Niels Christensen, IRO

Thank you, operator. Good afternoon everyone, and thank you for joining us.

Earlier today, Unisys released its first quarter 2013 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. Good afternoon, everyone, and thank you for joining us today to discuss our first-quarter 2013 financial results. Please turn to Slide 4 of the presentation to begin our discussion.

This was a challenging quarter for Unisys as lower revenue in both our services and technology businesses impacted our profitability and resulted in a net loss in the quarter.

We saw lower technology revenue in the quarter following the strong performance in the fourth quarter of 2012 when we benefited from some earlier-than-expected ClearPath sales. As we’ve said, given the variability of our technology sales from quarter to quarter, we measure this business on an annual basis. We continue to target flat technology revenue overall in 2013 from 2012 levels.

In services, while we were pleased to see growth in IT outsourcing revenue in the quarter, we saw revenue declines for project-based systems integration services, where the market for discretionary projects remains soft and where we need to improve our execution.

The lower revenue pressured our services margins in the quarter, which declined from year-ago levels and resulted in an operating margin that was below our targeted 8 to 10 percent range.

These were disappointing results, especially given the progress we’ve made in recent years in enhancing our profitability, and they underscore the need to improve our execution around driving profitable revenue growth while also maintaining a competitive cost structure.

As a reminder, our stated revenue goals are to grow at market rates in our systems integration and IT outsourcing businesses while maintaining flat revenue in technology.

As I outlined in our last call, to drive revenue in these businesses we are making investments to enhance our current solution offerings to take advantage of disruptive industry trends such as cloud computing, mobility, cybersecurity, big data and smart computing, social computing, and IT appliances.

Further, we are investing in ClearPath enhancements and follow-on products; in our Stealth Solution Suite of cybersecurity products; in application outsourcing to complement our end user and data center outsourcing services; and in continuing to build out our reseller channel, which is initially focused on value-added resellers to sell our Stealth Solution Suite.

As we look at how we’re performing against our revenue goals, we’ve maintained or grown our ClearPath software and server sales for each of the past three years. The innovations we’ve made in evolving our server offerings have resulted in what we believe is the most secure, open, high-end Intel Xeon-based server platform on the market today.

Supporting this comment, I point you to Slide 5, which provides a report from the National Institute of Standards and Technology of known security vulnerabilities reported on a wide variety of computer platforms. As you can see, standing out from the others, with an unmatched security record, are the two Unisys ClearPath operating environments.
And, as noted earlier we continue to invest in innovations that can expand market opportunities for our high-end server products.

In our services business, our revenue progress has been mixed.

We were pleased to see our IT outsourcing business grow in the first quarter. We are encouraged by a strong pipeline of opportunities for IT outsourcing engagements, particularly in the area of end user outsourcing and support services, where we continue to enhance our reputation as a leading services provider.

Recently Forrester placed Unisys as a Strong Performer in Global Workplace Services – our first placement in this influential report. Unisys received the highest scores for client references among all evaluated vendors, which is gratifying given our focus on customer service and satisfaction. This follows recognition by Gartner in that firm’s Magic Quadrants for help desk outsourcing and data center outsourcing services in North America and Europe.

Within our services business, the biggest issue we’re facing from a revenue perspective is in our systems integration business.

Turning to Slide 6, there are several different factors that we believe are contributing to the weakness we’re seeing in our systems integration business.

First, certainly there are some economic headwinds that we’re facing in the market for discretionary projects. Our largest vertical industry is the public sector, where we’ve been impacted by budget pressures on shorter-term government projects. We’ve seen deferrals by our clients of planned discretionary projects as well as a trend toward smaller deal sizes and projects of more limited scope.

Second, unlike many of our systems integrator competitors that focus on systems integration and consulting around COTS - or commercial off-the-shelf - software such as ERP applications, our core strength within our systems integration business has traditionally been in addressing a more narrow set of industry vertical application, modernization and implementation projects.

Moving to Slide 7, to drive improved results in our industry-based systems integration business, we are taking steps to deepen our specialization within our sales and delivery teams. This involves dedicating skilled specialists to sell and deliver specific solutions for our focused industries, which are frequently based on Unisys application software, such as public safety and security solutions, core banking and retail delivery solutions, voice messaging solutions and other software for communications providers, and airline passenger and air cargo solutions.

An example of where we’ve been successful with this specialized vertical industry approach is with our next-generation AirCore airline passenger solution. AirCore is built on open technology and allows airlines to modernize their passenger sales and services applications.

TravelSky, the leading provider of IT solutions to China’s growing aviation industry, recently awarded Unisys a contract for the first phase of implementing AirCore to replace its existing inventory and flight information applications as part of a multi-year modernization project to replace its legacy passenger sales and services systems.

The continued expansion of our AirCargo and cloud-based Portal Services is further evidence of our transportation industry success.

In addition to building specialized industry skills and resources needed to win industry-specific project opportunities, we believe that our investments in building our application managed services capability will make us more effective in competing for systems integration projects and provide more project opportunities.

Until recently, lacking a broader and more comprehensive set of application outsourcing offerings, we’ve limited ourselves in competing for project-based system integration work, as frequently these projects are part of, or closely adjacent to, the broader application outsourcing scope and service provider relationship.

In part to address this gap, we are investing in a dedicated set of offerings and a team focused on pursuing growth opportunities for application managed services, both for existing clients and new clients. We believe that having this application-based managed services capability will allow us to more effectively pursue not just longer-term application outsourcing opportunities, but also associated application modernization and implementation project work.

It will take us some time to execute the changes I’ve just discussed in our systems integration business, especially given current softness in this market. As a result, we expect our systems integration revenue to remain soft as we implement these actions.

This quarter’s results also highlight the importance of maintaining an effective and efficient cost structure. We have more work to do in this area, both in terms of improving the efficiency of our services delivery and reducing overhead.

In summary, this was a difficult quarter for us. While we are disappointed with this quarter’s results, we are confident in our strategy and optimistic about the growth opportunities we see in the market.

Together with the actions I have described today to improve our system integration business – greater industry and solution sales specialization; development of an application outsourcing capability to complement our project capabilities; and a more effective cost structure – we believe Unisys has the capabilities and offerings, as well as the improved financial structure, needed to address the market opportunities before us.

I look forward to updating you on our progress in our next call. Now, here’s Janet to take you through our results in more detail, and then we will be happy to take your questions.
Thanks, Ed. Hello, everyone. Let me start with our overall first quarter 2013 financial results. Please turn to Slide 9.

At the top line, we reported revenue of $810 million in the quarter, which was down 13 percent year-over-year.

It was a softer technology quarter compared to the year ago period. And as we have mentioned, our technology business benefited in the fourth quarter 2012 from some earlier-than-expected ClearPath revenue.

While we saw 5 percent growth in our IT outsourcing business during the first quarter of 2013, revenue in our other service portfolios declined and aggregate services revenue fell by 12 percent. Most significantly, our Systems Integration business declined by 31 percent due to lower demand for project-based services and solutions particularly public sector in-quarter sell-and-bill.

On our last earnings call, we provided the amount of opening services backlog for this quarter. We also provided the range that the opening backlog has represented of a given quarter’s services revenue over the previous eight quarters. The first quarter services revenue of $723 million was at the low end of the range implied by the amount of revenue in opening backlog at the start of this quarter and our typical volume of sell-and-bill revenue in the quarter.

Currency had a 1 percentage point negative impact on our revenue in the quarter and, based on today’s rates, we anticipate currency to have a minimal impact on revenue in the second quarter of 2013 compared to the second quarter of 2012.

As a result of the lower year-over-year volume in our services and technology segments as well as the mix of our technology revenue, our gross profit margin declined from 24.3 percent in the first quarter of 2012 to 19.9 percent in the first quarter of 2013.

Operating expenses fell by approximately 1 percent year over-year in the first quarter of 2013. We were able to reduce operating expenses in the quarter sufficient to more than offset the incremental investments we continued to make in our ClearPath enhancements and follow-on products, our Stealth Solution Suite, Application Managed Services offerings and reseller channel initiatives.

Further, as we noted last year, first quarter 2012 SG&A included the $11.3 million pre-tax gain related to the sale of our interest in a South African joint venture which was reported as a reduction of SG&A expenses in that period. Excluding the benefit of that gain from our prior year SG&A, year-over-year operating expenses decreased by more than 8 percent.

Interest expense decreased by more than two thirds from $9.3 million in the first quarter of 2012 to $2.7 million in the first quarter of 2013 reflecting the impact of our debt reductions and refinancing.

Other income/expense for the first quarter of 2013 was $4.9 million of other expense, which was primarily attributable to a $6.5 million foreign exchange loss related to the devaluation of the Venezuelan currency.

This compares to $13.2 million of other expense in the year ago quarter which included foreign exchange losses of $7.0 million and $7.2 million in debt reduction charges.

First quarter 2013 pension expense was $23.2 million compared to $25.7 million in the first quarter of 2012. Within the income statement, pension expense is allocated to cost of revenue, SG&A, and R&D on the same basis as the salaries of active employees. Pension expense is not included in the segment results. We expect approximately $92 million in pension expense in 2013, compared with pension expense of about $108 million in 2012.

At the tax line, we had a $21.4 million tax provision in the quarter on a pre-tax loss of $6.0 million compared with a $22.0 million tax provision in the year-ago quarter on pre-tax profit of $41.9 million. As I have said previously, our effective tax rate varies significantly quarter to quarter based on the geographic distribution of our income and we saw that in this quarter.

We reported a net loss of $33.9 million in the quarter, versus net income of $13.4 million in the year ago quarter. Excluding the impact of pension expense in both years and debt reduction charges in the first quarter of 2012, we reported a non-GAAP net loss of $11.6 million for the first quarter 2013 compared to a non-GAAP net income of $49.2 million in the prior year period.

Our first quarter 2013 diluted earnings per common share was a loss of 77 cents per share compared to income of 30 cents in the year-ago quarter.

Excluding the impact of the debt reduction charges and pension expense, our first quarter 2013 non-GAAP diluted EPS was a loss of 26 cents per share compared to income of 97 cents in the first quarter of 2012.

Moving to discuss our first-quarter revenue in more detail, please turn to Slide 10. As noted earlier, services revenue, which represented 89 percent of our revenue in the first quarter of 2013, declined 12 percent year-over-year and currency did not have a material impact on services revenue comparisons in the quarter.

Technology revenue, which accounted for 11 percent of our total revenue, declined 18 percent year-over-year, 12 percent on a constant currency basis.

On Slide 11, you can see services revenue and margins.

We saw lower sell-and-bill revenue in the first quarter, particularly in Systems Integration project revenue as compared to last year. As Ed noted, our goal remains to grow at market rates in Systems Integration but we have work to do to achieve consistent growth.

As I said earlier, year-over-year IT outsourcing revenue grew 5 percent in the first quarter of 2013.
The path to our long term goal of 8 to 10 percent services operating margins requires revenue growth from our focus services areas, some improvement in our U.S. Federal business, as well as continued improvements in the delivery of our services through increased automation and efficient labor utilization. These actions would improve our gross margins. In addition, revenue growth would enable us to better leverage our operating expenses and would contribute to improved operating margins in our services business.

As we work to drive services revenue growth through some of the initiatives that Ed discussed we will continue to take actions to improve our services operating margins by optimizing our delivery costs and closely managing operating expenses.

Moving on to Technology revenue and margins on Slide 12, Enterprise Class Software and Server revenue declined 16 percent year-over-year while sales of Other Technology, all of which is third party product, declined by about $3 million.

Lower ClearPath revenue in the first quarter of 2013 as well as less software revenue as a percentage of the total technology revenue in the quarter drove the decline in technology gross profit margins from 62.2 percent to 45.8 percent. As we have mentioned before, in addition to the revenue mix, the profitability of the ClearPath business is sensitive to revenue volumes because of the relatively high proportion of fixed costs. Our technology operating margins declined from 25.6 percent a year ago to break-even.

As we have said previously, the technology business performance is best measured on an annual basis.

Slide 13 shows our first-quarter revenue by geography and industry.

Our North America revenue which represented 42 percent of our revenue in the quarter declined 14 percent with softness in systems integration driving most of this decline. Revenue from the U.S. Federal government represented 14 percent of total Unisys revenue in the first quarter.

International revenue declined 11 percent in the quarter and was down 9 percent on a constant currency basis.

Revenue in our European region was down 13 percent in the first quarter on an as reported basis and declined 12 percent in constant currency. This decrease was principally related to lower in-quarter public sector systems integration projects.

The Asia Pacific Region revenue decreased by 17 percent as reported and 16 percent on a constant currency basis.

While revenue declined 1 percent in our Latin America region on a reported basis, it was up 6 percent on a constant currency basis.

From an industry perspective, Public Sector, which reported an 11 percent year-over-year decline in revenue, remained our largest single industry revenue source, representing 43 percent of total revenue.

Revenue from Commercial industry customers represented 36 percent of our first quarter revenue while the Financial Sector was 21 percent. Both declined in the quarter with lower technology and systems integration revenue.

Slide 14 provides more detail on our U.S. Federal government revenue over the past five quarters.

In the first quarter of 2013 revenue from Civilian agencies represented about 50 percent of our overall U.S. Federal government revenue.

Revenue from Homeland Security agencies represented 27 percent of our overall U.S. Federal government revenue.

Revenue from agencies within the Department of Defense and various Intelligence agencies represented about 23 percent of our overall Federal government revenue.

Compared to the year-ago quarter, our overall U.S. Federal revenue declined approximately 9 percent to $113.7 million. This decline reflected delayed governmental decision making, lower funding on certain services contracts, the continued roll-off of revenue from some services contracts lost in prior quarters as well as lower technology revenue.

We ended the first quarter of 2013 with about $293 million of U.S. Federal services backlog, which was down 11.5 percent versus the first quarter of 2012.

Looking forward, the U.S. Federal environment remains challenging. We do not yet have a full assessment of the impact of sequestration on Unisys. We continue to work with the agencies we serve on a contract-by-contract basis to understand the impact but do not know what effect, if any, it will have on the company. We expect continued procurement process delays that are often extended by award protests. Pricing pressures remain significant and competition is aggressive. While 2012 included a significant volume of recompetes, Unisys is relatively well-positioned in 2013 with a smaller number of contracts to defend and we are focused on trying to grow our business through a focus on mission critical opportunities, offerings that provide innovation and cost savings as well as our ongoing commitment to client satisfaction. Incumbency is not the advantage it once was and lower win rates are evident for incumbents across the U.S. Federal marketplace.
In the first quarter, our services orders declined slightly year-over-year but were flat sequentially.

One highlight in our order performance was the significant growth in IT outsourcing orders which were at their highest level in over four years, driven by strong renewals.

From a geographic perspective, we saw year-over-year services orders growth in our European and Latin American regions during the first quarter. Orders in our North American and Asia Pacific regions declined in comparison to the first quarter of 2012.

We ended the first quarter with $5.1 billion in services backlog, and backlog has been stable over the past four quarters.

Of the $5.1 billion in services backlog at March 31, 2013, approximately $650 million is anticipated to convert into second quarter 2013 services revenue. During seven of the past nine quarters, we have noted an increase in the level of sell-and-bill business as a percentage of total quarterly services revenue. During that period, the amount of revenue in backlog at the start of the quarter has ranged between 85 and 90 percent of our quarterly services revenue for the full quarter and the sell-and-bill revenue has accounted for the remainder.

Moving to cash, please turn to Slide 16 for an overview of our cash flow performance in the quarter.

We generated $14.1 million of cash from operations in the first quarter of 2013 compared to $33.4 million in the year-ago quarter.

We contributed $26.6 million in cash to our defined benefit pension plans in the first quarter of 2013 versus $68.2 million in the first quarter of 2012. The pension funding contributions are reflected in cash flow from operations.

Excluding the impact of the debt reduction charges and pension expense, Unisys generated adjusted EBITDA of $57.6 million in the first quarter of 2013 versus $123.4 million in the prior year period.

Capital expenditures were $25.9 million in the first quarter of 2013, versus $30.4 million in the first quarter of 2012. We expect full year capital expenditures of about $150 million.

We had free cash flow usage of $11.8 million in the first quarter of 2013 versus free cash flow generation of $3.0 million for the same period last year. Our free cash flow generation before the pension cash contributions was $14.8 million for the first quarter of 2013 versus $71.2 million in the first quarter of 2012.

Depreciation and amortization was $40.2 million in the quarter, down from $41.8 million in the first quarter of 2012.

Our debt balance was $211 million at March 31, 2013, down from $296 million at March 31, 2012 as a result of a series of debt reduction actions completed during the second and third quarters of 2012.

Our cash balance was $629 million at March 31, 2013 and was roughly three times our debt.

And as we have announced and discussed previously, in December 2012 our Board of Directors authorized the purchase of up to $50 million of the Company’s common or preferred stock through December 2014. We have not repurchased any shares under that authorization.

Let me conclude by saying that as we move through 2013 we are focused on improving our services revenue and margins and will be taking actions to drive top line growth and profitability toward the levels we have outlined in our strategic financial goals.

Thank you for your time.