Jack McHale, Investor Relations Officer

- Thank you operator. Good morning, everyone, and thank you for joining us.
- About an hour ago, Unisys released its first quarter 2009 financial results. With us this morning to discuss our results are Ed Coleman, our CEO, and Janet Haugen, our CFO.
- Before we begin, I want to cover just a few housekeeping details.
- First, today’s conference call and the Q&A session are being webcast via the Unisys investor website.
- Second, you can find on our investor website the earnings release and the presentation slides that we will be using this morning to guide our discussion. These materials are available for viewing as well as downloading and printing.
- Third, today’s presentation, which is complementary to the earnings press release, includes some non-GAAP financial measures. In the presentation, we have provided a reconciliation of our reported results on a U.S. GAAP basis to any non-GAAP measures.
- Finally, I’d like to remind you that all forward-looking statements made in this conference call are subject to various risks and uncertainties that could cause actual results to differ materially from expectations. These factors are discussed more fully in the earnings release and in the company’s SEC filings. Copies of these SEC reports are available from the SEC and from the Unisys investor website.
- Now here’s Ed.

Ed Coleman, Chief Executive Officer

- Thanks, Jack. Hello, everyone. Thank you for joining us.
- As we begin our call today, please turn to Slide 1 of the presentation for highlights of our first quarter.
- We made progress in the quarter, in a challenging economic environment, in driving our turnaround program at Unisys.
- I was encouraged by the progress we made in reducing expenses and improving cash from operations. We’ve put out a strong message internally about the importance of reducing expenses and driving cash as we work through this economic period … and our people rose to the challenge.
- Operating expenses declined 24% year-over-year in the quarter. Some of that improvement came from currency, but the bulk of this improvement was driven by the actions we have been taking – and continue to take – to simplify the organization and reduce SG&A.
- Progress on expenses in the quarter helped us to offset some of the pressure on our gross margins due to lower revenue. In fact, we were able to slightly improve operating margins in our services business over the year-ago quarter.
- We also did a good job managing working capital and driving cash. We generated $39 million of operating cash flow compared with a cash usage of $49 million a year ago. That’s an $88 million improvement … and it came in what is seasonally a weak cash quarter for us.
- Another highlight was our U.S. federal government business, which grew revenue and orders in the quarter. Hopefully you’ve seen some of the orders we’ve announced in this business in recent months.
- Turning to Slide 2 … unfortunately, we were not able to fully leverage our expense improvement and bring it to the bottom line because of lower volume at the top line.
- The demand environment remains highly uncertain. While our U.S. federal government business did well in the quarter, we saw continued weakness in the commercial side of the business as clients delayed spending on IT projects.
- Our first-quarter revenue declined 15% … 5% if you exclude the impact of foreign currency, which had a 10-point negative impact on our revenue.
As you’ll see when Janet takes you through the numbers, the revenue decline impacted our gross margins in the quarter. We saw the most significant impact in our technology business, where a number of expected high-margin mainframe deals were deferred during the quarter, particularly in Japan.

Gross margins in services were also impacted. Some of this was due to currency, but we clearly need to drive greater volume and get some help from a better demand environment to fully leverage the improvements we are making in our expense structure.

In the meantime, we aren’t waiting for economic conditions to improve to drive bottom-line improvement.

We continue to take aggressive actions against our priorities to tighten our strategic focus, build brand differentiation, reduce costs and expenses, and drive profit and cash flow.

In doing so, we feel we will be positioned to benefit at the bottom line when business conditions improve and demand comes back.

You’ll remember from our last call in February that there are four priorities in our turnaround program. You can see those listed on Slide 3. They are:

⇒ To concentrate our resources on fewer, high-potential markets with a portfolio of value-added offerings;
⇒ To offer clear, compelling value propositions that differentiate Unisys;
⇒ To drive expansion in our gross profit margins by enhancing the cost-efficiency of our labor model;
⇒ And finally, to simplify the organization and significantly reduce our expense structure.

The first two priorities are about driving profitable revenue by being more focused in the markets we serve and providing solutions that clients recognize as being differentiated and adding value.

The third and fourth priorities are about bringing more of this revenue to the bottom line by being extremely efficient in how we deliver services and operate our business.

Turning to Slide 4 … in the first two priorities of business concentration and market differentiation, we’ve worked in recent months to tighten our strategic focus in terms of how and where we invest our resources.

As I discussed in our last call, we have focused our resources on pursuing growth opportunities in four primary market areas – security, data center transformation and outsourcing, end-user outsourcing and support services, and application modernization.

We chose these four because they match growing areas of market need with strengths that are core to Unisys … such as our decades of experience in the data center … our expertise in security … industry-recognized capabilities in outsourcing and end-user support … and our skills in building, managing, and modernizing enterprise, mission-critical applications.

Throughout 2009 we will be strengthening our portfolio of offerings in each of these targeted markets. We will be introducing differentiated solutions that help clients cut costs, improve security and efficiency, and achieve greater return on investment – which is what every client I’ve talked to is looking for right now.

As part of narrowing our strategic focus, we are also working to identify and explore potential divestitures of non-core assets and to rationalize our geographic presence. To put this effort in perspective, the four areas of strength that I just noted (security, data center transformation including our mainframe business, end user outsourcing, and application modernization) represent about 75 to 80% of today’s business, as measured by revenue.

Moving to Slide 5 …

As I mentioned on our last earnings call in February, we need to improve our service margins and reduce our overhead to be more in line with our competitors and with industry benchmarks.

We are currently taking specific actions to reduce our cost base on an annualized basis by about $310 million, which is up from the $225 million we discussed on our last call. We are on plan to get about $275 million of these savings in 2009.

We are taking a multi-pronged approach to reducing our cost base and enhancing our margins.

First, we are working on changing the mix of the services and solutions that we provide. Our expectation is that increased applications work and security work, in particular, have the potential to improve our overall service gross margins.

Second, we are also working to enhance gross margins by becoming more efficient in how we deliver services.

As part of this, we are making use of sophisticated knowledge management and IT tools to handle a greater percentage of support requests through automated and self-service channels, which cost significantly less than sending a technician.
• And third, we also continue to enhance the cost-efficiency of our labor model by increasing our use of lower-cost labor, both offshore and onshore, as part of a balanced services delivery pool.

• Over the past six months, we have grown our pool of lower-cost labor to about 18% of our workforce from about 15%.

• Regarding overhead, we continue to be aggressive in acting to simplify our business model and reduce expenses. You can see the results to date in the 25% year over year reduction in SG&A reflected in this quarter’s results.

• Since the fourth quarter of last year, we have taken actions to reduce our annual SG&A expenses by about $175 million. This is up from the $150 million that we talked about in our last call. We expect about $160 million of these savings to flow in 2009 and we continue working to identify additional SG&A savings opportunities.

• To further support the strategy I’ve outlined since joining Unisys, we’ve been successful over recent weeks in attracting a number of terrific, experienced executives.

• Lazane Smith has joined us to lead our evaluation of non-core assets and geographic rationalization. Frank Boyer, formerly the leader of procurement at EDS, has joined Unisys with the goal of better leveraging our procurement spend. Suresh Mathews has joined as our new CIO with the goal of reducing our IT spend and simplifying our systems and workflow to capture the full benefits of what is now a simpler organization and management structure.

• Before I conclude this morning, I’d like to comment on the balance sheet.

• We are fully aware of the need to strengthen our balance sheet and we are approaching this with a sense of urgency.

• As we’ve previously stated, we continue to explore alternatives to address the debt situation including asset sales, improving our operations, and evaluating options for secured financing. As you saw in the press release, there are two specific actions we are currently evaluating.

• Moving to Slide 6 … we are taking broad-based actions in support of our turnaround program to drive improvement in our financial results.

• The difficult economic environment is muting some of our progress right now, but we are beginning to see results in terms of reducing expenses and improving cash flow.

• I am seeing a great deal of pride and enthusiasm internally as to the progress we’re making and the new direction of the company.

• This is without question the most challenging economic environment I’ve seen in my thirty years in the industry. But this company has a great deal going for it. I continue to be impressed by the capabilities and talent that I uncover as I travel to our operations to speak with our people.

• I believe we are taking the right actions to reinvigorate Unisys in the marketplace … and that we will come out stronger on the other side of this global downturn.

• Let me thank you again for joining us this morning and turn it over to Janet to take you through the quarter results in more detail.

Janet Haugen, Chief Financial Officer

• Thanks, Ed. Hello, everyone.

• As Ed discussed, the tough economic environment in the first quarter, along with foreign exchange, impacted our top line.

• We significantly reduced SG&A expenses, improved working capital management, and drove improvements in the cash requirements of our business model. Our cash flow from operations improved significantly year over year in the quarter.

• This morning, I will take you through our financial results for the quarter and the key drivers behind the expense reduction and the improved cash performance in the quarter.

• I will also update you on our revised outlook for cash funding to our U.S. pension plan in 2010.

• 1Q Order Trends

• To start our financial review, please turn to Slide 7 for an overview of order trends in the quarter.

• As Ed mentioned, we continue to see organizations pulling back on discretionary spending in this uncertain economy and deferring decisions on IT projects. We saw order declines in the U.S. and all international regions with the exception of Latin America, where orders grew. We closed the quarter with $5.7 billion in services backlog, which was down 6% from services backlog at December 31, 2008.

• Slide 8 summarizes our financial results in the first quarter.
• At the top line … we reported revenue of $1.1 billion, a decline of 15% year over year. Foreign currency exchange had a 10-point negative impact on revenue this quarter – this is the highest we’ve seen in many years. On a constant currency basis, revenue was down 5%. Based on today’s rates, we anticipate a 9 - 10 percentage-point negative impact on revenue in the second quarter of 2009.

• As you can see in our results, our gross margin was impacted in the quarter by lower revenue and the negative impact of foreign currency fluctuations. More than half of the impact on the gross margin percentage was due to foreign currency exchange.

• Operating expenses came down 24% year over year, driven by the cost-reduction actions we’ve taken as well as the favorable impact from currency. Currency was about 9 points of the 24 percentage point decline.

• The reduction in operating expenses helped mitigate some of the impact of lower revenue in the quarter. In fact, we were able to slightly improve operating profit margins in our services business on lower revenue.

• Operating profit declined primarily due to the loss of royalty income from Nihon Unisys Limited and weak sales of high-margin servers, particularly in Japan.

• Other Expense increased to $6.7 million in the quarter. The year-over-year increase was largely driven by foreign currency losses in 2009.

• At the tax line, we had a $15.6 million tax provision in the quarter, versus a tax provision of $23.9 million in the year-ago quarter. At the bottom line after taxes, we reported a $24.4 million net loss in the quarter, compared with $23.4 million net loss a year ago.

• Slide 9 shows our first-quarter revenue by geography.

• Our U.S. revenue was flat in the quarter and represented 49% of our revenue in the quarter. Within the U.S., growth in our U.S. federal government revenue was offset by revenue declines in commercial markets. We saw double-digit growth in our Federal Systems revenue in the first quarter.

• International revenue declined 27% and represented 51% of revenue in the quarter.

• On a constant currency basis, international revenue declined 10%. In constant currency, revenue grew in Latin America and declined in Europe and Pacific-Asia.

• Slide 10 provides more detail on our first-quarter revenue by business offering.

• Outsourcing, our largest business offering, declined 14% in the quarter, while systems integration continued to show stabilization, declining 1%.

• We continued to see significant declines in infrastructure services as we de-emphasize lower-margin aspects of this business.

• Enterprise server revenue declined 38% in the quarter. Lower sales in Japan, including the loss of royalty revenue income from NUL, accounted for a large portion of this decline.

• Core maintenance declined 21% while specialized technology revenue increased slightly.

• Moving on, Slide 11 highlights our margin trends in the quarter …

• As you can see, gross margins in both our services and technology businesses were impacted in the quarter by lower revenue and negative currency translation. The impact was greater in our technology business because of the higher fixed costs in this business.

• On the operating line, we were able to improve operating profit in our services business by 40 basis points by reducing expenses. However, our technology business reported an operating loss in the quarter on lower volume of enterprise server sales, primarily in Japan.

• Slide 12 shows the progress we made in the quarter in our ongoing program to reduce operating expenses. Operating expenses came down 24% to approximately $200 million in the first quarter. Operating expenses have also declined as a percentage of revenue. Given the continued weak revenue environment, we are proactively working on additional opportunities to reduce expenses.

• Now, please turn to Slide 13 for an overview of our cash flow performance in the first quarter.

• We generated $39 million of cash from operations in the quarter, an improvement of $88 million year-over-year compared to the $49 million of cash used for operations in the year-ago quarter.

• Our cash performance was driven by strong working capital management – in particular, a 12-day year-over-year improvement in days of sales outstanding.

• We used $27 million of cash in the quarter for restructuring payments, compared with $21 million a year ago.
• We continue to tightly manage capital expenditures as we work through the economic downturn. Cap ex for the first quarter was $47 million, down from $65 million in the first quarter of 2008.

• After capital expenditures, we used $8 million of free cash in the quarter compared with $114 million of free cash usage a year ago, an improvement of over $100 million.

• Depreciation and amortization was $84 million in the quarter, down from $100 million last year – reflecting a lower CapEx base and currency translation.

• We ended the quarter with $469 million of cash on hand, down from $544 million at December 31, 2008, due primarily to the $61 million of cash that was used to collateralize letters of credit previously issued under the company’s revolving credit facility. Since the cash is restricted, the $61 million is not reported in cash – it is in Other Assets.

• For the full year of 2009, we look for capital expenditures in the $200 - $225 million range compared with $295 million in 2008. We look for D&A in the $325 to $350 million range in 2009.

• Moving on to Slide 14, I’d like to update you on cash requirements for our worldwide pension plans.

• In the first quarter we made $14 million of cash contributions to our international pension plans. We made no cash contributions to our U.S. qualified pension plan in the first quarter, and we are not required to make any cash contributions to this plan for 2009.

• For the full year of 2009, we expect to make cash contributions of approximately $90 to $95 million to our international pension plans.

• Looking ahead to 2010, we have revised our expectation for funding requirements of our U.S. qualified pension plan.

• I had mentioned in our last call in February that, based on our underfunded position at year-end 2008, at that time we expected that we would have to contribute a maximum of $90 million to our U.S. qualified pension plan in 2010.

• Under recently clarified IRS regulations, we now do not expect to be required to make a cash contribution in 2010 to fund our U.S. qualified pension plan.

• Turning to Slide 15 … in summary, I am pleased by the work we’re doing and the progress we’re showing in reducing expenses across the organization and driving improved cash flow.

• This expense improvement is helping us weather a very difficult demand environment and offset some of the pressure we are seeing at the top line.

• We will be aggressive in looking for further opportunities to reduce our cost base, operate more cost-efficiently, and improve the cash flow performance of the business.

• Thank you for your time.