Niels Christenson, IRO

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

Earlier today, Unisys released its third quarter 2015 financial results. With us this afternoon to discuss our results are Peter Altabef, our President and CEO, and Janet Haugen, our CFO. Before we begin, I would like to cover a few 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.

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 reconciliations within 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 Peter.

Peter Altabef, CEO

Thank you, Niels, and thank you all for joining us today to discuss our third quarter results and the progress we are making toward our goals of transforming the business and improving our financial results. In the third quarter, we improved our underlying operating profitability sequentially, showed progress in our Services business and began implementing a go-to-market strategy with improved offerings and capabilities that are enhancing our competitiveness in the market.

We are increasing our focus on higher value integrated solutions that combine industry domain expertise with leveraged capabilities. There are three primary pillars supporting this transition. The first is an emphasis on a more vertically oriented go-to-market strategy that provides more domain knowledge, deepens our client and prospect discussions, and allows for customized offerings within each vertical, while leveraging a central delivery engine.

The second pillar is an improved services and software revenue mix with an emphasis on growing our consulting, security, applications, and higher margin cloud and infrastructure work. The evolving mix of revenue will include enhancing the company’s software and intellectual property portfolio.

The final pillar is an optimized cost structure that is expected to reduce SG&A over the longer term to approximately 13 percent of revenue and also yield greater efficiency in our services delivery organization, supporting an increased Services gross margin.
In the quarter, we had several accomplishments. In September, we presented our new positioning and differentiated solutions at two Unisys industry analyst events, in the Americas and EMEA. You can find presentations from these events on the Investor Relations section of our website.

We highlighted innovative IP-based vertical solutions and horizontal service and technology offerings. These offerings leverage advanced capabilities in areas such as cyber security, mobile, data analytics, and the cloud. We have had numerous instances of positive analyst feedback since these events.

In one example, Technology Business Research, a leading independent technology market research and consulting firm that attended the Americas event wrote, "Unisys ... has a sound plan to become a Tier 1 IT services provider" and that our "unified message of focused vertical services and horizontal technologies brings new life to this mature but transforming IT services company."

During the third quarter, our security solutions practice announced a range of advanced security products and solutions, including a new software-based release of Stealth, which delivers identity-based micro-segmentation to protect sensitive data by making endpoints undetectable to unauthorized parties.

Our security solutions continue to be well received. For example, Network World has named Stealth among its New Products of the Week, noting that it, "secures data using micro-segmentation and cryptography to limit a user’s -- or potential attacker’s -- view of data and services to only a tiny segment of the enterprise. By virtualizing all network security, Unisys has reduced security deployment times and management complexity."

Unisys recently earned a positive placement as a "High Performer" within the "Trust-as-a-Service", a new category in the HFS Blueprint Report. The report places a strong emphasis on the ability of security service providers to influence enterprise transformation as well as support broad-based Technology and Services delivery. And finally, NelsonHall recently placed Unisys in the "Leaders" quadrant of their evaluation of providers of managed security services.

Security wins and expansions during the quarter included Stealth, identity management, and managed services, with organizations that included a large U.S. Federal agency, a U.S. state, a foreign government, a utility company in Latin America and a large European-based multinational foods products company.

Operationally in the quarter, we are realigning our client-facing account executives consistent with our vertical strategy. We are progressing well against our previously announced cost reduction plans, which contributed approximately $21 million in lower costs during the quarter. Our goal remains to achieve $100 million in annualized net savings by the end of 2015 and an additional $100 million by the end of 2016.

In terms of our third quarter business results, we reported revenue of $739 million, a decline of 16 percent from the same quarter of last year, down 8 percent on a constant currency basis. We had 1 percent growth in our Services segment on a constant currency basis, which is the third consecutive quarter of constant currency growth. As we have highlighted throughout the year, the Technology business faces a very challenging year-over-year comparison in the second half, due to lower license renewal opportunities and currency impacts.

Our focus on a more vertically-oriented go-to-market strategy builds on our already significant presence globally among many large enterprises in the verticals where we are focused. We have identified several vertical initiatives where we see the most significant growth opportunities and where we are focusing investments to enhance our solutions and offerings.

Within the government sector, we see growth opportunities in the area of justice, law enforcement and border security, one of our vertical initiatives. Around the world, government organizations are faced with challenges of how to efficiently process daily immigration traffic and manage high risk threats, modernizing justice and law enforcement operations, cloaking sensitive government data and manage digital environments to secure citizen data and thwart adversaries, and to take advantage of mobile technologies and cost-effective cloud-based IT delivery environments.
These are markets that Unisys knows well and where we have strong offerings and credentials with the work we are doing for organizations such as the U.S. Customs and Border Protection, the U.S. Department of Justice, the State of Florida, the UK police forces, the Bavarian Ministry of Justice and the Australian Department of Defense.

Within the Financial Services sector, we see an opportunity to grow our revenue in commercial and retail banking by helping financial services organizations exploit digital and other channels to better serve their clients, make use of predictive proactive fraud detection tools and techniques and improve time-to-market and flexibility; all reducing costs by taking advantage of as-a-service delivery models. This is an area where Unisys has substantial strength, building on our work serving over half of the top 25 global banks. We are focused on providing innovative services and IP-based solution offerings to expand our share of this growing market.

Moving on to the Commercial sector. One example of our presence in this sector is our position as a major supplier to the Travel and Transportation industry, with advanced IP-based solutions in the area of passenger service systems, airport passenger facilitation, airport operations management, and logistics and cargo management. Our solutions are used today to move about 25 percent of the world’s air freight, board 20 percent of the world’s passengers, and improve operations at more than 100 airports worldwide.

We’re focused on helping airlines and airports take advantage of new digital technologies and delivery models to provide continuous innovation. One recent example of our work in this space is a "Home printed bag tag solution". We developed this solution to allow passengers to self-tag their bags at home for easy drop-off at airport counters. When implemented at the Billund Airport in Denmark, this solution reduced the total working hours for passenger handling by 13 percent, reduced 40 percent of the queue time in the check-in bag drop point, enhanced customer satisfaction, and reduced flight delays due to check-in by 70 percent.

This was a strong quarter for orders, including important renewals with many of our largest customers. Within the government sector, we extended a contract with a government agency in the Philippines to operate and support a civil registry system, which relies on our Infomage software database, consisting of over 156 million images of civil registration documents.

We extended our relationship with the government agency in New Zealand to provide application management, application development and modernization, and private cloud services in support of a vehicle and driver registration system.

Within the U.S. Federal portion of our government sector, we had a number of exciting awards. Building on our recognized expertise in this area, we signed a contract with the Department of Transportation’s, Surface Transportation Board, a new client, to provide cloud migration services for e-mail and collaboration to a Microsoft Office 365 cloud environment. We also expanded an enterprise storage services contract with another new agency client to extend Unisys secure private storage more broadly within that agency.

In the Financial Services sector, Unisys signed a contract with Capita, the UK BPO leader and a new client for Unisys, supporting their contract to outsource and transform the mortgage service operation of a large bank. Unisys will deliver application management services, workflow and imaging capabilities and new multi-channel mortgage services for an improved customer experience. As part of this engagement, Unisys will work with Capita to migrate 260,000 mortgage accounts to the Unisys Financial Services System, the platform that supports more than 40 percent of the UK mortgage market. The Unisys solution will be delivered via a Software-as-a-Service model from Unisys’ UK datacenter.

In the Commercial sector, we expanded our cloud and infrastructure services work with an international retail chain in the U.S. and a global retailer in Latin America. We renewed cloud and infrastructure services engagements with U.S. based multinational companies in life sciences and manufacturing industries. We also
won a new cloud and infrastructure services contract with a leading global manufacturer of food products for their work in Brazil.

We were also recognized for our innovation and thought leadership by a number of third-parties during the quarter. Our client, the City of Philadelphia, was recognized by Government Computer News at its annual GCN Awards last week. The award acknowledged the City of Philadelphia’s 311 system, which has now been migrated to SalesForce.com, based on a relationship management solution that we implemented on behalf of the city.

Microsoft named Unisys the Azure Innovation Partner of the Year, recognizing our use of Azure in a range of solutions, including global deployment of our Edge Service Management ITSM Solution and the creation of an automated provisioning platform for the ServiceNow enterprise cloud on Azure.

We expect 2015 will be a transitional year and we are making progress on our path towards sustainable profitability and competitive differentiation. To help you understand our plans with greater specificity, beginning in 2016, we will be providing annual guidance on overall revenue, operating profit and free cash flow.

Thank you again for joining us. I will now turn the call over to Janet to discuss our third quarter results in more detail before we open the call to questions.

Janet Haugen, CFO

Thanks, Peter. Hello, everyone and thank you for joining us this afternoon. In the third quarter, non-GAAP operating profit margin was 7.2 percent and almost doubled sequentially reflecting the benefit of the cost savings actions taken by the company.

In the quarter, Services revenue grew on a constant currency basis for the third consecutive quarter and both gross and operating margins improved sequentially. Our Technology revenue which can vary significantly based on the timing of software license renewals, as well as the volume of low margin third-party technology sales, declined 51 percent year-over-year. The timing of license renewals within a year causes the Technology revenue to be very lumpy. For example, we have closed two larger license renewals in October that were expected to sign in September. If they did, the year-over-year comparisons would be better.

We’ve discussed our expectations for the Technology business throughout the year and, as we have noted, the second half of 2015 has lower license renewal opportunities than in the year-ago period. Additionally, as we mentioned on our last call, the calendarization of Technology revenue is different from 2014. In 2014, Technology revenue was 30 percent in the first half of the year and 70 percent in the second half of the year. In 2015, we anticipate Technology revenue will be more like 42 percent in the first half of the year and 58 percent in the second half.

Currency negatively impacted year-over-year Technology revenue comparisons by 5 percent in the third quarter. And based upon current exchange rates, currency is anticipated to have a negative 7 percent to 8 percent impact for the full year technology revenue comparison.

Moving on, let me provide an update on our ongoing cost reduction plan. We are on track with our plan. As previously announced, we expect to record pre-tax charges of approximately $300 million over 2015 and 2016.

The cash non-cash split of the $300 million is that $280 million is estimated to require cash outlay of which $225 million is for head count reduction related costs; and $20 million of the $300 million charge relates to non-cash items. Geographically, of the estimated $300 million charge, $220 million is for actions in EMEA, which are skewed more into 2016 and $80 million for the rest of the world.
Through the third quarter of 2015, we recognized pre-tax charges of $70 million under this plan; $17 million in the third quarter of 2015 and $53 million in the second quarter of 2015. These cost reduction actions are anticipated to generate annualized savings of approximately $200 million exiting 2016.

During the third quarter, our savings related to these actions totaled approximately $21 million, $14 million in lower operating expenses and $7 million in lower cost of services. With $21 million of savings in the third quarter of 2015, we are already close to the quarterly run rate of $25 million necessary to deliver the goal of annualized savings of $100 million that we have targeted to achieve exiting 2015.

The cash outlays for these cost reduction actions which commenced in the second quarter of 2015 is expected to continue through 2015 and 2016. Cash payments of $25 million were made in the third quarter, bringing our total cash payments this year to $38 million.

Please turn to Slide 3 for a discussion of our third quarter 2015 financial results. We reported revenue of $739 million in the quarter, which was down 16 percent year-over-year and 8 percent on a constant currency basis. Services revenue grew slightly above 1 percent on a constant currency basis. So the overall decline in revenue was attributable to the lower Technology volume with the reasons I noted earlier.

We were pleased to report the third consecutive quarter of year-over-year constant currency Services revenue growth. Based on today’s rate, we anticipate currency to have an 8 percentage point to 9 percentage point unfavorable impact on revenue comparisons for the fourth quarter of 2015 compared to the fourth quarter of 2014, and an unfavorable impact of roughly 8 percentage points for the full year.

Our overall gross profit margin of 19.0 percent declined from 26.6 percent in the third quarter of 2014. Of this 760 basis point reduction, the cost reduction charges and increased pension expense were responsible for 230 basis points of the decline with a 100 basis points due to currency fluctuations. The remaining 430 basis point reduction reflected the impact of lower gross margins in both Services and Technology.

Year-over-year, operating expenses declined $26 million, which was net of $9 million for cost reduction charges and a $2 million increase in pension expense. Excluding cost reduction charges and pension expense, operating expenses declined 25 percent year-over-year or $38 million, reflecting a $14 million benefit from our cost reduction action, currency benefits of $15 million, and the remainder from other operational actions.

Our operating profit margin of 7.2 percent, the non-GAAP, which is before restructuring charges and pension expense, almost doubled sequentially reflecting the benefit of the cost saving actions taken by the company.

Our third quarter 2015 diluted loss per common share was $0.19, which included $0.33 for cost reduction charges and $0.53 for pension expense. This compared to diluted earnings per share of $0.95 in the year-ago quarter, which included $0.35 for pension expense. On a non-GAAP basis, third quarter 2015 diluted earnings per common share was $0.67 versus $1.30 in the year-ago quarter.

Slide 4 shows our third quarter 2015 revenue by segment, geography and vertical. We have also added a view of our revenue type that provides visibility into the split of our Services revenue between recurring and non-recurring. From a segment view, Services represented 89 percent of our third quarter 2015 revenue.

Looking at some elements of the segment in more detail, Cloud & Infrastructure Services decreased by 5 percent on a constant currency basis. This reflected lower in-quarter sell-and-bill revenue than in the prior year. Application Services was up 17 percent on a constant currency basis. Our work at the U.S. Federal Customs and Border Patrol under the BEMS contract and other border security works contributed to the revenue growth.

Moving to a geographic view, revenue from U.S. and Canada declined 4 percent in constant currency, reflecting lower Technology revenue including lower third-party technology product sales to the U.S. Federal government. Our EMEA and Asia-Pacific regions reported constant currency revenue declines, principally
related to lower Technology revenue. And the Latin America region reported constant currency growth of 6 percent, with growth in both Services and Technology revenue.

From a vertical perspective, within government, U.S. Federal grew by 17 percent year-over-year, while public sector, the other components of our U.S. government group, declined 19 percent in constant currency. Revenue from Financial Services customers increased 9 percent in constant currency, principally reflecting higher Technology revenue. And revenue from the Commercial sector declined by 21 percent on a constant currency basis due to lower revenue in both Technology and Services.

Moving to discuss our third quarter segment results in more detail, please turn to Slide 5. Services gross profit margin declined a 150 basis points year-over-year to 17.3 percent, with currency causing 50 basis points of that decline. In addition to currency, our third quarter 2015 Services gross margin was impacted by continuing transition costs on a few multi-year engagements and lower in-quarter sell-and-bill revenue. Our Services delivery team is working to improve Services gross margin by refining our Services delivery model, solution guidelines, workforce pyramids, the mix of onshore and offshore resources and leveraging automation.

We also expect some benefit from our cost reduction actions in the gross margin, although the most significant reductions to cost of revenue will come from our actions in Europe, the majority of which will not begin to take effect until 2016.

Services gross margin increased 1.6 percentage points compared to the second quarter of 2015. This sequential improvement reflects the benefit of our cost reduction action. While our Services operating margin of 4.8 percent in the third quarter of 2015 was down slightly year-over-year, we saw a continuation of the sequential improvement with a 260 basis point increase that reflected the benefit of approximately $17 million in savings related to the cost reduction actions taken during the past two quarters.

Technology gross margins declined 630 basis points year-over-year to 55.0 percent. Currency fluctuations negatively affected Technology gross margins by 450 basis points. The remaining 180 basis points decline reflected the lower revenue.

The operating profit margin decreased as the declines in operating expenses were more than offset by the gross margin impact of lower revenue. Technology gross profit margin increased to 55.0 percent from 43.9 percent in the second quarter of 2015 due to a richer mix of revenue. Sequential Technology operating profit margin increased to 20.7 percent from 15.6 percent.

For some comments on Services order bookings, please turn to Slide 6. We had a good order bookings quarter, particularly for renewal. In the third quarter of 2015, order bookings were $778 million. Order bookings increased year-over-year and were up in every region. We ended the third quarter with $4.4 billion in Services backlog. Backlog was up 2 percent year-over-year and 10 percent in constant currency.

Of the Services backlog at September 30, 2015, approximately $585 million is expected to convert into fourth quarter 2015 Services revenue. The amount of revenue and backlog at the start of the quarter is typically between 90 percent and 95 percent of our quarterly Services revenue for the full quarter.

Moving to cash flow, please turn to Slide 7 for an overview of our performance in the quarter. Before pension and cost reduction charges, Unisys generated adjusted EBITDA of $99 million in the third quarter of 2015 versus $141 million in the prior-year period. We generated cash from operations of $20 million before pension funding and cost reduction payment in the third quarter of 2015, compared to $51 million in the third quarter of 2014.

Third quarter cash flow from operations was adversely affected by slower payments from two of our larger public sector clients in the U.S. Both entities are experiencing budget delays and this has affected their ability to pay vendors. This is not a collectibility issue, but it’s created near-term funding challenges in those entities, which delayed approximately $40 million in anticipated receivable collections during the third quarter.
Including the cost reduction payments of $25 million and the pension funding of $40 million in the quarter, cash used in operations was $44 million for the third quarter of 2015, compared to operating cash usage of $8 million during the third quarter of 2014, which included $58 million of pension funding.

Capital expenditures of $57 million in the third quarter were up about 4 percent year-over-year. We continue to work through a number of engagements that have required significant levels of capital, but remain focused on implementing a more capital light model. For the full year, we anticipate CapEx of approximately $220 million.

We had free cash usage of $101 million in the third quarter of 2015 versus free cash usage of $62 million for the same period last year. Free cash usage before the pension contributions and cost reductions was $36 million for the third quarter of 2015 versus free cash usage of $4 million in the third quarter of 2014. The increased usage principally reflected the impact of the public sector budget delays impacting our receivables that I just mentioned. At the end of the third quarter, the company had approximately $293 million in cash and approximately $310 million in debt.

I also wanted to provide an update regarding our defined benefit pension plan. On Slide 8, we show assets, liability and the underfunded position as reported in the company’s financial statements at December 31, 2014. We also provided the value of assets at September 30, 2015 and an estimate of the liability at 2015, if all actuarial assumptions remain constant except for the discount rate used to present value the pension liability. The net effect would be an approximate $200 million improvement in the underfunded position from December 31, 2014.

As always, we will reevaluate the pension calculations at year-end to provide updated estimates of the ongoing contribution requirements related to the U.S. and international plans.

During the third quarter, we continued to make progress towards our objectives of improving the competitiveness of our offering as Peter covered. Our cost reduction actions are tracking in line with our plan to create a more competitive cost structure and rebalance the company’s global skill set.

Thank you for your time. And now, I’d like to turn the call back over to Peter.