



# Xerox Corporation (XRX)

Updated November 1<sup>st</sup>, 2022, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$15	<b>5 Year CAGR Estimate:</b>	3.1%	<b>Market Cap:</b>	\$2.2 B
<b>Fair Value Price:</b>	\$6.50	<b>5 Year Growth Estimate:</b>	14.0%	<b>Ex-Dividend Date:</b>	12/29/22 <sup>1</sup>
<b>% Fair Value:</b>	231%	<b>5 Year Valuation Multiple Estimate:</b>	-15.4%	<b>Dividend Payment Date:</b>	01/31/23
<b>Dividend Yield:</b>	6.7%	<b>5 Year Price Target</b>	\$13	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	D	<b>Rating:</b>	Sell

## 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 \$2.2 billion.

Xerox reported third quarter earnings on October 25<sup>th</sup>, 2022, and results were much worse than expected. In addition, the company slashed guidance, and as a result, estimates have come way down since our second quarter update.

Revenue was \$1.75 billion, which was down only fractionally year-over-year, but missed estimates by \$10 million. In addition, adjusted earnings-per-share came to 19 cents, which was less than half the 40 cents that was expected by the analyst community.

Gross margin declined from 32.4% to 31.8% of revenue year-over-year. Adjusted operating margin was 3.7% of revenue, down 50 basis points from the year-ago period.

Operating cash flow nearly evaporated year-over-year, falling from \$108 million to just \$8 million.

The company noted that the strong US dollar is putting pressure on its revenue and cash flow guidance for the year. The latter was cut from \$400 million to just \$125 million. Free cash flow was lowered due to supply chain and inflation headwinds.

We now see 65 cents in earnings-per-share for this year after weak guidance from management.

## 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>\$0.65</b>	<b>\$1.25</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>2</sup></b>	306	297	279	253	254	255	230	213	198	159	<b>155</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 \$0.65 per share, we expect 14% 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 2023. Xerox' guidance after Q3 results was much weaker than anticipated.

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, provided free cash flow recovers at some point. Most of our earnings-per-share growth projection comes from the buyback program as revenue losses and margin gains largely

<sup>1</sup> Estimated date

<sup>2</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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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 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, and if free cash flow remains weak, the next dividend move will be a cut, not an increase.

## 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	23.1	10.0
Avg. Yld.	2.3%	2.4%	2.0%	2.4%	3.2%	3.4%	3.6%	3.1%	4.6%	4.4%	6.7%	8.0%

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 23.1 times earnings the stock trades for today, implying a huge 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 8.0% in the future and note that the 6.7% yield today is quite strong. Again, we note the company's free cash flow must improve to maintain this payout.

## 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%	154%	80%

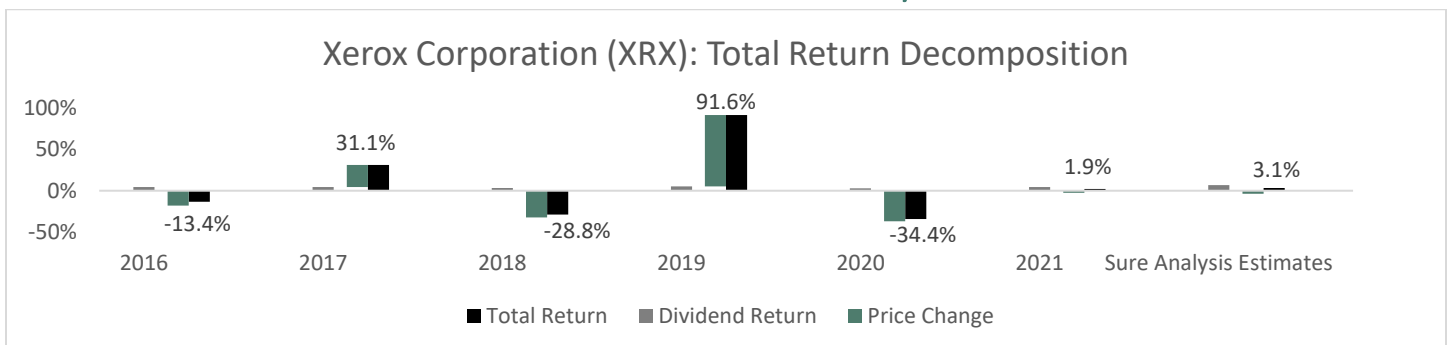
The payout ratio is 154% of earnings now that estimates have been cut for 2022. Xerox hasn't said it plans to cut the dividend yet, but the current payout ratio is clearly unsustainable. We continue to think that Xerox will have a difficult time raising the payout anytime soon given earnings weakness 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 3.1% annual total returns in the coming years, which is slightly higher than our last update. The yield will contribute 6.7%, and growth could be 14%, but that could be offset by a 15.4% valuation headwind. The stock remains overvalued in our view but does offer a sizable yield. We now rate the stock a sell after horrible Q3 earnings and guidance.

## 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>LTD/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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