



Xerox Corporation (XRX)

Updated July 31st, 2023, by Josh Arnold

Key Metrics

Current Price:	\$16	5 Year CAGR Estimate:	10.9%	Market Cap:	\$2.5 B
Fair Value Price:	\$18	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	09/28/23
% Fair Value:	89%	5 Year Valuation Multiple Estimate:	2.4%	Dividend Payment Date:	10/31/23
Dividend Yield:	6.3%	5 Year Price Target	\$22	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

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 \$2.5 billion.

Xerox posted second quarter earnings on July 25th, 2023, and results were mixed. Adjusted earnings-per-share came to 44 cents, which was 12 cents ahead of expectations. However, revenue was up only fractionally year-over-year to \$1.75 billion, missing estimates by \$10 million.

Operating cash flow of \$95 million was up from a cash flow deficit of \$85 million a year ago. Free cash flow was \$88 million, up from a deficit of \$98 million year-over-year.

Gross margin was up nicely from the year-ago period, adding 210 basis points to 34% of revenue. In addition, RD&E costs fell 160 basis points, along with a further 160 basis point improvement in SAG costs. Combined, that led to a massive expansion in operating margin, tripling from 2.0% to 6.1% of revenue year-over-year.

Xerox guided for adjusted operating margin for the year of 5.5% to 6.0% of revenue, and for free cash flow of at least \$600 million, which would be about a quarter of the company's current market cap. Revenue is expected to be about flat, and our estimate now stands at \$1.80 in earnings-per-share for the year.

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	\$1.80	\$2.19
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
Shares¹	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 \$1.80 per share, we expect 4% 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 still low by pre-COVID 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; it certainly appears that it will given recent guidance. 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 Share count in millions

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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, particularly given the yield is currently in excess of 6%.

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	8.9	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%	4.6%

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 ahead of the 8.9 times earnings the stock trades for today, implying a modest tailwind to annual total returns should the valuation normalize over the next five years. We expect the stagnant dividend and higher valuation to produce a yield around 4.6% 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, and in fact, that the company can pay the dividend and deleverage quite easily.

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%	56%	46%

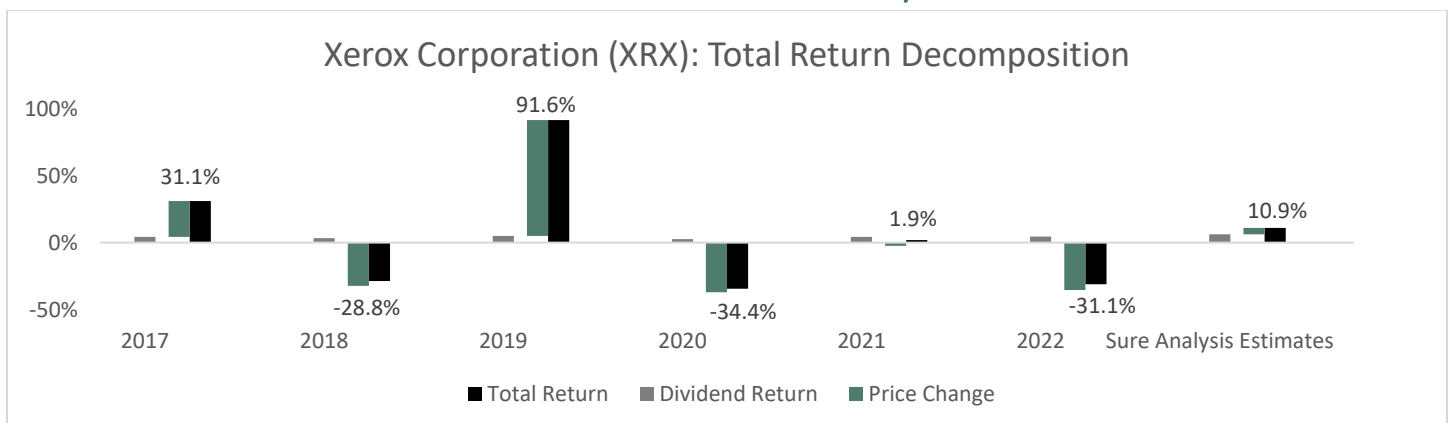
The payout ratio is 56% of earnings now that estimates are higher for 2023. Xerox hasn't said it plans to cut the dividend, and we believe it's sustainable at the current level. We continue to think that Xerox will have a difficult time raising the payout anytime soon given relative earnings weakness, but deleveraging and share repurchases have taken precedence in recent years anyway.

Xerox suffered immensely from the COVID recession, but is showing signs of improvement. 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 10.9% annual total returns in the coming years, which is higher than our last update. The yield will contribute 6.3%, and growth could be 4%, and could be aided by a 2.4% valuation tailwind. The stock is still undervalued in our view and does offer a sizable yield, and the earnings picture is improving. We reiterate our buy rating after good results in Q2.

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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