Jack McHale, IRO

- Thank you operator. Good morning everyone, and thank you for joining us.
- About an hour ago, Unisys released its second 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.
- 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, CEO

- Thanks, Jack. Hello, everyone. Thank you for joining us today to discuss our second-quarter 2009 financial results.
- As we begin our call, please turn to Slide 1 of the presentation.
- In our last two calls, I’ve outlined the turnaround program that we are driving at Unisys to enhance our profitability, strengthen our balance sheet, and improve our competitive position in the IT marketplace.
- We saw some encouraging signs in the second quarter that our efforts are working and beginning to show results.
- Driven by our actions to focus, simplify, and reduce expenses, we more than tripled our operating profit in the quarter from a year ago … and we delivered net income. We also reduced our free cash usage to almost breakeven levels.
- Also during the quarter we took steps to address our debt by conducting a private debt exchange.
- The exchange process isn’t complete yet – the offers will expire at midnight tonight. As of yesterday, about $230 million of the $300 million March 2010 notes had been tendered for exchange. Janet will comment more on this later.
- As we implement our turnaround program, our primary focus is on driving profitability and cash flow. So I’m pleased by our results in the quarter and the progress we’re making in turning around the financial profile of the company.
- At the same time, we recognize that this is only a first step. Our objective is to build a company that is consistently and predictably profitable and that generates free cash flow.
- While we were profitable in the quarter, we must continue the progress.
- Although we came close to generating free cash flow in the quarter, we have to turn that corner and begin to generate free cash flow on a consistent basis.
- So we have a lot of work to do. And we are doing this work in what continues to be a very difficult business environment.
- Our revenue was down 16% in the quarter, or about 8% on a constant currency basis. We saw continued soft demand in our commercial business as organizations remain cautious about investing in new IT projects as they work through the economic downturn.
• However, our U.S. federal government business continued to grow as we benefit from government spending on security and other key areas of focus for us.

• To drive profitable revenue, our teams are doing exciting work to introduce innovative services and solutions tied to our focused areas of strength. I’ll talk more about this in a moment.

• But it will take time for these new initiatives to gain traction, particularly given the broader economic environment. In the meantime, we will continue to simplify the organization, reduce our cost base, and work more efficiently.

• Janet will provide more details on our second-quarter results in her comments. Now, I’d like to take a few minutes to review our progress against the four key priorities of our turnaround program.

• Please turn to Slide 2. This should be a familiar slide because I used it last quarter and will continue to use it in the months ahead as we track our progress.

• The first two priorities are about driving profitable revenue by being tightly focused in where and how we invest our resources and by providing solutions that clients recognize as being differentiated and adding value.

• The second two priorities are about driving cost efficiency and margin improvement across our businesses by enhancing our labor model and reducing overhead expenses.

• All four priorities are aimed – as I said before – at the overriding objective of creating an organization that is consistently and predictably profitable and that generates free cash flow, while delivering great customer service and satisfaction.

• Moving to Slide 3 … reviewing our progress against the first two priorities, I believe we’ve taken some major strides forward over the past six months in terms of sharpening our business focus and our market differentiation.

• We have identified our core strengths as a company … we’ve matched up our strengths against the marketplace and growing areas of client need … and we have focused on four areas of the market where we are investing our resources to drive profitable revenue.

• These four areas are security, data center transformation and outsourcing, end-user outsourcing and support services, and application modernization and outsourcing.

• Across these four areas of strength, we are doing innovative work to bring to market differentiated solutions and services that solve critical problems being faced by our clients.

• I hope you’ve seen some of the announcements we’ve made recently around cloud computing and security, outsourcing, and our ClearPath mainframe technology.

• Our recent cloud computing launch, which builds on all four of our areas of strength, is a good example of the work we are doing to apply our resources in a more focused way to drive profitable revenue in a growing area of the market.

• The cloud computing market is a natural one for Unisys to play in. Organizations increasingly recognize the advantages of migrating their IT workloads to the cloud … but they face significant obstacles that are holding them back from widespread adoption.

• One of the biggest obstacles is security. Before shifting applications to a cloud environment, clients need to make sure their organizational data and applications will be truly secure.

• Unisys brings to this market our mainframe heritage … a deep understanding of the data center … decades of experience in managing and modernizing complex, mission-critical applications … and recognized capabilities in managing these applications in an outsourced environment. Very few providers in the market have this combination of capabilities.

• We also have something else that differentiates us from others in this market – our security capabilities, including our groundbreaking network security technology that we call Stealth.

• By bringing together these capabilities, we can provide the added levels of security and reliability that clients need to move safely and securely into an online cloud environment.
• We have received positive responses in the media and analyst communities to our new cloud solutions and our other recently announced offerings. We have additional solution offerings planned in the months ahead as we continue to enhance our portfolio.

• So as a company we are becoming more focused, which I believe will help us not only to be more profitable, but also to gain critical mass and traction in those areas of the market where we have chosen to place our bets.

• Turning to Slide 4 …

• Our second set of priorities is aimed at enhancing our profit margins by enhancing both our gross margins and our operating margins by improving our services labor model and reducing overhead expenses.

• Reviewing our progress on the gross margin side, our goal is to improve our services gross profit margins by four to five percentage points from where they’ve been running in recent years. We are working to do that by shifting our services mix toward more higher-margin work, such as application modernization and security … and by delivering services more cost-efficiently.

• To date we’ve initiated actions to lower our annualized cost of revenue by about $150 million by expanding our base of lower-cost offshore and onshore labor pools and making greater use of automated tools in service delivery.

• We saw the results in our services gross margins, which improved by nearly two percentage points year-over-year in the second quarter.

• But as a company we still have more work to do, particularly in expanding our use of offshore and onshore low-cost labor pools. We are behind our competition in this area, and I am making it a priority to improve our execution in this important area.

• In terms of overhead expenses, as I have stated before, our goal is to reduce our annualized SG&A expenses by about $250 million.

• We have moved effectively on this program, and to date we have put in place actions to reduce our annual SG&A expenses by about $200 million.

• Slide 5 shows our SG&A expense levels over the first half of the year. You can see the progress we’ve made in bringing down our SG&A, both on a dollar basis and as a percent of revenue.

• Our SG&A expenses came down 33% in the second quarter, of which about 7 points came from currency.

• This progress on expenses was key to the operating margin improvement we saw in the quarter, particularly in our services business.

• As we continue our work to simplify the business, we expect to uncover additional opportunities to streamline the business that will move us further toward our $250 million savings target.

• Moving to Slide 6 …

• Looking ahead, we will remain focused on the two primary objectives of profitability and improved cash flow.

• We will continue to be vigilant on costs and to look for ways to operate more cost effectively and reduce overhead.

• We will also continue to drive new, differentiated offerings across our four areas of strength … and make sure we are showcasing Unisys and our enhanced portfolio to the market.

• Yet it’s important to remember that economic conditions remain difficult and we are in the seasonally soft third quarter. But with a more focused business model, a streamlined cost base, and a continuing commitment to service quality and customer satisfaction, we have taken a solid first step and are better positioned to take advantage of economic trends as they improve.

• Again, thank you again for joining us this morning. Now, here’s Janet to take you through the quarter results in more detail.

Janet Haugen, CFO

• Thanks, Ed. Hello, everyone.
• We made good progress in the second quarter in making Unisys a leaner, more cost-efficient and profitable company. I was pleased with our cost and cash management as we work through what continues to be a difficult economic environment.

• This morning, I will take you through our financial results for the quarter.

• I will also review our cash flow in the quarter and provide an update on expectations for capital expenditures. In addition, I will provide a brief update on the debt exchange process.

• Starting with orders, please turn to Slide 7 for an overview of order trends in the quarter.

• Our services orders showed substantial declines from the year-ago quarter, primarily reflecting order declines for outsourcing and systems integration projects.

• However, our services orders increased sequentially from the first quarter of 2009.

• Geographically, we saw year-over-year order declines in the U.S. and Europe, partially offset by order gains in Latin America and Asia Pacific.

• We closed the second quarter with $5.9 billion in services backlog, which was up 4% from services backlog at March 31, 2009. The increase in services backlog was driven by foreign currency exchange. On a constant currency basis, services backlog was down about 3% from March 31 backlog.

• Slide 8 summarizes our financial results in the second quarter.

• At the top line … we reported revenue of $1.13 billion, a decline of 16% year over year. Foreign currency exchange had an 8-point negative impact on revenue this quarter. On a constant currency basis, revenue was down 8%.

• Based on today’s rates, we anticipate a 4 - 5 percentage-point negative impact on revenue in the third quarter of 2009 and a 2-3 percentage-point positive impact on revenue in the fourth quarter of 2009.

• Total gross profit dollars declined due to lower revenue volume, but our overall gross profit margin improved by 120 basis points from the year-ago period as we benefited from actions to enhance the cost-efficiency of services delivery.

• During the quarter, the company recorded a benefit of approximately $11 million related to a change in a Brazilian gross receipts tax law. Approximately $6 million of this benefit was recorded in cost of revenue and $5 million in other income.

• Operating expenses declined 31% year over year, driven by significant reductions in SG&A expenses as well as a 6 percentage-point benefit from currency translation.

• Our operating profit more than tripled in the quarter to $75 million, and we reported an operating profit margin of 6.7%, which was up 500 basis points from the year-ago period.

• At the Other Income/Expense line, which improved $9 million year over year, about half of the change is related to the Brazilian matter I discussed earlier and the other half due to changes in foreign exchange gains and losses.

• At the tax line, we had a $16.6 million tax provision in the quarter, versus a tax provision of $3.5 million in the year-ago quarter.

• At the bottom line after taxes, we reported $38.1 million in net income, compared with a net loss of $14.0 million a year ago.

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

• Our U.S. revenue declined 5% in the quarter and represented 48% of our revenue in the quarter. Within the U.S., we saw double-digit growth in our federal government revenue, which was more than offset by revenue declines in commercial markets.

• International revenue declined 24% and represented 52% of revenue in the quarter. On a constant currency basis, international revenue declined 10%.

• Internationally, revenue declined on a constant currency basis in all regions with the exception of Asia Pacific, where revenue grew 4%.

• Slide 10 provides more detail on our second-quarter revenue by business offering.
• We saw revenue declines in all of our service and technology offerings in the quarter.

• Our technology business in particular was impacted by deferrals by clients of expected IT purchases.

• Moving on to expenses and margins, please turn to Slide 11 …

• Despite lower revenue, we were able to significantly improve margins in our services business as a result of improved execution and cost reduction actions.

• Gross margins in services improved by 180 basis points to 21 percent. Service operating margins increased even more significantly – 460 basis points to 7.9 percent – driven by significant reductions in expenses. About a half-point of the improvement came from the Brazilian tax matter I mentioned earlier. I want to remind you that we are in the seasonally slow third quarter, which we expect will have an impact on our services margins.

• In our technology business, we were able to maintain and slightly improve our gross margins, despite lower revenue, by focusing on higher-margin areas of the business.

• However, technology operating margins declined 170 basis points year over year. We reduced operating expenses significantly in this business but were impacted by the sizeable revenue decline in the quarter.

• Now, please turn to Slide 12 for an overview of our cash flow performance in the quarter.

• We generated $48 million of cash from operations in the second quarter. This was down slightly from $52 million of cash generated from operations in the year-ago quarter.

• Year to date, operating cash flow has increased to $88 million compared to $2 million in the first six months of 2008.

• We used $20 million of cash in the quarter for restructuring payments, compared with $22 million a year ago.

• We continue to tightly manage capital expenditures as we work through the current economic environment. Cap ex for the second quarter declined to $53 million from $71 million in the second quarter of 2009. Cap ex for the first six months has declined to $101 million compared to $136 million over the year-ago period.

• Looking at free cash flow, which is cash from operations less capital expenditures, we used $5 million of free cash in the quarter compared with $19 million of free cash usage a year ago. Year to date, free cash usage has decreased to $13 million compared with $134 million over the first six months of 2008.

• Depreciation and amortization was $90 million in the quarter, down from $99 million last year – reflecting a lower capex base and currency translation.

• We ended the quarter with $475 million of cash on hand, compared to $469 million as of March 31. The current cash balance is down from $544 million at December 31, 2008, due primarily to $72 million of cash used to collateralize letters of credit. This restricted cash is reported in Other Assets, not in cash.

• 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 compared with D&A of $418 million in 2008.

• For the full year of 2009, we have increased our expectation for cash contributions to our defined benefit pension plans to $100 - $105 million. This increase is solely due to the impact of exchange rates.

• Finally, moving to Slide 13, I’d like to provide a bit more color on the private debt exchange offers that we are currently conducting to address our outstanding debt, including the March 2010 maturity of $300 million of our debt.

• We are offering to exchange the March 2010 unsecured notes for secured notes maturing at a later date and cash. We are also offering to exchange our other unsecured notes for secured notes and shares of common stock.

• The offers expire at midnight tonight. We expect to announce final results later this week.

• As of yesterday, approximately $230 million of the 2010 notes had been tendered in the exchange, which would leave about $70 million outstanding that come due next March. We intend to address any remaining 2010 notes from cash generated through improved operations, asset sales, additional refinancing, or a combination of these.
• About $290 million of our $400 million of 2012 notes have also been tendered in the exchange.

• The exchange offers have a condition that at least 40% of the 2010 notes and 40% of the 2012 notes be tendered, and we have met that condition.

• We are committed to strengthening our balance sheet, and this will remain a key focus of the company and the management team going forward.

• Turning to Slide 14 …

• In summary, this was a quarter of important progress for the company.

• I am pleased by the discipline we showed in the quarter in reducing expenses, increasing our profitability, and continuing to improve the cash flow performance of the business.

• As we look forward to the third quarter, we expect that services business will be softer in the quarter due to seasonal patterns combined with the economic environment.

• As we work through this period, we will continue to look 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.