Niels Christensen, VP, Investor Relations

- Thank you operator. Good afternoon everyone, and thank you for joining us.
- Earlier today, Unisys released its first quarter 2011 financial results. With us this afternoon to discuss our results are Ed Coleman, our CEO, and Janet Haugen, our CFO.
- Before we begin, I want to cover 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 afternoon 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. These have been provided in an effort to give investors additional information. The non-GAAP measures have been reconciled to the related GAAP measures and we have provided reconciliation charts at the end of the presentation.
- 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 I’d like to turn the call over to Ed.

Ed Coleman, CEO

- Thanks, Niels. Hello, everyone. We appreciate you joining us today. Please turn to Slide 1 to begin our discussion.
- The first quarter was a challenging one for Unisys as our results were impacted by weakness in our U.S. Federal government business.
- This was our first quarter without the TSA contract, which represented about $30 million in revenue in the year-ago quarter, so we knew we had a tough hurdle coming into the quarter.
- In addition, we saw less than expected Federal agency spending as a result of the government budget impasse that continued throughout the quarter. Until the 2011 Federal budget was finally passed a couple weeks ago, six months into its fiscal year, the government was operating on a series of continuing resolutions that limited funding on new contracts. This also affected funding availability for many of our existing cost-plus and time and materials contracts, which represent about half of our Federal revenue.
- These two factors contributed to a $50 million decline in our Federal revenue, which, along with the charge related to our debt reduction activities, put pressure on our overall results and contributed to a net loss in the quarter.
- The focus on spending cuts and deficit reduction in Washington is creating a more challenging environment in the Federal market, which represents about 20 percent of our revenue.
- Nonetheless, Unisys – with our long history in the government space – brings a great deal of innovation and experience to this market, and we are focused on opportunities to help agencies cut costs and operate more effectively and securely through our outsourcing, applications modernization, security and cloud computing solutions.
- While our Federal results and the loss in the quarter were disappointing, we remain confident in our strategy and focused on achieving the three-year goals we have set.
- In fact, as we look at our performance outside the U.S. Federal business, we saw progress in the quarter against these goals.
- As a reminder, these goals, which you can see in Slide 2, are to increase our annual pre-tax profit to $350 million in 2013, excluding any change in pension income or expense from 2010 levels; to reduce our debt by 75 percent from the September 2010 level by the end of 2013; and to consistently achieve an 8 to 10 percent services operating margin.
To achieve these goals, we are focused both on growing our IT outsourcing and system integration services revenue at market rates, adjusted for the fact that we no longer have the TSA revenue in 2011, while maintaining flat technology revenue over the three-year period.

As we look at progress against our goals, turning to Slide 3 ... first, during the last 60 days we took actions that accelerated our progress toward achieving our 75 percent debt reduction goal.

As you saw in our recent announcements, in the first quarter we completed a mandatory convertible preferred stock offering and used the proceeds to redeem approximately $211 million of our high-coupon senior secured notes. We took a charge of approximately $32 million in the quarter related to these actions.

On April 11, we used cash to retire an additional $179 million of our senior secured notes.

Since September 2010, we have reduced our debt by about half.

These actions will enable us to reduce our annual interest expense by $53 million, an important contributor to achieving our 2013 pre-tax profit goal.

Second, we continued to show good cost discipline. Operating expenses were down again in the quarter, and outside of the Federal business, we improved our services operating margins year over year.

Third, we saw progress during the quarter against our top-line goals.

While our total services revenue was down 6 percent in the quarter, outside the Federal business, services revenue was flat year-over-year compared to the last few years of declines.

In our IT outsourcing business, we grew our non-Federal revenue by 9 percent in the quarter. This represents the fifth consecutive quarter of year-over-year growth in non-Federal ITO revenue.

We are having particular success in the area of end-user outsourcing, where Unisys is increasingly recognized as an industry leader. For instance, Gartner recently placed Unisys again in the Leader Quadrant for North American help desk outsourcing providers. We continue to add new IT outsourcing accounts and we have a strong and growing pipeline of opportunities.

In our project-based systems integration business, we saw some improvement in the first quarter following double-digit revenue declines in 2010. While we have work to do to get this business to market growth, we see opportunities in this market around disruptive technology trends, particularly in helping clients build out secure private and hybrid clouds and modernize their mission-critical applications to deal with increased mobility and the use of social networking.

In our technology business, while overall revenue was down in the quarter, we grew sales of ClearPath systems 7 percent in the first quarter, which followed 5 percent growth in ClearPath revenue for the full year of 2010.

As you know, our ClearPath sales vary from quarter to quarter depending on timing of transactions, so we believe it’s best to judge this business on a full-year basis. But we clearly got 2011 off to a good start in the first quarter.

So in summary, turning to Slide 4, while this was a challenging quarter for us and we are not yet firing on all cylinders as a company, there was progress in the quarter that moves us further down the road toward our long-term objectives.

We recognize that our biggest challenge right now is to drive profitable revenue growth in our areas of strength that enables us to leverage the foundational work we’ve done to strengthen our cost structure, balance sheet, and portfolio.

There’s no lack of opportunity in the market. Organizations are looking for help to reduce costs and to address and harness disruptive new technologies like mobile computing, social computing, cloud computing, smart computing, IT appliances and cybersecurity.

To capture these growth opportunities, we are focused on improving our sales execution. We have strengthened our sales leadership, are investing in building our sales force to take our solutions to the market, and have changed the way we approach client planning to increase cross-selling efforts across our business units.

Across the business, I continue to be excited by the client engagements we are winning.

- In the U.S., we are working with the General Services Administration to move agency employees to a cloud-based Google email and collaborative computing environment ... helping the USDA provide real-time monitoring and response to security incidents across its 29 agencies ... and building a new child welfare system for a Midwest state.
In Latin America, we are rolling out a national citizen identification program using advanced biometric technologies for 100 million Mexican citizens … and using our ClearPath ePortal technology to allow customers of a major utility to pay their water bills using their smartphones.

In Continental Europe, we are helping a national Social Security agency modernize its IT accounting applications to more cost-effectively serve citizens … and working with a major manufacturer to standardize and enhance end-user services to 48,000 employees globally.

In Asia Pacific, we are helping China’s growing aviation industry build advanced passenger processing systems for new airports … and helping Hertz New Zealand protect customer credit card data against fraud through the use of our Stealth data protection technology.

There are many more examples, but the point I’d like to leave you with is that because of the work we’ve done in refocusing the business, reshaping the portfolio, strengthening the balance sheet and reducing our costs, we believe that Unisys is positioned to benefit from important trends that are reshaping the IT market and creating opportunities for growth.

I am confident we have the right strategy. We are focused on executing that plan and achieving our stated financial goals.

Thanks again for joining us today. 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

Our first quarter performance reflected the challenges we faced in our US Federal government business as Ed discussed.

We were encouraged by the continued improvements in ITO revenue outside of our US Federal business, which rose by about 9 percent compared to first quarter 2010. Our Technology revenue was down for the quarter but our ClearPath revenue grew 7 percent year-over-year.

We continued to exercise discipline in our control of operating expenses and optimizing cash across the company.

And we continued our efforts to strengthen our balance sheet and capital structure through the issuance of mandatory convertible preferred stock, the related $211 million debt reduction in March and the additional April debt reduction of $179 million through the tender offer. Together, these transactions significantly reduce our debt and interest expense, increase our equity and are accretive to our earnings per share after the impact of the charges associated with the debt reductions.

The $31.8 million charge in the first quarter related to the March debt redemption, together with our operational challenges in the US Federal business and a $17 million year-over-year increase in tax expense resulted in a net loss for the quarter.

I will now provide more details on our first quarter results.

To start our financial review, please turn to Slide 5 for an overview of order trends in the quarter.

We ended the first quarter with $5.8 billion in services backlog, which was slightly up sequentially from December 31, 2010 but down by about a point on a constant currency basis. Year over year, services backlog was up 2 percent versus March 31, 2010, but down 4 percent at constant currency rates.

Geographically, North America services backlog outside of US Federal grew sequentially and year over year. We also saw services backlog growth in the UK and Continental Europe. Services backlog fell slightly in our Latin American and Asia Pacific regions.

First quarter services orders declined by double digits versus the first quarter of 2010. This decline was primarily attributable to lower year-over-year orders in Outsourcing, Infrastructure Services and Core Maintenance, much of which was attributable to lower orders in our US Federal business. These declines more than offset the orders growth in Systems Integration.

The orders growth in Systems Integration resulted from a large public sector renewal as well as a number of new business wins across a number of regions, particularly in the public sector.

In terms of geographic trends, we saw year-over-year services order growth in our North American region during the first quarter outside of our US Federal business. Orders in our U.S. Federal business were adversely
impacted by the ongoing budget challenges and were down significantly. Orders in our other regions were also
down versus the first quarter of 2010.

- Slide 6 highlights our financial results in the first quarter.
- At the top line, we reported total revenue of $911 million in the quarter, which was down 7 percent year-over-year.
  Five percentage points of this decline were related to the $50 million decline in Federal government revenue.
- Currency had a 2 percentage-point favorable impact on our revenue in the quarter. Based on today’s rates, we
  anticipate currency to have about a 4 to 5 percentage-point positive impact on revenue in the second quarter of
  2011.
- We reported an operating profit of $41.9 million in the quarter which was lower than the year-ago quarter’s
  operating profit of $58.5 million. Declines in our gross profit margin more than offset continued reductions in
  operating expenses and resulted in an operating profit margin of 4.6 percent, down from 6.0 percent a year ago.
- Other expense for the first quarter of 2011 was $23.8 million which included a $31.8 million charge related to the
  March debt reduction.
- In the first quarter of 2010, other expense of $36.9 million included $35.4 million in foreign exchange losses, $20
  million of which was related to the Venezuelan devaluation.
- In terms of US GAAP pension expense … as we outlined in our last call, we expect approximately $33 million in
  pension expense in 2011, compared with pension income of about $3 million in 2010. For the first quarter of 2011
  our pension expense increased $9 million versus the first quarter of 2010.
- Beginning with 1Q11, defined benefit pension income or expense is not included in segment performance. We
  believe this will make it easier to understand the operational performance of the segments. In the past, we
  provided non-GAAP information which showed the segment performance without pension income or expense.
  Prior periods have been reclassified to be consistent with 2011.
- Our pre-tax loss from continuing operations was $7.8 million compared to a loss of $4.9 million in the first quarter
  of 2010.
- At the tax line, we had a $28.2 million tax provision in the quarter compared with an $11.2 million tax provision in
  the year-ago quarter. As I have said previously, our tax provision continues to be highly variable from quarter to
  quarter depending on the geographic distribution of our income.
- We reported a net loss of $39.4 million in the quarter, versus a net loss of $11.6 million in the year ago quarter.
- Our diluted earnings per common share declined to a loss of 95 cents per share from a loss of 27 cents per share
  in the year ago quarter.
- Moving to our first-quarter revenue and margins by portfolio.

- On Slide 7, you can see, services revenue declined 6 percent year-over-year. Our US Federal revenue decline
  drove nearly all of this decline. Currency had a 2 percentage point favorable impact on revenue in the quarter.
- Services gross profit margin, as a percentage of revenue, decreased 40 basis points year-over-year to 18.0
  percent from 18.4 percent in the first quarter of 2010. Declines in our US federal business gross margins more
  than offset improvements in the rest of the business.
- Our services operating margin declined by 70 basis points year-over-year to 4.0 percent as declines in our US
  federal business gross margins more than offset improvements in the rest of the business.
- Systems integration and consulting revenue declined 3 percent year-over-year. While the rate of decline slowed
  from prior periods, we still have more work to do to reach our goal of growing this business at market rates.
- Within Outsourcing, ITO revenue was down 5 percent versus the first quarter of 2010. ITO revenue from the US
  Federal government is down for the quarter due principally to the loss of revenue from the TSA contract which
  represented 10 percent of ITO revenue in the first quarter of 2010. We were pleased that outside of our business
  with the U.S. Federal government, ITO revenue rose by 9 percent year-over-year which we believe exceeds the
  current market rate of growth.
- Infrastructure services revenue declined 12 percent compared to the first quarter of 2011.
- Core maintenance revenue declined 12 percent year-over-year and approximately half of the decline resulted
  from the sale of our check reader and sorter business in the first quarter of 2010.
- Business Process Outsourcing (BPO) revenue declined 2 percent versus the first quarter of 2010 principally
  reflecting continued declines in check processing volumes in our UK joint venture.
Approximately $750 million of the March 31, 2011 services backlog is anticipated to convert into second quarter 2011 services revenue. Over the past 9 quarters, we typically have between 87 to 93 percent of our quarterly services revenue in our opening backlog. The balance of our services revenue comes from sell-and-bill business during the quarter.

Moving on to Technology on Slide 8, Technology revenue decreased 13 percent. While ClearPath revenue grew 7 percent year-over-year, sales of our other servers and Other Technology which includes third party equipment were lower.

We reported a technology gross margin of 51.1 percent, down slightly from the prior year. Our technology operating margin declined by 240 basis points to 10.9 percent compared with 13.3 percent in the first quarter of 2010.

Slide 9 provides more detail on the performance of our federal government business over the past five quarters.


Civilian agencies represent our single largest revenue base within the U.S. federal government, accounting for about 49 percent of our overall U.S. federal government revenue.

Revenue from agencies within the U.S. Department of Defense and various Intelligence agencies represent about 29 percent of overall Federal government revenue.

With the end of the TSA contract effective November 30, 2010, revenue from Homeland Security agencies has declined significantly as a percentage of our total Federal revenue and in the first quarter of 2011 represented about 22 percent of our overall U.S. federal government revenue.

As you can see in the slide, our overall U.S. federal revenue declined $50 million or approximately 24 percent in the first quarter of 2011 to $157 million with a little more than half of that decline due to the end of the TSA contract. We were also impacted by the US federal government budgetary situation.

We ended the first quarter of 2011 with about $332 million of U.S. federal services backlog, which was down 22 percent compared to the first quarter of 2010.

Slide 10 shows our first-quarter revenue by geography and industry.

Our North America revenue represented 41 percent of our revenue in the quarter and declined 16 percent in the quarter. Within North America, our revenue from the U.S. federal government represented 17 percent of total Unisys revenue in the first quarter, and, as we noted earlier, declined 24 percent year-over-year due to the absence of our TSA contract revenues as well as the impact of the US Federal budget challenges. Excluding the US Federal Government business, our North America revenue declined by 9 percent.

International revenue rose 1 percent in the quarter due to higher revenue in our Asia Pacific and Latin American regions. On a constant currency basis, international revenue was down 3 percent.

From an industry perspective, Public Sector remained our largest single industry revenue source. The 11 percent decline in Public Sector revenue year-over-year was driven primarily by the decline in our US Federal government revenue. All other Public Sector business was essentially flat compared to the first quarter of 2010.

Revenue from Commercial industry customers represented 33 percent of our first quarter revenue while the Financial Sector was 23 percent.

Turning to Slide 11 You can see our revenue mix as we reshape our business. As we leverage our capabilities in systems integration, IT outsourcing and technology and continue to invest in those areas, our goal is to drive growth at market rates in our ITO and systems integration businesses adjusting for the ending of the TSA contract, while holding Technology revenue stable.

Please turn to Slide 12 for an overview of our cash flow performance in the quarter.

We generated $28 million of cash from operations in the first quarter of 2011 compared to cash usage of $28 million in the year-ago quarter. As we have mentioned before, the first quarter of 2010 included the impact of a $100 million reduction in receivables sold through the company’s US accounts receivable securitization facility.

As part of our ongoing focus to reduce the cash requirements of our business model, capital expenditures were $43 million in the first quarter of 2011, down $26 million from $69 million in the first quarter of 2010.

Our free cash flow usage was $15 million in the first quarter of 2011 versus usage of $97 million for the same period last year, which included the impact of the $100 million reduction in receivables sold through the company’s US accounts receivable securitization facility.
Depreciation and amortization was $53 million in the quarter down from $67 million in the first quarter of 2010.

We contributed $22 million in cash to our international pension plans in the first quarter of 2011. For the full year, we continue to anticipate contributing approximately $115 million of cash to these pension plans.

Our cash balance of $833 million at March 31, 2011 was slightly above the $828 million level we reported at December 31, 2010 and was $365 million above the level reported at March 31, 2010.

Turn to Slide 13 for an update on our balance sheet and capital structure. We remain very focused on our three year goal of reducing debt by approximately 75 percent or approximately $625 million from the September 30, 2010 levels.

We are pleased with the completion of a significant step toward that goal with the $211 million reduction in our high coupon long-term debt – notes that paid 14.25 percent and 12.75 percent - during the first quarter using the proceeds from a mandatory convertible preferred stock offering we completed in February.

Following up on that transaction, we used $220 million of cash on hand earlier in April to tender for more of this high coupon debt.

Together, these actions reduced debt by approximately $390 million and will lower interest expense by approximately $53 million annually. The initial benefit in lower interest will start to be evident in the second quarter.

From a cash perspective, this benefit is partially offset by the payment of $16 million in dividends annually on the mandatory convertible preferred stock during the three years until it converts into common stock.

Slide 14 illustrates the improvements we have made over the past 10 quarters in reducing the company’s leverage. We ended the first quarter of 2011 with net cash of $214 million versus a net debt position of $379 million at the end of the same quarter last year. We have also provided a proforma view of our debt and cash positions reflecting the impact of our tender offer which closed on April 11. In summary, the tender offer reduced debt by approximately $179 million using $220 million in cash on hand. As a reminder, we will record a one-time charge of approximately $46 million in the second quarter in other income expense related to the premium and expenses paid in association with the tender.

In closing, this was a challenging quarter for Unisys particularly in the US Federal government space. However, we made continued progress during the quarter in driving growth in our non-US Federal ITO business and higher ClearPath revenue, reducing operating expenses, and strengthening our balance sheet.

As we move through 2011, we will remain focused on extending our successes and addressing our challenges as we continue to drive towards our longer-term financial goals.

Thank you for your time.