



# Xerox Corporation (XRX)

Updated April 25<sup>th</sup>, 2022, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$17	<b>5 Year CAGR Estimate:</b>	7.5%	<b>Market Cap:</b>	\$2.7 B
<b>Fair Value Price:</b>	\$11	<b>5 Year Growth Estimate:</b>	12.0%	<b>Ex-Dividend Date:</b>	06/30/22 <sup>1</sup>
<b>% Fair Value:</b>	155%	<b>5 Year Valuation Multiple Estimate:</b>	-8.3%	<b>Dividend Payment Date:</b>	08/02/22 <sup>2</sup>
<b>Dividend Yield:</b>	5.9%	<b>5 Year Price Target</b>	\$19	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	D	<b>Rating:</b>	Hold

## 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 \$2.7 billion.

Xerox reported first quarter earnings on April 21<sup>st</sup>, 2022, with results coming in far weaker than expected. Earnings-per-share on an adjusted basis were a loss of 12 cents, which was a long way off from expectations of 13 cents per share in profits. Revenue was \$1.67 billion, off 2.3% year-over-year, but slightly ahead of expectations. The company's earnings were negatively impacted by inflationary pressures and increased logistics costs.

Operating losses on an adjusted basis were \$3 million, down from a profit of \$89 million a year ago. Pre-tax losses were \$89 million, down from a profit of \$53 million in last year's Q1. Xerox mentioned supply chain issues as impacting profits, but also its inability to source material to fulfill all demand. That brought the company's backlog of work up to \$422 million, up 21% from Q4, and 3X last year's Q1 level. Management said these headwinds should begin to subside in the back half of this year.

The company estimates revenue at \$7.1 billion this year, and at least \$400 million in free cash flow. In addition, it expects to return at last half of that to shareholders through dividends and buybacks. We've cut our estimate for earnings-per-share for this year significantly following the weak start to the year, and we now stand at \$1.10 for this year.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$3.76	\$3.92	\$3.84	\$3.20	\$2.32	\$3.48	\$3.46	\$3.55	\$1.41	\$1.51	<b>\$1.10</b>	<b>\$1.94</b>
<b>DPS</b>	\$0.68	\$0.92	\$0.98	\$1.09	\$1.25	\$1.00	\$1.00	\$1.00	\$1.00	\$1.00	<b>\$1.00</b>	<b>\$1.00</b>
<b>Shares<sup>3</sup></b>	306	297	279	253	254	255	230	213	198	159	<b>145</b>	<b>100</b>

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 \$1.10 per share, we expect 12% growth moving forward, not because the business has necessarily improved, but because Xerox continued to buy back huge amounts of its own stock, and because the current base of earnings is so low. Given recent guidance, it appears that weakness is going to drag on longer than initially expected, and well 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

<sup>1</sup> Estimated date

<sup>2</sup> Estimated date

<sup>3</sup> 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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growth will likely be tough to come by; we are counting on a meaningful share reduction for the coming years. That view 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	15.5	10.0
Avg. Yld.	2.3%	2.4%	2.0%	2.4%	3.2%	3.4%	3.6%	3.1%	4.6%	4.4%	5.9%	5.2%

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 15.5 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 5.2% in the future and note that the 5.9% 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%	91%	52%

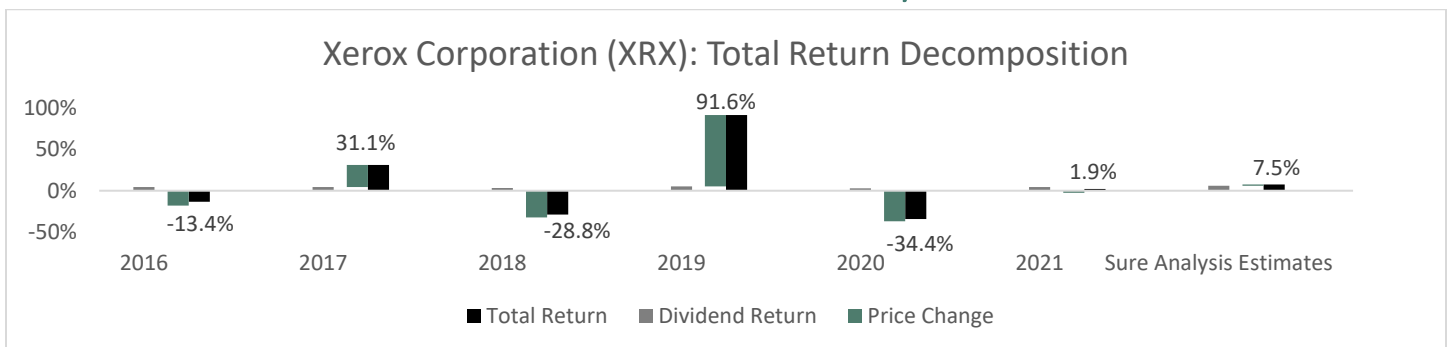
The payout ratio is 91% of earnings now that estimates have been cut for 2022. We don't think a dividend cut is necessary given ample free cash flow, and that the payout ratio should decline meaningfully in 2023 and beyond. We continue to think that Xerox will have a difficult time raising the payout 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 7.5% annual total returns in the coming years, which is slightly higher than our last update. The yield will contribute 5.9%, 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
<b>Revenue</b>	20,421	20,006	12,679	11,465	10,771	9,991	9,662	9,066	7,022	7,038
<b>Gross Profit</b>	6,787	6,485	5,110	4,582	4,305	4,071	3,869	3,650	2,626	2,403
<b>Gross Margin</b>	33.2%	32.4%	40.3%	40.0%	40.0%	40.7%	40.0%	40.3%	37.4%	34.1%
<b>SG&amp;A Exp.</b>	4,141	4,073	3,133	2,865	2,636	2,514	2,379	2,085	1,851	1,718
<b>D&amp;A Exp.</b>	1,301	1,358	639	590	563	527	526	430	368	327
<b>Operating Profit</b>	1,690	1,504	1,381	1,146	1,148	1,080	1,045	1,147	417	320
<b>Op. Margin</b>	8.3%	7.5%	10.9%	10.0%	10.7%	10.8%	10.8%	12.7%	5.9%	4.5%
<b>Net Profit</b>	1,195	1,159	1,013	448	(471)	195	361	1,353	192	(455)
<b>Net Margin</b>	5.9%	5.8%	8.0%	3.9%	-4.4%	2.0%	3.7%	14.9%	2.7%	-6.5%
<b>Free Cash Flow</b>	2,067	1,948	1,887	1,463	660	(372)	1,050	1,268	474	561
<b>Income Tax</b>	256	253	198	193	62	468	247	179	64	(17)

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	30,015	29,036	27,658	25,541	18,051	15,946	14,874	15,047	14,741	13,223
<b>Cash &amp; Equivalents</b>	1,246	1,764	1,411	1,228	2,223	1,293	1,081	2,740	2,625	1,840
<b>Acc. Receivable</b>	2,791	2,764	2,531	838	741	1,160	1,097	1,091	834	912
<b>Inventories</b>	1,011	998	934	901	841	915	829	694	843	696
<b>Goodwill &amp; Int.</b>	12,766	12,557	11,577	4,291	4,077	4,407	4,232	4,221	4,426	3,498
<b>Total Liabilities</b>	18,002	16,268	16,556	16,075	13,090	10,439	9,621	9,239	8,931	8,556
<b>Accounts Payable</b>	1,913	1,626	1,584	1,342	1,126	1,108	1,073	1,053	983	1,069
<b>Long-Term Debt</b>	8,489	8,021	7,741	7,279	6,316	5,517	5,230	4,282	4,444	4,246
<b>Total Equity</b>	11,521	12,300	10,678	9,074	4,709	5,256	5,005	5,587	5,592	4,436
<b>D/E Ratio</b>	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
<b>Return on Assets</b>	4.0%	3.9%	3.6%	1.7%	-2.2%	1.1%	2.3%	9.0%	1.3%	-3.3%
<b>Return on Equity</b>	10.2%	9.7%	8.8%	4.5%	-6.8%	3.9%	7.0%	25.5%	3.4%	-9.1%
<b>ROIC</b>	5.8%	5.6%	5.1%	2.5%	-3.4%	1.7%	3.4%	13.2%	1.9%	-4.7%
<b>Shares Out.</b>	306	297	279	253	254	255	230	213	198	159
<b>Revenue/Share</b>	61.45	62.84	43.29	42.61	42.08	38.94	38.39	38.88	33.21	38.42
<b>FCF/Share</b>	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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