



Xerox Corporation (XRX)

Updated January 31st, 2023, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|-----------------------|
| Current Price: | \$16 | 5 Year CAGR Estimate: | 9.3% | Market Cap: | \$2.4 B |
| Fair Value Price: | \$13 | 5 Year Growth Estimate: | 9.0% | Ex-Dividend Date: | 03/29/23 ¹ |
| % Fair Value: | 123% | 5 Year Valuation Multiple Estimate: | -4.1% | Dividend Payment Date: | 04/30/23 |
| Dividend Yield: | 6.3% | 5 Year Price Target | \$20 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Rating: | 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 \$2.4 billion.

Xerox reported fourth quarter and full-year earnings on January 26th, 2023, and results were quite strong. Revenue was up 9% year-over-year to \$1.94 billion. Revenue was up almost 14% on a constant currency basis. Adjusted earnings-per-share was 89 cents. That was up from just 34 cents a year ago.

Adjusted operating margin was 9.2% of revenue, nearly double what it was in the year-ago period. Operating cash flow was slightly weaker, declining \$12 million to \$186 million from last year's Q4. Free cash flow was \$168 million, also down slightly year-over-year.

For the year, adjusted earnings-per-share fell from \$1.51 to \$1.12. Revenue was up 1% on a reported basis, but up 4.8% on a constant currency basis. Adjusted operating margin was 3.9% of revenue, down from 5.3% in 2022.

The company guided for 2023 revenue of flat to slightly lower, and operating margin of at least 4.7%. In addition, free cash flow is expected to be at least \$500 million, or about one-fifth of market cap.

We are starting Xerox with a 2023 earnings estimate of \$1.30 per share.

Growth on a Per-Share Basis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$3.92 | \$3.84 | \$3.20 | \$2.32 | \$3.48 | \$3.46 | \$3.55 | \$1.41 | \$1.51 | \$1.12 | \$1.30 | \$2.00 |
| DPS | \$0.92 | \$0.98 | \$1.09 | \$1.25 | \$1.00 | \$1.00 | \$1.00 | \$1.00 | \$1.00 | \$1.00 | \$1.00 | \$1.00 |
| Shares² | 297 | 279 | 253 | 254 | 255 | 230 | 213 | 198 | 159 | 156 | 155 | 155 |

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 2023 is \$1.30 per share, we expect 9% growth moving forward. We see the earnings base for 2023 as sufficiently low, as well as the company's improving fortunes regarding revenue and margins. Given recent guidance, we see a strong rebound in earnings in 2023, but note that even so, earnings are quite low by historical standards.

We think the revenue and margin outlooks for Xerox look much better than they have in the recent past, and its buyback program should be able to help alleviate some of the burden when it comes to growth, provided free cash flow recovers as planned. We note the buyback has slowed enormously in recent quarters, but Xerox will need to find ways to spend its prodigious free cash flow, and we believe it may begin the buyback program again in earnest.

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 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.

Valuation Analysis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 9.7 | 13.0 | 14.3 | 16.8 | 8.5 | 8.0 | 9.0 | 15.5 | 15.1 | 13.0 | 12.3 | 10.0 |
| Avg. Yld. | 2.4% | 2.0% | 2.4% | 3.2% | 3.4% | 3.6% | 3.1% | 4.6% | 4.4% | 6.8% | 6.3% | 5.0% |

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 12.3 times earnings the stock trades for today, implying a modest 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 5.0% in the future and note that the 6.3% yield today is quite strong. The guidance for 2023 free cash flow suggests dividend safety concerns are no longer an issue.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 23% | 26% | 34% | 54% | 29% | 29% | 28% | 71% | 66% | 89% | 77% | 50% |

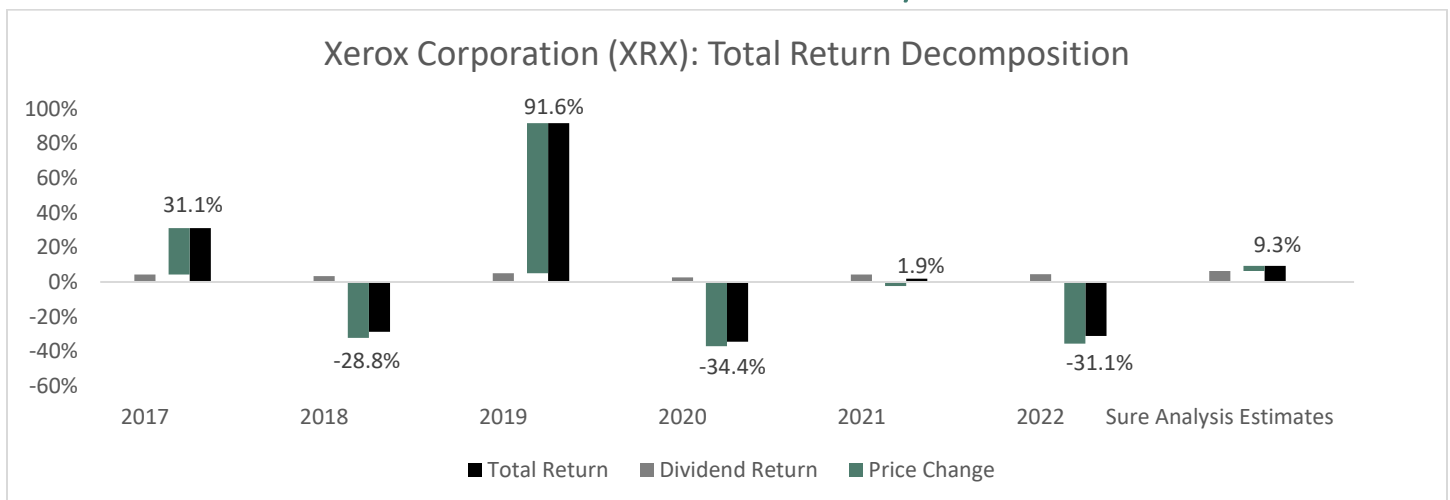
The payout ratio is 77% of earnings now that estimates are higher for 2023. Xerox hasn't said it plans to cut the dividend, and we believe it's sustainable at the current level. We continue to think that Xerox will have a difficult time raising the payout anytime soon given relative earnings weakness.

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 9.3% annual total returns in the coming years, which is much higher than our last update. The yield will contribute 6.3%, and growth could be 9%, but that could be partially offset by a 4.1% valuation headwind. The stock remains overvalued in our view but does offer a sizable yield, and the earnings picture is improving. We now rate the stock a hold.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|--------|--------|--------|--------|-------|-------|-------|-------|-------|-------|
| Revenue | 20,006 | 12,679 | 11,465 | 10,771 | 9,991 | 9,662 | 9,066 | 7,022 | 7,038 | 7,107 |
| Gross Profit | 6,485 | 5,110 | 4,582 | 4,305 | 4,071 | 3,869 | 3,650 | 2,626 | 2,403 | 2,318 |
| Gross Margin | 32.4% | 40.3% | 40.0% | 40.0% | 40.7% | 40.0% | 40.3% | 37.4% | 34.1% | 32.6% |
| SG&A Exp. | 4,073 | 3,133 | 2,865 | 2,636 | 2,514 | 2,379 | 2,085 | 1,851 | 1,718 | 1,760 |
| D&A Exp. | 1,358 | 639 | 590 | 563 | 527 | 526 | 430 | 368 | 327 | 270 |
| Operating Profit | 1,504 | 1,381 | 1,146 | 1,148 | 1,080 | 1,045 | 1,147 | 417 | 320 | 212 |
| Op. Margin | 7.5% | 10.9% | 10.0% | 10.7% | 10.8% | 10.8% | 12.7% | 5.9% | 4.5% | 3.0% |
| Net Profit | 1,159 | 1,013 | 448 | (471) | 195 | 361 | 1,353 | 192 | (455) | (322) |
| Net Margin | 5.8% | 8.0% | 3.9% | -4.4% | 2.0% | 3.7% | 14.9% | 2.7% | -6.5% | -4.5% |
| Free Cash Flow | 1,948 | 1,887 | 1,463 | 660 | (372) | 1,050 | 1,268 | 474 | 561 | 102 |
| Income Tax | 253 | 198 | 193 | 62 | 468 | 247 | 179 | 64 | (17) | (3) |

Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|--------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total Assets | 29,036 | 27,658 | 25,541 | 18,051 | 15,946 | 14,874 | 15,047 | 14,741 | 13,223 | 11,543 |
| Cash & Equivalents | 1,764 | 1,411 | 1,228 | 2,223 | 1,293 | 1,081 | 2,740 | 2,625 | 1,840 | 1,045 |
| Acc. Receivable | 2,764 | 2,531 | 838 | 741 | 1,160 | 1,097 | 1,091 | 834 | 912 | 2,011 |
| Inventories | 998 | 934 | 901 | 841 | 915 | 829 | 694 | 843 | 696 | 797 |
| Goodwill & Int. | 12,557 | 11,577 | 4,291 | 4,077 | 4,407 | 4,232 | 4,221 | 4,426 | 3,498 | 3,028 |
| Total Liabilities | 16,268 | 16,556 | 16,075 | 13,090 | 10,439 | 9,621 | 9,239 | 8,931 | 8,556 | 8,180 |
| Accounts Payable | 1,626 | 1,584 | 1,342 | 1,126 | 1,108 | 1,073 | 1,053 | 983 | 1,069 | 1,331 |
| Long-Term Debt | 8,021 | 7,741 | 7,279 | 6,316 | 5,517 | 5,230 | 4,282 | 4,444 | 4,246 | 3,726 |
| Total Equity | 12,300 | 10,678 | 9,074 | 4,709 | 5,256 | 5,005 | 5,587 | 5,592 | 4,436 | 3,343 |
| LTD/E Ratio | 0.63 | 0.70 | 0.77 | 1.28 | 1.01 | 1.00 | 0.74 | 0.77 | 0.91 | 1.11 |

Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------|-------|-------|-------|-------|--------|-------|-------|-------|-------|-------|
| Return on Assets | 3.9% | 3.6% | 1.7% | -2.2% | 1.1% | 2.3% | 9.0% | 1.3% | -3.3% | -2.6% |
| Return on Equity | 9.7% | 8.8% | 4.5% | -6.8% | 3.9% | 7.0% | 25.5% | 3.4% | -9.1% | -8.3% |
| ROIC | 5.6% | 5.1% | 2.5% | -3.4% | 1.7% | 3.4% | 13.2% | 1.9% | -4.7% | -4.0% |
| Shares Out. | 297 | 279 | 253 | 254 | 255 | 230 | 213 | 198 | 159 | 156 |
| Revenue/Share | 62.84 | 43.29 | 42.61 | 42.08 | 38.94 | 38.39 | 38.88 | 33.21 | 38.42 | 45.56 |
| FCF/Share | 6.12 | 6.44 | 5.44 | 2.58 | (1.45) | 4.17 | 5.44 | 2.24 | 3.06 | 0.65 |

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

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