Niels Christensen, VP, Investor Relations

- Thank you operator. Good morning everyone, and thank you for joining us.
- About an hour ago, Unisys released its first quarter 2010 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 the earnings press release and the presentation slides that we will be using this morning to guide our discussion on our investor website. 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. Certain comparisons made in this call will be between periods on a constant currency basis or excluding the impact of foreign exchange. In the presentation we have provided an explanation of the basis for constant currency calculations.
- Finally, I’d like to remind you that all forward-looking statements made during 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, Niels.
- Hello, everyone. Thank you for joining us today to discuss our first-quarter 2010 results.
- We continued to make good progress in the quarter in our ongoing turnaround program at Unisys.
- If you’ve been following our progress, you know that we are focused on four priorities in our turnaround program.
- Those priorities – which you can see on Slide 1 – are to drive profitable revenue by better focusing our resources and enhancing our portfolio … and to drive cost-efficiency and margin expansion by enhancing our service delivery model and simplifying the organization.
- In 2009 we succeeded in improving the profitability and cash flow of the business while addressing our debt situation in a very challenging economic environment. In 2010 our goal is to continue to deliver improved profitability and cash flow – and do so consistently and predictably.
- While we continue this work, we are also focused in 2010 on stabilizing our revenue, which has been impacted by the economic downturn last year and our own work to better focus our resources.
• Our first quarter performance had a number of positive indicators of progress against our goals for 2010. I’d like to highlight three in particular, which you can see on Slide 2.

• First, our year over year operating results improved in the quarter despite lower revenue as we continue to simplify, reduce expenses, and improve cost-efficiency across the business.

• While we reported a net loss in the quarter driven by foreign currency losses, our operating profit nearly quadrupled over the year-ago period to $59 million.

• In our services business, we more than doubled our operating profit margin to 4.6 percent. Our goal is to get our services business to a consistent 8 to 10 percent operating margin, so we still have a lot of work to do, but we are moving in the right direction.

• One of the key drivers of our service margin improvement is enhanced profitability of our IT outsourcing business.

• Outsourcing is our largest services business at about $1.7 billion in annual revenue. About 75 percent of this revenue comes from IT outsourcing with the remainder in business process outsourcing.

• We’ve been working to enhance margins by shifting our outsourcing business mix more toward IT outsourcing, and also by making greater use of automation and lower-cost labor.

• While it takes some time to make this transition, we are beginning to see results in terms of improved outsourcing services margins.

• Operating results also improved significantly in our technology business. Our technology operating margin improved to 13.7 percent in the quarter, reversing a year-ago operating loss, as we benefited from higher ClearPath sales and lower costs.

• This was the second consecutive quarter of year-over-year growth in ClearPath sales. Over the past year we’ve refreshed our ClearPath product line with contemporary features and functionality including support for iPhones and mobile devices.

• Today, we believe we have the most modern, open mainframe platform available on the market, and we have been working to communicate these benefits to our client base. So we are pleased to see the recent improved results in this business.

• Tight cost management will continue to be a key focus for us in the year ahead as we look to build on our operating improvement.

• Through the cost actions we’ve taken already, we have met our previously disclosed target for $500 million of annualized cost reductions across cost of service delivery and SG&A expenses.

• But particularly given the pressure on revenue, it’s critical that we continue to look for ways to operate more cost efficiently. We are focused on identifying and implementing additional cost reduction opportunities. As one example, we now have 23% of our employee population residing in lower cost labor pools, either offshore or onshore. This is up from 20% at the start of the year, but we realize we still have much more to do to match competition in this area.

• The second key area of progress in the quarter that I’d like to highlight is our balance sheet.

• Over the past year we have reduced our long-term debt by about $200 million.

• During the quarter we repaid the remaining $65 million of our original $300 million of senior notes that were due in March 2010. You’ll recall that a year ago this debt maturity was a major concern for the market, and we are happy that this issue is now behind us.

• In addition, as Janet will discuss in her remarks, we effectively eliminated another $100 million of debt during the quarter by reducing the utilization of our U.S. accounts receivable securitization facility.
• We have less need now to use this facility as a source of operating cash because of the improved profitability and cash flow of our operations.

• We also continue to explore potential, selected divestitures to sharpen our operating focus. We are working to close the sale of our health information management business, as previously announced, for about $135 million of cash.

• Strengthening the balance sheet will continue to be a key area of focus for us.

• The third key highlight in the quarter from my perspective was services orders.

• Our services orders grew double digits in the quarter – a positive indicator as we work to stabilize our revenue and build a foundation for profitable growth.

• We’ve done good work over the past year to refresh our portfolio of services and solutions in our focused growth markets. These markets, as you may recall, are security; data center transformation, including our server business; end user outsourcing; and applications modernization.

• With the global economy showing signs of improvement, we are seeing some encouraging signs of traction in these areas of strength for Unisys.

• In particular, this was the third consecutive quarter of significant year-over-year order growth in outsourcing, which we think speaks to the value clients see in the new solutions we’ve announced, as well as their increased comfort level with our improving financial picture.

• So to summarize, turning to Slide 3, this was a quarter of continued progress for Unisys in our turnaround program.

• We saw further improvement in profitability and in reducing expenses and debt.

• We want to keep that progress going and are focused on building a track record of delivering consistent, predictable profitability and cash flow.

• We are also focused on stabilizing the top line, and while we still have pruning left to do in the business, we feel with the work we’ve done – and continue to do – with the portfolio, the balance sheet, and the organization, Unisys is better positioned to take advantage of the growth opportunities that we are seeing in the market.

• Thank you again for joining us this morning. Now, here’s Janet to take you through our results in more detail, and then we will be happy to take your questions.

Janet Haugen, CFO

• Thanks, Ed. Hello, everyone.

• The company showed continued good cost discipline in the first quarter, and we made further progress in enhancing our operating profitability. However, our quarterly results were significantly impacted by foreign currency losses, and we reported a first quarter net loss.

• This morning I will provide more details on our first-quarter 2010 financial results, expenses, and margin trends.

• I will also provide detail around our cash flow performance and update you on our continued progress in reducing debt.

• Lastly, please note our results include the health information management business as a discontinued operation reflecting our decision to sell this business in a transaction that is expected to close this quarter.

• To start our financial review, please turn to Slide 4 for an overview of order trends in the quarter.
• After a very difficult business environment in 2009, we saw positive indicators of improved demand in the first quarter.

• Our service orders showed double-digit growth in the quarter, reflecting order gains across all areas of the services portfolio with the exception of infrastructure services.

• Information technology outsourcing orders showed double-digit gains. This was our third consecutive quarter of double-digit outsourcing order growth.

• We recognized mid-single digit order growth recognized within our systems integration and consulting projects.

• Orders for infrastructure services declined double digits as we continue to de-emphasize lower-margin areas and shift business toward longer-term outsourcing engagements.

• Geographically, services order growth was driven by our international businesses, where we saw substantial order gains in Europe and Latin America. Order gains in these regions were partially offset by order declines in Asia Pacific. Excluding the impact of our divested specialized technology check sorter equipment and related U.S. maintenance business, U.S. orders were up slightly.

• We closed the quarter with $5.9 billion in services backlog, which was up from March 31, 2009 services backlog of $5.3 billion. Approximately half of the increase was due to favorable currency translation. The $5.9 billion of services backlog at the end of the quarter was down from year-end 2009 backlog of $6.1 billion, due primarily to unfavorable currency translation.

• Slide 5 shows a comparison of our financial results in the first quarter.

• At the top line, we reported revenue of $998 million, which was down 7% year over year. Approximately 2 points of this decline was due to divested businesses. Currency had a 5 percentage-point positive impact on our revenue in the quarter. Based on today's rates, we anticipate a 2 - 3 percentage-point positive impact on revenue in the second quarter of 2010.

• We reported operating income of $59 million in the quarter compared to operating income of $15 million in the first quarter of 2009. Our operating profit margin improved to 5.9 percent from 1.4 percent a year ago

• The quarter’s results include approximately $9 million in charges related to the exit of the divested business and the costs of a country exit.

• We reported $37 million of expense in the Other Income/Expense line.

• This reflects approximately $35 million of pre-tax foreign exchange losses, which included $20 million related to the January 2010 Venezuela currency devaluation which I mentioned on our last earnings call in early February. The remaining $15 million of the first quarter 2010 foreign exchange losses compares to approximately $7 million of foreign exchange losses in the first quarter of 2009.

• At the tax line, we had a$11 million tax provision in the quarter compared with a $13 million tax provision in the year-ago quarter. As a reminder, our tax provision continues to be highly variable from quarter to quarter depending upon the geographic distribution of our income.

• At the bottom line, we reported a net loss of $11.6 million in the quarter, which compared with a net loss of $24.4 million in the first quarter of 2009.

• Slide 6 shows our first-quarter revenue by geography.

• Our U.S. revenue declined 16 percent and represented 43 percent of our revenue in the quarter. Within the U.S., we saw similar revenue declines in both our federal government and commercial businesses.

• International revenue grew 1 percent in the quarter as gains in Latin America and Asia Pacific were partially offset by declines in Europe. On a constant currency basis, international revenue declined 9 percent

• Slide 7 shows more detail on our first-quarter revenue on a portfolio basis.
• Outsourcing revenue, our largest business, declined 2 percent in the quarter. Within outsourcing, growth in our strategic focus area of IT outsourcing was offset by double-digit declines in business process outsourcing.

• Systems integration and consulting revenue declined 13 percent in the quarter. As I mentioned earlier, however, we saw single-digit order growth for these services in the quarter.

• Enterprise server revenue grew 29 percent in the quarter, driven by ClearPath sales, which were up more than 30 percent over the year ago period.

• Infrastructure services and core maintenance declined by double-digits in the quarter.

• Turning now to expenses and margins, Slide 8 shows a comparison of our segment margins in the first quarter compared to the prior-year period.

• Despite lower first-quarter services revenue, we significantly improved services gross and operating profit margins for the quarter based on actions we’ve taken to enhance the cost-efficiency of services delivery and reducing SG&A expenses. First quarter 2010 SG&A expenses were 9% lower than the year ago quarter. On a constant currency basis, our SG&A expenses were actually 18% lower year-over-year.

• Services gross margins improved 240 basis points year over year to 18.2 percent. Services operating margins more than doubled year over year, improving 260 basis points to 4.6 percent.

• Margins in our technology business can vary substantially from quarter to quarter depending on specific deal closure.

• As you can see, driven primarily by the strong ClearPath sales as well as progress in reducing costs, technology margins increased substantially in the quarter. We reported a technology gross margin of 52.2 percent, up from 33.3 percent a year ago, and our technology operating margin improved to 13.7 percent compared with a negative operating margin of 11.6 percent in the first quarter of 2009.

• Please turn to Slide 9 for an overview of our cash flow performance in the quarter.

• Note that our cash flow comparisons in the quarter versus the year-ago quarter were impacted by reduced utilization of our U.S. $150 million accounts receivable securitization facility.

• Because of our improved cash flow and cash position, we had less immediate need for cash from selling accounts receivable under this U.S. accounts receivable securitization facility.

• As a result, we sold no accounts receivable under this facility in the first quarter of 2010. We had sold $100 million of receivables as of December 31, 2009.

• Including the reduction in our utilization of the accounts receivable securitization facility we used $28 million of cash from operations in the current quarter compared with $39 million of cash generated from operations in the year-ago quarter.

• Capital expenditures increased year-over-year in the quarter driven primarily by increased investments in deal specific outsourcing assets and to a lesser extent, capital expenditures related to new facilities as part of our multi-year plan to reduce our leased square footage space. Cap ex increased to $69 million compared with $47 million in the first quarter of 2009.

• After capital expenditures, we used $97 million of free cash in the first quarter compared with $8 million usage of free cash in the year-ago period.

• Looking ahead, we anticipate capital expenditures of $200 to $225 million for the full year of 2010.

• Depreciation and amortization was $67 million in the quarter. For the full year 2010, we now expect D&A of around $280 million.

• As Ed mentioned, during the quarter we repaid the remaining $65 million of principal due on our March 2010 senior notes.
• We ended the quarter with $469 million of cash on hand.

• Our current cash balance is down from $648 million of cash on hand as of year-end 2009. The $179 million decrease in cash on hand from December 31 reflected the reduction of $100 million in receivables sold under our accounts receivable securitization facility and the $65 million of debt repayment in the quarter.

• Finally, just a quick update on our previously announced agreement to sell our health information management business to Molina Healthcare. We continue to expect this transaction to close in the second quarter of 2010, for cash proceeds of approximately $135 million, subject to working capital adjustments at time of close.

• As Ed mentioned, we continue to explore potential selected divestitures to focus the business on our areas of strength. We expect to use proceeds from divestitures to help strengthen our capital structure.

• In closing, we continued to make good progress during the quarter in reducing expenses and enhancing our profitability.

• We will continue to maintain tight cost discipline and emphasis on driving cash as we move through the year.

• Thank you for your time.