

FINAL TRANSCRIPT

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XRX - Q2 2010 Xerox Corporation Earnings Conference Call

Event Date/Time: Jul. 22. 2010 / 2:00PM GMT



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PRESENTATION

Operator

Good morning and welcome to the Xerox Corporation second-quarter 2010 earnings release conference call hosted by Ursula Burns, Chairman of the Board and Chief Executive Officer. She is joined by Larry Zimmerman, Vice Chairman and Chief Financial Officer. During this call Xerox executives will refer to slides that are available on the web at www.Xerox.com/investor.

At the request of Xerox Corporation today's conference call is being recorded. Other recording and/or rebroadcasting of this call are prohibited without express permission of Xerox. After the presentation there will be a question-and-answer session. (Operator Instructions).

During this conference call Xerox executives will make comments that contain forward-looking statements which by their nature address matters that are in the future and are uncertain. Actual future financial results may be materially different than those expressed herein. At this time I would like to turn the meeting over to Ms. Burns. Ms. Burns, you may begin.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Good morning and thanks for joining us today; we'll get started on slide 3. Our second-quarter results reflect strong across the board improvement in driving revenue growth, generating cash and expanding earnings. I'm quite pleased with our solid performance and am confident that we'll continue to deliver consistent steady progress throughout the year.



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Along with reporting Q2 earnings today we're also raising full-year earnings guidance. It's a good sign of our improving business and momentum in the marketplace. So let's start with a review of the quarter.

Just as a reminder, considering the acquisition of ACS that closed in February and its related expenses, we are reporting not only GAAP earnings but also adjusted earnings per share. And to ensure we're providing clarity on year-over-year compares, we're also reporting on a pro forma basis which assumes that ACS was in our 2009 results.

Our second-quarter pro forma revenue was up 2%, or 3% in constant currency. We delivered Q2 adjusted EPS of \$0.24, above our guidance of \$0.20 to \$0.22. On a GAAP basis earnings were \$0.16 per share; this includes restructuring and intangibles as well as acquisition-related litigation costs. Cash from operations continue to be quite strong at \$678 million in Q2.

For the first half of the year we generated \$1.1 billion keeping us well on track to meet our full-year operating cash expectations of \$2.6 billion. Through disciplined cost and expense management our operating margin of 10.1% was up nearly 1 point on a pro forma basis. Revenue and cost synergy targets related to the acquisition are on target; I'll provide more detail about this in a moment. First, let me review our revenue results and Larry will cover our financial performance and I'll close and we'll both take your questions. So let's turn to slide 4.

The first quarter we introduced our new revenue categories and segments to better reflect the balance between our technology and services businesses, each of which represent about 46% of total revenue. Our revenue categories are now equipment and annuity. Equipment revenue represents the sale of our document technology, annuity includes everything else -- recurring revenue associated with our technology and services business. It represents about 83% of our total revenue.

Our segments are now Technology, Services and Other. Revenue from Technology includes the sale of document systems as well as the supplies, technical service and financing of products. Revenue from Services represents our business process, information technology and document outsourcing offerings.

Total revenue of \$5.5 billion was up 48% including a 1 point impact from currency. On a pro forma basis it was up 2%, or 3% in constant currency. Annuity revenue on a pro forma basis was flat in the quarter and up 1% in constant currency and we made good progress in equipment sales growth, up 14%. This is the payoff of decisions that we made at the height of the recession to continue investing in new products. It is also a result of our ramp up in marketing spending to drive more equipment sales.

We launched 34 products in 2009 and another 14 through the first half of this year. So as the economy has turned more positive we've been winning in the marketplace and saw the benefit this quarter in equipment sales and install activity. You can expect this increased investment in marketing to continue, both in demand generation campaigns that support our product sales and in brand building awareness around our expanded offerings in business process and information technology outsourcing.

Let's turn to slide 5. In our technology business we closely monitor page growth and machines in field, or MIF. It's always worth repeating that our technology business helps to fuel our annuity stream. More MIF leads to more pages which generate more revenue from supplies and technical service.

For Q2 we saw steady growth in MIF supported by a 45% increase in install. This install activity reflects strong demand across all segments including a 56% increase in entry level devices. That's a good indicator of accelerated demand from developing markets and small- and mid-sized businesses, most of which comes through our indirect channels or network of global imaging companies.

As important, our leadership in color printing continues to drive an increase in the share of MIF and pages, important trends that generate more revenue and gross profits than our business from black-and-white systems.



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Total color revenue grew 8% in the quarter reflecting the continued success of our ColorCube MFP and the very strong launch in Q2 of the Xerox Color 800 and 1000 series. Color pages were up 9% year over year and grew 1 point sequentially from quarter one. It's a good sign that usage trends continue to improve, helping to offset declines in black-and-white pages.

We saw sequential page growth across most categories. The most notable decline was in production black-and-white. This is no surprise since the total production monochrome market is declining. It's still a highly profitable business and one that we benefit from. However, our growth strategy, and where we're aligning our investment, is all about advancing customized digital printing to create more color pages.

In some cases we're replacing monochrome pages with color; in many other areas we're generating new color pages through applications that only exist -- that only exist because of the advantages of our digital technology, think photo books and highly personalized direct mail as examples.

In the service side of our business we have -- which has tripled since the ACS acquisition, signings were \$4.2 billion, up from \$3.9 billion in Q1. On a trailing 12-month basis signings grew 12%. And the pipeline continues to look exceptionally strong from our business process, information technology and document outsourcing offerings. The joint sales activities between the Xerox and ACS plus increased interest in our diverse services portfolio led to a significant Q2 increase in pipeline.

So to sum up the quarter, we're seeing consistent positive trends in the marketplace since the beginning of the year. For us these are signs of modest yet steady economic improvements as well as the benefit of a broad product line and expanded services. Demand continues to improve for our technologies, especially in color, developing markets and from SMB.

With annuity revenue at 83% of total revenue and services signings up double-digit we're getting great leverage from multi-year contracts for business process and document management. Our portfolio is now well balanced between technology and services, each of which contributed to a strong first half of the year. It's momentum that gives me confidence in a strong second half as well. And that's a good place for me to turn it over to Larry. Larry?

Larry Zimmerman - Xerox Corporation - Vice Chairman, CFO

Thank you, Ursula, and good morning. As Ursula said, we delivered second-quarter earnings above our guidance, which is the result of positive trends in our business which we expect will continue. Revenue growth improved, solid gross profit margin and dollar growth, good expense management, significant growth in earnings and operating margin and excellent cash generation. We also see continued progress in cost and revenue synergies associated with our acquisition of ACS. So let's start with our technology slide.

Technology revenue grew 3%, 4% constant currency, and represented \$2.6 billion or 46% of our business with a segment margin of 10.7%. We've categorized the lines of business in technology as entry which includes all A4 devices and desktop printers, mid-range which includes A3 devices that generally serve workgroup environments in mid to large enterprises and high-end which includes production printing and publishing systems that generally serve the graphic communications marketplace and large enterprises.

All of these lines continue to trend positively with color performing well across the board. In entry both black-and-white and color had strong install growth reflecting the continued strength we are seeing in developing markets as well as in other channels. Mid-range also had good install activity with particular strength in color.

With the ColorCube launch last year and more recent color laser A3 launches we have refreshed our color products in this segment with more to come in the third quarter. Additionally, in second quarter we refreshed our black-and-white A3 product line which should drive black-and-white install improvement.



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At the high-end the recently launched color 800 and 1000 is off to a strong start and helped fuel production color growth. Black-and-white improved but remains pressured reflecting both the move to color and continued weakness in the graphic arts market. We were pleased with revenue growth of 4% at constant currency and segment margins of 10.7% which improved almost 1 point from last year.

Slide 7. The Services Segment is comprised of three lines of business -- business process outsourcing, document outsourcing and information technology outsourcing. Revenue mix for the quarter was about 53% business process outsourcing, 33% document outsourcing and 14% IT outsourcing. On a pro forma basis total revenue grew 1% driven by BPO which grew 3%. Growth areas include electronic payment services, federal debt card services and the healthcare services.

Although growth was somewhat lower than in Q1 we expect stronger growth in Q3 due to strength in signings and pipeline expansion. Document outsourcing growth improved sequentially in constant currency. ITO revenue improved sequentially and essentially showed flat revenue in the quarter.

Operating margin was strong at 12.6% which on a pro forma basis is 1.4 points improvement over prior year. Indicators for future revenues were very positive as signings and pipeline growth were strong. On a trailing 12-month basis new business signings, including a growing amount of synergy signings grew 16% and total signings of \$4.2 billion grew 12%. We saw strength in both BPO and document outsourcing.

Signings in ITO continue to be affected by delayed decisions in large accounts, but looking forward we see an improving pipeline. On a year-over-year basis we grew our total services revenue by 23% including synergies which are now over \$2.5 billion. We expect to convert this pipeline into signings in the coming quarters. So overall positive results in both Technology and Service segments.

Slide 8. Pro forma revenue grew 2% and 3% at constant currency and is within our 2010 business model of 1% to 3% growth at constant currency. Gross profit margin was 34.8% which is up almost half a point on a pro forma basis and at the high end of our 33% to 35% range.

We have done a lot of cost work to offset the year-to-year pressure of changes in currency exchange rates. This cost work coupled with hedging and currency sharing with our partner, Fuji Xerox, gives us the confidence that we will remain in the 33% to 35% gross profit margin guidance range.

RD&E improved \$8 million year over year driven by cost savings from restructuring, SAG increased \$9 million on a pro forma basis and improved as a percent of revenue. Improvements in bad debt expense and G&A were offset by investments in selling. Improvements in all cost ratios delivered almost 1 point in operating margin improvement to 10.1%. Our adjusted tax rate was 32% and we delivered \$0.24 of EPS on an adjusted basis which was above our guidance as we saw improved revenue growth and good cost and expense performance.

We continue to differentiate between GAAP earnings and adjusted earnings for guidance and actuals reporting in order to give you transparency into the fundamentals of our business. 2010 earnings on an adjusted basis will exclude amortization of intangibles, restructuring and asset impairment costs, acquisition-related costs including direct transaction costs and specifically defined integration costs and any discrete unusual items. So overall a very solid quarter across all lines of the income statement.

Slide 9. In 2Q we delivered \$678 million of cash flow from operation driven by earnings. Year-to-date cash flow from operations is \$1.1 billion. Working capital was a \$90 million source of cash in the quarter with accounts receivable more than offsetting growth in inventories. Working capital will improve in the second half of the year.

Free cash flow was \$551 million with CapEx and cost of internal software of \$127 million. Our year-end estimate of CapEx is approximately \$600 million; this includes about \$400 million from ACS which is consistent with their historical CapEx levels.



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Cash from financing was a use of \$457 million driven by the payment of \$950 million of senior notes which came due in the quarter, partially offset by an increase in the revolver which we anticipate paying down over the balance of the year.

We ended the quarter with \$1.1 billion cash balance and we are very confident in our ability to achieve our commitment of \$2.6 billion cash flow from operations for the full year.

Next slide. To continue the story on cash we are making excellent progress on paying down debt to get to our desired leverage and achieve \$1 billion of available cash in 2011. We reached a peak of \$10.5 billion of debt with the closing of ACS on February 5 and have reduced debt by \$900 million or half of our \$1.8 billion target for 2010.

In the top right box you can see the math of the first-half actuals, \$1.1 billion cash flow and \$900 million of debt reduction. In looking at the second half we have \$1.5 billion cash flow to go with \$900 million more debt reduction to reach our target.

Given our positive performance in the first half our intention is to call in the first quarter our 2003 10-year bonds of \$550 million which carry a 7-5/8 coupon and have three years remaining. This will not only save us interest expense but will give us increased flexibility in our debt reduction.

In our fourth quarter we expect to report a \$15 million charge as a discrete item which represents \$8 million of a non-cash item of unamortized issuance costs from 2003 as well as \$7 million of a premium. Last point, we were confident of the \$1 billion projection of available cash in 2011.

Now let's look at the debt in the financing dynamics box. I continue to show this debt breakdown to ensure there is perspective and context in understanding our debt and our commitment to maintaining an investment grade rating. We have \$9.6 billion of debt of which \$6 billion is in support of our financing business, the finance receivables of \$6.9 billion is a committed revenue stream from our customers.

In addition, we stagger our debt ladder to be well below our annual free cash flow and total liquidity so we can access capital markets opportunistically. And just to touch on receivables, we had significant improvement in second-quarter year over year in both our write-off experience and requirements for bad debt provisions.

So we are making significant progress paying down the debt, remaining debt supports the financing of our customer equipment, our cash flow and financial flexibility are strong, we will focus on significant debt reduction in 2010 which will enable a return to other cash uses such as share repurchase during 2011.

In summary, we continue to be very encouraged by our results and we are optimistic going forward. Now I'll give it back to Ursula.

Ursula Burns - Xerox Corporation - Chairman, CEO

So, thanks, Larry. And before we wrap up here's a quick update on our acquisition synergy. They're coming through three main areas -- cost, revenue and innovation. During this year of -- the first year of the acquisition, the synergies we're achieving are primarily through cost reductions. We're ramping now in the other areas for payoffs we'll see in years two and three.

In the cost synergy category we captured all the governance of its synergies. We're also seeing productivity gains where we've integrated ACS' proprietary practices into our existing technical and managed services. Pursuing revenue synergies we are cross-selling in more than 100 accounts. From these efforts we have over 10 new signings to date in a joint pipeline of more than \$2.5 billion, up from \$500 million in quarter one.



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And the third area is innovation synergies. For the past couple of years we've been calling the research in our lab smarter document technologies. It's the software and data recognition tools that turn static information into more dynamic data.

With ACS' offerings our innovation is creating more automation and less paperwork, meaning faster transactions and simpler business processes. We're starting to embed these technologies across ACS capturing savings along the way and a stronger return on our innovation investments.

So good progress on all fronts. And I'm personally tracking it with the team on a regular basis. In doing so I am confident that we'll deliver above our \$100 million target for year one. Let's turn to slide 12, then Larry and I will take your questions.

We are now a new Xerox and I always like to remind customers, investors and our people of that. Xerox is now the world's largest enterprise for business process and document management. Through our expanded offerings, through our broad distribution channels, through our global scale our renowned brand and our innovation we're more differentiated in the marketplace and we're more competitively advantaged.

The benefits are reflected in our first-half results. Revenue was up, we generated strong cash flow and we improved operating margins. And as a result adjusted earnings were above our guidance and position us well to raise our expectations for the full year. For the third quarter we expect to deliver adjusted earnings of \$0.19 to \$0.21 per share. And for the full year we now expect adjusted EPS to be \$0.88 to \$0.92 per share, that's an increase from our previous guidance of \$0.75 to \$0.85 per share.

With that I thank you again for joining us today and now let's open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Shannon Cross, Cross Research.

Shannon Cross - Cross Research - Analyst

Good morning. Ursula, can you provide just some more commentary on what you're hearing from your customers, both geographic as well as vertical in terms of demand, how they're feeling about their budgets and just any color you can give?

Ursula Burns - Xerox Corporation - Chairman, CEO

Thanks for the question. Overall still very cautious across the board. But we're seeing some lift in certain areas just like we did in quarter one. Small and midsize customers are investing a little bit more -- they've invested more in quarter one and fortunately continue to invest a little bit more in quarter two.

In our developing markets the activity is strong. Customers are a bit more confident. Obviously financing -- all that has loosened up a bit, so our DMO activities are strong as well. Enterprise customers, we're seeing stability with some signs of hope, some signs of life.

Color is doing better than black-and-white in enterprise, especially at the high end. Still a little cautious. So color is good, black-and-white still not investing that heavily, good results on a quarter-over-quarter basis though. So some solid outlook on a quarter-over-quarter basis.

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In Europe what we're seeing is -- interestingly, despite all of the bad news, we're seeing a pretty strong business environment. Clearly there's caution, clearly there are questions, but what we see is continued investment in color, continued investment in the new technologies we're putting out and definitely continued investment in services. And so not -- so overall balanced results.

And in government, let me just cover government because that's another high point. Another interesting point, we hear a lot about pressure on government, but what we're seeing in particularly our services area which is where we have the most immediate response, we see that government, state and local, is still very interested in our offering, very strong position there.

Growth there, so signings are up there, our pipeline is very strong at state and local government because what we provide to them are services that either are mandated by the federal government so they have to do it, or they provide either cost-cutting or some level of efficiency. So, activity with the government is up; lots of conversations, lots of signings and good pipeline. So overall it's a reasonable balance in revenue -- because we have revenue growing.

Shannon Cross - *Cross Research - Analyst*

Great. And then can you talk a little bit -- I mean the \$2.5 billion for the pipeline of services clearly from sort of revenue synergies is really strong. Where is that relative to where your expectations were? And how far do you think you are in terms of milking that 100 customers that you've talked about?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, so the \$2.5 billion that we talked about is I would say at the higher end of our expectations. So strong. We knew that -- and we talked about this in the first quarter, that we knew that people were interested in the new offering, the new Xerox. And we knew that because they called us or because when we called them they were very excited to speak to us.

That's now turning into literally deals that we can put our hands on and even though not all signed yet, we have 10 deals -- over 10 deals signed, but the \$2.5 billion of pipeline is all interest that's been gated to us. So net-net, at the high end of what we expected, so positive -- positive so far.

Shannon Cross - *Cross Research - Analyst*

Okay, great. And then I've got a question for Larry. Can you just talk a bit about how you're managing currency both euro and yen? Clearly Euro more top-line and I guess SG&A and then yen on the COGS side.

Larry Zimmerman - *Xerox Corporation - Vice Chairman, CFO*

Sure. Well, just to set the stage, there are two kinds of currency that we deal with -- one is translation which is converting local currency, so France euros into dollars. You can convert the whole P&L and since Europe is about 20% of our business the translation currency relationship between the dollar and euro in translation usually hits at some point of the margin of that business.

And so that is something that we've dealt with year in and year out as long as I've been -- since 1972 when we went off the gold standard. So every company deals with translation rates going back and forth. And I don't think that's an issue for us.

Transaction currency, which is primarily transferring costs from one location to another and in our case it would be yen to euro in Europe and also to the United States, the biggest change is the euro to the yen, the dollar hasn't changed that much. And



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we're going to manage this the same way that we managed when the same thing happened in the fourth quarter of 2008 and managed our way through 2009 with not really having a blip on gross profit margin.

And the way we do that is, number one, we address it as a cost issue. So translation -- transaction currency changes, your costs go up and you have to address it like you would any other cost increase. And so we have a lot of cost reduction programs centered around it. Sourcing, suppliers, those kinds of things are ways that you can manage those kinds of costs. We do hedging; to some degree that helps us.

We have a currency sharing agreement with Fuji Xerox that says that we don't take the whole brunt of any currency changes, so we're usually going after a smaller part of the currency change. We have opportunities for pricing because obviously other -- our competitors in Europe are getting product and it's got to be higher cost for them also so everybody has the same cost pressure.

And I have a high confidence that we're going to be in our guidance range not in spite of any kind of currency headwinds here. And I think we always give a balanced guidance view which takes into consideration that we get some good things happening, some tougher things happening and we'll work through them.

Shannon Cross - *Cross Research - Analyst*

Great. Thank you very much.

Operator

Ben Reitzes, Barclays Capital.

Ben Reitzes - *Barclays Capital - Analyst*

Yes, hi, thanks. Can you talk a little bit about the install growth? It looked like the entry level was extremely strong, but I know -- I know there were easy comps, but it still looks very high. Can you talk about what's going on in the markets like entry, mid-range and the high-end and compare and contrast what was better than expected and what some of the trends are that show this install growth which looked pretty impressive?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Right, so the entry -- so, hi, Ben, thanks for the question. The entry, the strength -- unusual strength within the entry segment. And DMO small and medium business clients are the largest uses of this type of technology. DMO had a bang up second quarter, they had a very, very strong first quarter, continued strength in the second quarter, very good therefore. I mean, it's almost as simple as that. No one else underperformed and DMO over performed.

So at mid-range we offer new products. By the way, we offer new products across entry, mid-range and high-end. So new products help in entry as well. Mid-range we offered new products, we have our color MFP, the ColorCube device out in the marketplace and that's doing very well.

We took the risk of launching it in the midst of one of the worst recessions that we had in 2009 and that really has taken off -- it's good. And we launched another set of color and black-and-white mid-range devices, so strength there.

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And into high-end, particularly in color, we launched a product called the 800, 1000, two configurations, we continue with the iGen with our 700, with our 7002/8002. So we have a very strong product line in color at the high-end and the activity is coming in all geographies at the high-end, in all geographies at the mid range, as I said, and then primarily in DMO at the very low-end.

Ben Reitzes - *Barclays Capital - Analyst*

Okay. And so did the high-end grow in total when you add it all up or was (multiple speakers)?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

It sure did. Yes, it grew like 7%.

Ben Reitzes - *Barclays Capital - Analyst*

Okay.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

And installs -- yes, installs also grew -- installs grew in color and declined in black-and-white.

Ben Reitzes - *Barclays Capital - Analyst*

Yes, when you net it together at the high end --?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, we grew.

Ben Reitzes - *Barclays Capital - Analyst*

Okay. Then moving away from that -- well, one last thing on that is that -- I mean, what do you think this says about the imaging market? I mean, are we turning? Is it just easy compares? I mean, is this sustainable? What does it say about the printer market?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Well, I think -- so we have to acknowledge that the compares are easy, easier. (inaudible) to avoid that. But despite that I think there are a couple of things that are happening. As the economy starts to stabilize and improve a bit people are starting to invest more in game changing technologies.

And in some cases that's as simple as going from a black-and-white device to a color device. We're offering them a lot more choice in color. So they're making that -- they're making those decisions as the economy loosens up a bit for sure.

If you look through the numbers though, you'll see that black-and-white production continued to decline. I think that that's another indicator that we're making this transition from color -- from black-and-white to color across -- basically across the board.

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So I think what it says is that this growth, this strength that we saw I don't expect to continue to be our norm for the rest of the quarters or even quarters into the future. This was a very, very strong quarter. But I do expect activity and particularly color activity to continue to grow in the years to come, just not at this rate.

Ben Reitzes - *Barclays Capital - Analyst*

Okay. And then can you just discuss a little more about your government exposure? There seems to be a lot confusion out there. What is the -- of the ACS you bought, my understanding is it's about 40% government and there's a large state and local.

If you can just talk about what you bought, what the government exposure is and then maybe what the combined Xerox looks like in terms of government exposure and differentiate between the federal and state and local? I think there's a lot of confusion out there as to what your exposure is and how that's really going.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, we call it an opportunity, not an exposure. We get -- 40% of our ACS revenues are from government, 35% is from state and local and 5% is from the federal government. In our legacy business we have about 20 -- a little bit more than 20%, 23% of our business is in government, about 20% in state and local and about 5% in federal. So in total we're about 25% in state and local, 5% in federal government, so those are the facts of our mix.

If you look at what we provide to state and local governments, our technologies for sure either document outsourcing or pure technology contracts, but the big piece that we bought from ACS is in Medicaid, Medicare, customer care, transportation, it's in the lines of business, ITO, etc., that they participate in.

As I said in the talk part of my -- of the earlier section, this is generally either federally mandated for state and local, federally mandated programs. So unemployment delivery -- unemployment cards, Medicaid or Medicare delivery, education, requirement, things that are required -- that's one set of activity that's done. By the way, as I said, the signings and the pipeline and the revenue that we generate from this in quarter two, all strong.

The pipeline is the highest that it's been since the first quarter of 2009. So we are not seeing a massive like wind in our face in the government at all in the ACS section of the business. Nor are we seeing it in the document outsourcing or technology side of the business.

So within ACS government business, as I said, single level growth, mid-single-digit growth in quarter two, bookings up at a very high rate and the pipeline is the largest that it's been. So the facts on the table are that we're not really seeing a big push in government.

Let me move it to Europe just quickly there. Similar type of mix of business, some of that is in our document outsourcing business and a little bit -- and growing portions in ACS. Similar type activities. We've talked to you in the past about the Department of Works and Pension contract. I was just over to DWP earlier in the year. And the request from them is similar that we're getting from everyone.

First, help us save money, please. Help us be more efficient in front of our clients because we have more and more of them in front of us. More using our services, we have to become more efficient and more effective in the way that we talk to them and we have to be cost effective. So they're speaking to us about not getting away from them, but please help us to automate and save money, make more customer friendly and save money, etc., etc.

Some of them are saying I need to save money, just plain and simple. So what we do there is do more services under the guise of the contract. And in some conversations we have about extending contracts such that we can actually lock in the revenue



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stream going forward and get some cost concessions for them in the near-term. Net-net we balance this fairly well. We balance it to the point where we actually can feel very comfortable about our position in both state and local and federal governments around the world.

Ben Reitzes - *Barclays Capital - Analyst*

All right. Just finally, any pricing pressure out there in the copier printer market? There's some thesis out there that pricing is going to get really bad when HP gets more product. We're not seeing it yet, I was wondering if you are.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

We are not. What we've seen, pricing 5% to 10% and it's now -- it's exactly tending toward the lower end of that range in quarter two. I would expect that we have -- that if there is price pressure by any single competitor we'll do as we always do -- we'll try to win in the marketplace -- win in the marketplace and provide the value.

And I think two other additional points. One is that everybody is going to feel the pressure if there are cost increases based on transaction currency. So I don't know what -- we're expecting the cost to go up, but we're actually managing to not put too much pressure negatively on price, so not to bring price down. (multiple speakers) and then the last thing (multiple speakers).

Ben Reitzes - *Barclays Capital - Analyst*

(multiple speakers) to cut price with a strong yen and a weak euro, right?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, exactly. The last piece is that we have a little bit of a different model than HP. HP has a printer-based model and we have a multifunction model. And multi-function means add a whole bunch of things together, put it in one device and become more efficient, more cost effective, etc. So our value proposition is better in this market, a market under pressure than HP's is.

Ben Reitzes - *Barclays Capital - Analyst*

Thanks a lot.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

You're welcome.

Operator

Ananda Baruah, Brean Murray.

Ananda Baruah - *Brean Murray - Analyst*

Thanks for taking the question. Congrats on a nice solid quarter. Hey, Ursula, I was wondering if you could just talk about usage trends as you saw them through the quarter. They seemed to improve the last quarter and just wondering if you saw the same kind of improvement or if things just sort of held steady there.

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Ursula Burns - Xerox Corporation - Chairman, CEO

Yes, so I think that we've seen an improving trend quarter to quarter and similar trend therefore. So, color and just about every segment think about it as improved. So color pages are up 9%, color MIF is up -- color is up. Color is up, that's good. Black-and-white, particularly in the core business, the core office segment of the business, that's very high-end. Color is -- black-and-white is up as well.

So we've seen strength in black-and-white, particularly all segments except for the very high-end have improved. The very high-end, so what we call high-end production in printing I think is -- whatever it's called, high-end production printing is under pressure. And that pressure continues. It started in the end of 2008 and it continues.

We're pushing a lot of that continuance. As we get more and better color offering the 800 and the 1000 for example, we moved -- we pushed to move pages from black-and-white to color. So we expect to see that portion of the business continue under pressure. By the way, we're not going to give it away because it's a big piece of our business, very, very profitable. And customers still do need it. But we don't expect to see growth there. We expect to see growth in color and we're seeing it.

Ananda Baruah - Brean Murray - Analyst

In the high-end business is there I guess any difference in the trends you're seeing I would say from -- kind of guessing your production business, the portion that goes into graphic arts versus the portion that goes into enterprise environments and how production centers whether it be placements or usage of placements?

Ursula Burns - Xerox Corporation - Chairman, CEO

Yes, it turns out nothing spectacular, but I am more than hopeful, I'm fairly confident that we'll start to see movement especially in the graphic arts segment of the business. The question is how do you capture that movement, what offerings, what special business development tools do you give them to move their business along.

I talk about photo books and packaging application, which a portion of this graphics arts business, that's where we're focusing our investment. And we're doing that because we know that there is a change a coming, as they would say. There's a need to automate their business and there is money there.

So we are helping the graphics arts customers to do that with technology, but we're also offering draft around it. But net-net quarter one to quarter two we've seen not significant improvement in -- or change in graphic arts or in enterprise.

Ananda Baruah - Brean Murray - Analyst

And are you seeing -- I believe the comment last quarter was things in enterprise, commercial enterprise, they're a little bit more stable-ish. You're seeing some deals get done that weren't getting done maybe second half of last year. It seems like the install trends are about the same. Are you seeing any change in the content -- or I guess the reason that those -- the reason the installs are getting done? Are you seeing any net new projects getting done or is it sort of still the same -- sort of the release of stuff that was on hold coming out of last year?

Ursula Burns - Xerox Corporation - Chairman, CEO

Yes, I'll answer it in two segments and then we'll move on to the next question. First from the technology side of our business, we're seeing upticks in certain geographies that we saw traction already in certain segments of the business. But in the other

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place that we saw kind of very solid growth was in high-end color and that's I think almost solely because we gave out -- because we offered two great products to the marketplace the 800 and 1,000.

Significant traction there, not only in that product but also because we have those product and people coming in looking to us and with selling other products as well. In the services side, as I said, we had amazing -- very strong revenue, very strong signings, very strong pipeline. And that is because we have very strong offerings and we have amazing coverage. The combination of ACS in Xerox together has made the value proposition that we offer significantly more compelling. And we are definitely seeing the benefit of that.

Ananda Baruah - *Brean Murray - Analyst*

Great, thanks a lot.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Thanks a lot.

Operator

Keith Bachman, Bank of Montreal.

Keith Bachman - *Bank of Montreal - Analyst*

Hi, guys. Thanks very much. You mentioned what signings were over the latest 12 months of plus 12%. Did you characterize what the signings were for the quarter on a year-over-year basis?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes we can. The signings for that -- we don't really give you specifics on the quarter, but we say that -- I can tell you that they are stronger -- that they are strong. Strong -- I would not put very in front of it, but they're strong.

Keith Bachman - *Bank of Montreal - Analyst*

So lower than the latest 12-month scenario of 12%?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

They're very high -- they're much higher than the trailing 12 months, which you would expect them to be. Because the trailing 12 months, and that's the reason why we give trailing 12 months because there are spikes up and down some days, sometimes higher, sometimes lower. This quarter, quarter two, the signings in that quarter for the 12 months to come is about \$2.5 billion. So, but signings overall -- signings in the quarter were stronger than the trailing 12 months. And they're very good.

Keith Bachman - *Bank of Montreal - Analyst*

Okay, fair enough.

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Ursula Burns - Xerox Corporation - Chairman, CEO

Okay. And one other thing about signings if I may. We talk about signings growth, services pipeline growth, and the services pipeline growth was about 23%. That goes well because the next time I speak to you you'll have those pipelines -- some portion of that pipeline into signings and then the next time I speak to you we'll have some portion of those signings into revenue. So it actually is a good way that it grows across the market -- yes, okay, good.

Keith Bachman - Bank of Montreal - Analyst

Okay, got it. Thanks very much. On the OpEx, Larry, I was hoping -- could you give us some color on what OpEx in total, both R&D and SAG, will do sequentially in the September quarter?

Larry Zimmerman - Xerox Corporation - Vice Chairman, CFO

Well, I mean it depends on currency. I mean, I don't see significant changes going forward (multiple speakers).

Keith Bachman - Bank of Montreal - Analyst

But let's just -- yes, let's hold currency constant at today's spot, does that mean that OpEx -- excuse me (multiple speakers).

Larry Zimmerman - Xerox Corporation - Vice Chairman, CFO

Yes, R&D I think you'll see improvements going forward to some degree. They're small. And I think generally speaking SAG will be flat or with a slight growth, but it won't be a dramatic change.

Keith Bachman - Bank of Montreal - Analyst

Okay. All right, thanks very much, guys.

Ursula Burns - Xerox Corporation - Chairman, CEO

Keith, let me just do one thing. If you can go to slide -- let me just make sure I find it because I'll be able to answer the signings segment question a little bit more concisely. If you go to slide 7 it will show you the signings for our BPO business, our ITO business and our document outsourcing business is about 4.2 billion -- it's 4. -- \$4.2 billion which is over the quarter on signings which were about \$3.9 billion.

So sequentially we see signings growth. And if you look at the last 12 -- the trailing 12 months growth it's about 12% versus 5% in the first quarter. So we're seeing growth across the business lines, we're seeing growth in both signings for the forward and signings for the trailing. So it's growth across every way that I can actually speak to you about it.

Operator

Are we ready for the next question?



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Unidentified Company Representative

Yes.

Operator

Richard Gardner, Citi.

Richard Gardner - Citi - Analyst

Okay, great. Thank you. Good morning. Ursula, there's been a lot of discussion around state and local government on the call. I wanted to follow up on the earlier question and ask, what is your assessment of the -- I guess the strength of the pipeline in state and local government now versus say six to 12 months ago?

And I understand that most of that is federally mandated, a lot of it's federally mandated and the bookings are strong. But is there a risk that those customers can come back a year or two before a contract comes up for renewal and ask for pricing concessions? And therefore put some pressure on the pricing and margins for existing contracts? Thanks.

Ursula Burns - Xerox Corporation - Chairman, CEO

So, as I said a little bit earlier, Richard, thanks for the question. Our pipeline in the quarter is of the highest that it's been since quarter one of 2009. So --.

Richard Gardner - Citi - Analyst

Particularly for state and local government?

Ursula Burns - Xerox Corporation - Chairman, CEO

State and local, state and local --

Richard Gardner - Citi - Analyst

Okay.

Ursula Burns - Xerox Corporation - Chairman, CEO

I mean, it is the strongest pipeline that we've had -- since we've seen the Company and since we've had the company, which hasn't been that long, and since we've been looking at it. Pipeline is strong, the signings are strong and the current business is strong. Is there a risk or chance or that people who come back can come back and actual price concessions in all of our business is that risk or chance, I mean everywhere we have it.

Are we seeing it? The answer is no. Are we having conversations? The answer is yes, every day with our clients. We understand -- sometimes we initiate those conversations because we understand exactly how much pressure states are under. So the way that we manage this business is not to wait for them to call us and say, my goodness, I need more help. We actually go out continuously and offer them more help.

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Sometimes that help us extended contracts, you extend the contract we'll give you some price concession. That saves us a significant amount of time and money in the long run. So we'll do that kind of thing. Or we'll add more to the service that we're providing them. Some from -- a lot of that is for some form of money, obviously. The more they need, they need more efficiency.

So the conversations are there, they are definitely happening and some of them I'm sure will result in us having to change the terms and conditions or the game of the contract. But that's not the norm here by any stretch of the imagination. Even in ACS' past, in our past, but in ACS' present with us, we're not seeing that either at the norm.

Richard Gardner - *Citi - Analyst*

Okay, all right, thank you. And then I wanted to go back to the install strength as well. And I know that you specifically mentioned DMO and SMD. And in DMO in particular do you think that this is just reflective of a typical cyclical rebound in those markets and strong end market growth in DMO or do you feel like you're actually gaining a significant amount of market share in DMO?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Yes, we're gaining market share in DMO, there's no doubt about that. But there is a level of cyclicity in this business. I mean, no doubt -- meaning in DMO is improving and a couple of years ago they were not. So we're doing more because the market is more buoyant in DMO. But in addition to that we're just not rising with the tide, we're definitely rising above the tide, especially in low-end MFPs and color. Just think about color. If you think about color growth then you can -- just about every line that we're doing business in up through the high end we're gaining share.

Richard Gardner - *Citi - Analyst*

Okay, great. And then I guess a skeptical analyst within the SMB area, I think some people might say that you're benefiting currently from the supply constraints of one of your major customers -- competitors there. And I'm just interested to get your assessment of whether you feel like that is a material benefit to your SMB momentum right now or whether you just simply feel like increased distribution with global imaging is the primary driver there?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

I see absolutely no benefit that we're getting from supply constraints from our competitor, none. All of our benefit, and this is as firm as I can be on the call, all of our benefit is because we have a great product line and we have great distribution, period. Next question.

Richard Gardner - *Citi - Analyst*

Thank you.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Thank you.

Operator

Chris Whitmore, Deutsche Bank.

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Chris Whitmore - Deutsche Bank - Analyst

Thanks very much. I actually wanted to follow-up on Rich's question. More on the renewal side or re-scoping side. Can you give any color on the bookings you're seeing and the pipeline that you see? How much of that represents new customers or new bookings versus renewals and extensions of existing contracts?

Ursula Burns - Xerox Corporation - Chairman, CEO

Right, the pipeline is 100% new. The way that we've talked to you about pipeline is new customers. Renewals for -- in our business are strong. We are -- this is probably the highest renewal quarter that we've had ever in ACS and we -- not even us, but ACS had. We're at the high-end of the 80% to 90% -- 85% to 95% -- 85% to 90%, sorry, renewal range, we are at the high-end of that. So think of the number that would be at the high-end of that and maybe a little bit before -- maybe a little bit above. So, renewals are phenomenal.

Last quarter we had a great signings quarter, new business signings quarter. So that's a little bit softer this quarter. Renewals are significantly stronger this quarter and the pipeline is strong, as I said, up 23%. And the pipeline is 100% new, there's no renewals in the pipeline.

Chris Whitmore - Deutsche Bank - Analyst

So if I understand that correctly, the new signings have moderated a little bit but renewals have increased. Why do you think that is?

Ursula Burns - Xerox Corporation - Chairman, CEO

Well, I mean one of the things that we focused on, making sure that we have vetted all of our contracts that are coming up. So we focus on them. We have a big book of business and we have to make sure that we bed down. That's the only reason, it's not really anything else. The big energy here and the big thing that you should focus on here is the pipeline. And you hit on it before, we were up 23%, the pipeline is up 23%, it is the strongest pipeline that we've ever had. And that pipeline is varied across all of our lines of business.

And so we're -- and the pipeline is not yet all signed, obviously or else it would be in signing. But we don't put it in the pipeline unless it's a real deal that we can get, a real, real deal that we can get. So we're very pleased with the pipeline.

And if you remember, on signings line -- we signed the California Medicaid -- California Medicaid (inaudible) \$1.6 billion contract that we signed in quarter one. And so quarter over quarter it's hard to replace California Medicaid, so new business signings are a little bit light because we had \$1.6 billion signing in quarter one.

Chris Whitmore - Deutsche Bank - Analyst

Got it. A question for you, Larry, on the guidance increase. I'm just trying to understand how much of the guidance increase is related to upside on the margins versus the top-line? You didn't talk much about topline guidance for this year.

Larry Zimmerman - Xerox Corporation - Vice Chairman, CFO

No, well we normally -- there are only so many lines that you're going to give guidance on. And so, we're confident of 88 to 92. And I think when we get the actuals we'll know exactly where we got them.



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Chris Whitmore - *Deutsche Bank - Analyst*

The \$22 billion that you've targeted previously, is it fair to say you're expecting some upside to that?

Larry Zimmerman - *Xerox Corporation - Vice Chairman, CFO*

Yes, I'm not sure I would say that. I mean, you have a currency that affects it, you have mix characteristics that affect it, it's a big number to point to. So --.

Chris Whitmore - *Deutsche Bank - Analyst*

Last one from me. On the cost-cutting or the synergies, the 100 to 150, are we not shading the high end of that range? Thanks.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

We're shading above 100. And I think that's the best way to categorize it. So we're above 100 and we're running towards 150. Next question, please. Thank you, very much.

Operator

Mark Moskowitz, JPMorgan.

Mark Moskowitz - *JPMorgan - Analyst*

Thank you, good morning. I want to come back to the ACS update in terms of the 10 signings to date, 10 plus signings. How much of those are competitive displacements of -- versus displacement of homegrown type of processes? And then the second kind of question -- or part of that question is, were these wins that were kind of predicated on (inaudible) processes that took place after ACS closed or were they kind of relationship sourced initiated months or even years ago?

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Thanks, Mark, I'll take both and Larry can feather in whatever he needs. As far as how many of the 10 plus are competitive, I actually don't know the numbers exactly, but I can tell you the flavor of the way that this business works a bit. A lot of what we compete against are processes the customer has already in place. It's not a competitor in there doing something, it's there, they're doing it themselves, so we're taking over their customer care or their HR processes or financial and accounting processes.

So in general that's the kind of business that ACS does. Most of the market is under penetrated. So I don't really know exactly the number -- the 10 plus, how they break out. But in general you would see that most of them break out, that we're displacing somebody's own homegrown process.

As far as bidding process goes, some of these and this will be the same going forward as well, is the expansion of a set of services at a client that we already do business with. So we do business with -- I'll use Procter & Gamble even though they're not one of the -- they may not be one of the 10. We do business with Procter & Gamble in customer care and we take over their health HR outsourcing business.

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Some of it is that and that's not generally a bid. So we generally don't bid for that, we generally prove ourselves and expand our business there sometimes, and some of these I am sure are bids as well. I don't know the breakdown specifically. But the flavor of the business goes that way.

Mark Moskowitz - *JPMorgan - Analyst*

And then as far as the --

Ursula Burns - *Xerox Corporation - Chairman, CEO*

I'm sorry, Mark, go ahead.

Mark Moskowitz - *JPMorgan - Analyst*

Did I interrupt, I'm sorry. As far as the install activity, getting back to the earlier question, I just want to get a sense of in terms of the distribution or composition of the install growth and to cross high-end, midrange, what have you. How should we think about the wholesale benefit a year from now? Would there be any sort of disruption to the trendline because of entry-level being a bigger part of that mix? And will post sale be maybe lighter relative growth a year from now? I know it's kind of hard to put the crystal ball together. But just trying to get a sense of the composition a little more.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

So, the post sale from these -- from this install growth, this activity growth, obviously it has a positive impact on post sale. But you are right to look at the entry level as a different type of install has been the high. So, you can't correlate -- you shouldn't correlate that high entry growth to a significant post sale growth. So it will grow because we have a lot more devices out there. High-end is more impactful in the post sale than low.

But I tell you what, this trend, this big movement in number of machines that we put in place and the high penetration of color devices will help for sure as they get in and start getting used. There is no -- this is all positive news from a post sale perspective.

Mark Moskowitz - *JPMorgan - Analyst*

Thanks, Ursula.

Ursula Burns - *Xerox Corporation - Chairman, CEO*

Thank you very much.

Mark Moskowitz - *JPMorgan - Analyst*

I have one question for Larry, actually, if I could real quickly. Larry, just given the strong performance in cash flow for the first half of the year and given how the second half historically has always seen an outsized performance versus the first half from a cash flow perspective. Just trying to get a sense, do you have a little more flexibility in terms of maybe not having the throttle forward as heavy on the working capital efficiencies that you talked about earlier this year? Do you have any more wiggle room, or could we see upside if you just keep throttling forward?

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Larry Zimmerman - Xerox Corporation - Vice Chairman, CFO

Well, our goal is I mean when it comes to setting a target for cash flow, we want to do well on every line. We want to do well on working capital. So, that is how we work it. So we look at the inventory by itself and we look at what we think is a competitive inventory to have. And hopefully, that yields us more than our goal.

If you look at last year, we blew the doors off on AR and inventory in the fourth quarter. I think we -- in the first two quarters of this year, we haven't really capitalized on those two. I think we will in the second half. And I'm not -- I don't have the goal of 2.6 that stops me from working on working capital. So, I hope that answers your question.

Mark Moskowitz - JPMorgan - Analyst

Thank you.

Ursula Burns - Xerox Corporation - Chairman, CEO

Thank you. We have time for one more question.

Operator

Douglas Ireland, JMP Securities.

Douglas Ireland - JMP Securities - Analyst

Thank you. This is a great looking quarter. Congratulations. I was wondering the ITO signings are up 125%, and I was wondering if that is where you are seeing a lot of your cross-selling success. Is there any way to --?

Ursula Burns - Xerox Corporation - Chairman, CEO

I don't think ITO signings were up 125%. We are trying to dig through it right now to find out what --.

Douglas Ireland - JMP Securities - Analyst

I am looking quarter over quarter, sorry.

Ursula Burns - Xerox Corporation - Chairman, CEO

Oh, quarter over quarter. Yes. I don't -- I feel signings are a small number. You can't -- in a quarter -- so you can't read -- you know, it's \$500 million, so you can't read a lot into it. So say your question one more time.

Douglas Ireland - JMP Securities - Analyst

I was just wondering if -- I'm trying to really get a line on where you are having success in the cross-selling. I'm very interested in how that is playing out. So I am looking for signs of where you are successful there.



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Ursula Burns - Xerox Corporation - Chairman, CEO

Sorry, Doug, for not getting clarity on the question earlier. So ITO signings were up, but so are business, BPO and document outsourcing. You can't -- you shouldn't read into the fact that the ITO signings were up as estimated driver. Signings were up because every portion of the business line including document outsourcing signings are up as well. So, the mix is good. The mix of the business lines in BPO and the mix of adding an ITO in document outsourcing is good.

Douglas Ireland - JMP Securities - Analyst

Okay. And is there also a technology pullthrough?

Ursula Burns - Xerox Corporation - Chairman, CEO

Yes, on the ITO piece in particular, there would be a pretty big technology pullthrough, but I will give you an example of a technology pullthrough from a BPO signing that we had. We signed California Medicaid last quarter. And when we signed California -- it was a \$1.6 billion signing -- one of the portions of California Medicaid was technology to support the BPO outsourcing. That technology was not through our technology. And one of the synergies -- we don't count it in the synergy number -- one of the synergies that we will benefit from is to remove all of the technology that is not Xerox and replace it all with Xerox.

We've already gotten that approval and we're in the process of -- we'll do that in the California Medicaid contract. It doesn't add revenue to us, right, because we -- \$1.6 billion is \$1.6 billion. But think about the gross profit and the profit benefit that we get from this additional ability to use Xerox's technology in a BPO contract that you cross sell, but we didn't cross sell, we cross implemented it that way.

So we're seeing cross-selling. ITO pulls management services for sure. BPO pulls technology. Our technology pulls the BPO offerings in ITO. So we're seeing cross selling in just about every way. \$2.5 billion pipeline from a synergies perspective comes from that, comes from the fact that we're bringing each other in and showing our wares to each other's clients.

Douglas Ireland - JMP Securities - Analyst

Excellent. And then it looked like the post sale revenue was just slightly down quarter over quarter. Is that seasonal? Is it affected by the price increase that happened at the end of last quarter?

Ursula Burns - Xerox Corporation - Chairman, CEO

You hit it right on the nose. The driver for that is -- and we did say beware of this. We had a very good supply to pull through because of the price increase and that we would actually normalize in this quarter and we have done that. So I think it's a little bit more normal.

So, thank you, everyone, for joining us today and for your interest and for the time. Enjoy the rest of your day. And good day.

Operator

Thank you for joining today's conference call. You may now disconnect.

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