecast Xerox producing 6.3% annual total returns in the coming years, which is slightly lower than our last update. The yield will contribute 4.8%, but that could be offset by a valuation headwind. The stock remains overvalued in our view but does offer a sizable yield. However, weak revenue guidance has us remaining cautious, and we reiterate the stock at a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	20,421	20,006	12,679	11,465	10,771	9,991	9,662	9,066	7,022	7,038
Gross Profit	6,787	6,485	5,110	4,582	4,305	4,071	3,869	3,650	2,626	2,403
Gross Margin	33.2%	32.4%	40.3%	40.0%	40.0%	40.7%	40.0%	40.3%	37.4%	34.1%
SG&A Exp.	4,141	4,073	3,133	2,865	2,636	2,514	2,379	2,085	1,851	1,718
D&A Exp.	1,301	1,358	639	590	563	527	526	430	368	327
Operating Profit	1,690	1,504	1,381	1,146	1,148	1,080	1,045	1,147	417	320
Op. Margin	8.3%	7.5%	10.9%	10.0%	10.7%	10.8%	10.8%	12.7%	5.9%	4.5%
Net Profit	1,195	1,159	1,013	448	(471)	195	361	1,353	192	(455)
Net Margin	5.9%	5.8%	8.0%	3.9%	-4.4%	2.0%	3.7%	14.9%	2.7%	-6.5%
Free Cash Flow	2,067	1,948	1,887	1,463	660	(372)	1,050	1,268	474	561
Income Tax	256	253	198	193	62	468	247	179	64	(17)

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	30,015	29,036	27,658	25,541	18,051	15,946	14,874	15,047	14,741	13,223
Cash & Equivalents	1,246	1,764	1,411	1,228	2,223	1,293	1,081	2,740	2,625	1,840
Acc. Receivable	2,791	2,764	2,531	838	741	1,160	1,097	1,091	834	912
Inventories	1,011	998	934	901	841	915	829	694	843	696
Goodwill & Int.	12,766	12,557	11,577	4,291	4,077	4,407	4,232	4,221	4,426	3,498
Total Liabilities	18,002	16,268	16,556	16,075	13,090	10,439	9,621	9,239	8,931	8,556
Accounts Payable	1,913	1,626	1,584	1,342	1,126	1,108	1,073	1,053	983	1,069
Long-Term Debt	8,489	8,021	7,741	7,279	6,316	5,517	5,230	4,282	4,444	4,246
Total Equity	11,521	12,300	10,678	9,074	4,709	5,256	5,005	5,587	5,592	4,436
D/E Ratio	0.72	0.63	0.70	0.77	1.28	1.01	1.00	0.74	0.77	0.91

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	4.0%	3.9%	3.6%	1.7%	-2.2%	1.1%	2.3%	9.0%	1.3%	-3.3%
Return on Equity	10.2%	9.7%	8.8%	4.5%	-6.8%	3.9%	7.0%	25.5%	3.4%	-9.1%
ROIC	5.8%	5.6%	5.1%	2.5%	-3.4%	1.7%	3.4%	13.2%	1.9%	-4.7%
Shares Out.	306	297	279	253	254	255	230	213	198	159
Revenue/Share	61.45	62.84	43.29	42.61	42.08	38.94	38.39	38.88	33.21	38.42
FCF/Share	6.22	6.12	6.44	5.44	2.58	(1.45)	4.17	5.44	2.24	3.06

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

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