Courtney Holben, IRO

Thank you, operator. Good afternoon, everyone. This is Courtney Holben speaking, VP of Investor Relations for Unisys. Thank you for joining us. Earlier today, Unisys released its second quarter 2016 financial results. With us this afternoon to discuss our results are Peter Altabef, our President and CEO; Janet Haugen, our CFO; and Inder Singh, our Chief Marketing and Strategy Officer.

Before we begin, I’d 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. The non-GAAP measures have been reconciled to the related GAAP measures, and we’ve provided reconciliations with the presentation.

Although appropriate under Generally Accepted Accounting Principles, or GAAP, the company’s results reflect changes that the company believes are not indicative of its ongoing operations and that can make its profitability and liquidity results difficult to compare to prior periods, anticipated future periods or to its competitors’ results. These items consist of pension and restructuring costs. Management believes each of these items can distort the visibility of trends associated with the company’s ongoing performance.

Management also believes that the evaluation of the company’s financial performance can be enhanced by use of supplemental presentation of its results that exclude the impact of these items in order to enhance consistency and comparativeness with prior or future period results. The following measures are often provided and utilized by the company’s management, analysts and investors to enhance comparability of year-over-year results, as well as to compare results to other companies in our industries: non-GAAP operating expenses, non-GAAP operating profit, non-GAAP diluted earnings per share, free cash flow and adjusted free cash flow, EBITDA and adjusted EBITDA and constant currency.

From time-to-time, Unisys may provide specific guidance regarding its expected future financial performance. Such guidance is effective only on the date given. Unisys generally will not update, reaffirm or otherwise comment on any prior guidance except as Unisys deems necessary and then only in a manner that complies with Regulation FD.

And 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 the actual results to differ materially from our expectations. These factors are discussed more fully in the earnings release and in the company’s SEC filings. Copies of those SEC reports are available from the SEC and from the Unisys investor website.

And now, I’d like to turn the call over to Peter.

Peter Altabef, CEO

Thank you, Courtney, and welcome to the company in your new role. Thank you, all, for joining us today to discuss our second quarter financial performance. Our results for the quarter demonstrated continued progress toward our objectives this year of improved profitability and cash flow.
Our non-GAAP operating profit margin for the quarter was 11 percent, which represents an increase of approximately 700 basis points year-over-year. Additionally, we continue to see significant improvements in our cash flow with a $76 million increase to free cash flow of $1 million versus $(75) million in this quarter last year. Adjusted free cash flow for the quarter was $54 million, which is a $79 million year-over-year improvement.

Some of the key business themes that we saw this quarter that help drive these results were strong performance from our Technology business, substantial growth in our Financial Services vertical and in our Asia-Pacific region. As I will discuss further shortly, our Services business is still evolving and we continue to make progress on that front. We will also continue to make progress on our goal of improving our cost structure, which has been one of the key drivers in our increased profitability and improving cash flow story.

As we previously discussed, we ended 2015 having achieved $100 million of annualized cost savings and added to that in the first quarter of 2016 with an incremental $25 million. This quarter, we achieved another $30 million, largely driven by further reductions in G&A expenses, which takes our total to-date of achieved annualized cost savings to $155 million. This represents continued progress in delivering on our overall cost reduction initiative plans, and we remain on target with respect to achieving our goal of $200 million of annualized savings by the end of this year, with another $30 million possible in 2017. We were pleased with our top line performance this quarter, with revenue being down less than 1 percent on a constant currency basis. Lastly, non-GAAP diluted earnings per share were positive this quarter at $0.81, marking a significant improvement versus $0.33 in the second quarter of 2015.

On the Services side of the business, revenue for the quarter declined 6 percent on a constant currency basis, principally due to weakness in the Cloud and Infrastructure Services business. The gross margins for the services business at 16.8 percent on a reported basis were up 110 basis points versus the second quarter last year, but still below where we had anticipated. We are continuing to invest in the transition of our business to more profitable industry relevant offerings with more advisory and consultative skills. We are also working to optimize and leverage the value of our strategic partnerships such as those with Dell, EMC, Amazon and Microsoft.

In terms of sales activity, total contract value, or TCV, which represents the total value of contracts signed over their expected lifetime in the second quarter was up slightly over the prior year at $807 million versus $805 million in the second quarter of 2015. As we look at the pipeline for the second half of the year, we are roughly flat to where we were at this time last year. We continue to execute on better aligning our sales team and client executives along industry lines to improve our go-to-market effectiveness.

Our Technology business had a very strong quarter, with total revenue of $135 million which was an increase of 31 percent on a year-over-year basis, largely driven by strong sales of our ClearPath Forward line.

We continue to focus on new logos, extensions and expansions of existing business, all on a profitable basis. As we have shared with you previously, we have begun taking a more rigorous approach to determining which opportunities make sense to pursue and which ones to walk away from, what I like to call empty calories. We also continue to gain traction with our industry go-to-market approach, and I’d like to talk a bit about the key trends and key wins for the business on a sector basis.

The Financial Services sector, which represented 26 percent of our revenue in the second quarter performed strongly, demonstrated 13 percent growth on a constant currency basis. We expect demand in this sector to grow as digital and mobile conversion will continue to be industry-wide drivers. As an example of our focus on this trend, we recently signed partnerships with Sandstone Technologies and Payment Card Technologies, which give us a digital and mobile proposition that we are beginning to leverage with our clients.

Additionally, as the industry moves to omni-channel banking, the focus on security and prevention of cybercrime will only increase. We recently won the Retail Banking Security Innovation of the Year Award in the
United Kingdom for a biometric solution that can be utilized by clients to address these concerns, and we have proof-of-concept with BehavioSec and National Building Society.

Some key wins in Financial Services in the second quarter included in EMEA a ClearPath Forward contract with Nationwide. In Latin America, CAIXA signed a 20-month contract extension with us to host, run, support, and maintain their mortgage system.

Within the Government sector, our Public business includes all government clients outside the U.S. Federal Government and accounted for 21 percent of our second quarter revenue.

Although Public Sector revenue was down 16 percent this quarter, this was anticipated as it was largely driven by several large contracts that had reached end of life. As we look to the second half of 2016 and into 2017, we see two major issues dominating our Public Sector clients’ spending plans. First is the goal of improving public trust, while simultaneously ensuring public safety.

Second, is cutting government costs, while improving service to levels typically found in today’s digital society. As a result, we are seeing large and growing demand for digital government solutions that marry our services with our deep understanding of government to deploy solutions that directly improve cost and performance ratios, such as shared services, and improve law enforcement situational awareness and responsiveness in an emergency.

As we move into the second half of the year, we have a strong pipeline. For instance, in the U.S., we have received RFPs for social services systems modernization projects resulting from increased grant funding to states as this is a priority for the current administration. In the second quarter, we had a number of significant client wins that speak to positive trends in this business, including a new logo contract from the city of Austin, Texas, one of the nation’s fastest-growing cities to design, configure and manage software applications supporting the city’s digital government initiatives in licensing, permitting, and inspections operations. The U.S. Federal business, which makes up 20 percent of our revenue was basically flat to last year, slightly better than expected due to tough compares. We continue to leverage our expertise in this market and we are focused on several large deals that are expected to be awarded later this year. We saw an important new logo win with the Office of the Comptroller of the Currency or OCC, which was our first competitive federal Microsoft Office 365 win. The OCC is only the second bureau within Treasury to migrate to Office 365 and six others will need to migrate soon.

Additionally, we received a signed contract with the U.S. General Services Administration to continue to support the development and deployment of that agency’s critical applications and systems for the Public Building Service. Unisys will support all the applications used by Public Building Service to perform its mission of providing state-of-the-art efficient workspaces for the federal government.

Moving on to the commercial sector, which includes both our Travel and Transportation and Life Sciences verticals and represented 33 percent of our revenue in the second quarter. Second quarter revenue for this sector was flat year-over-year. As we look at the growth drivers that will enable us to expand our footprint in this sector, it is clear that information security is a top priority for our clients. As companies are looking to establish more secure digital environments to manage their connectivity and information flow. To address this need, we are planning to introduce a new digital collaboration platform that brings to bear the unique integration of our strong industry expertise, cloud technologies and our Stealth security capabilities.

In terms of key wins during the quarter, we signed several renewals including with Nihon, Microsoft Retail and Quest Dynamics along with expansion contracts TravelSky, Whole Foods and AutoNation. We were also able to sign several new logos in the quarter, including an end user and workspace new logo deal with Regeneron to serve approximately 6,000 users.

In our last quarterly call, we began to discuss the increasing importance of our security products and offerings including our Stealth offering. Our goal is to distinguish Unisys through a focused effort to build leading
security protocols into all our solutions companywide. And as you can see on slide four, in a pictorial representation of the majority of our security business.

Our Stealth suite is our most unique security offering. These products offer a secure software centric approach to identity based micro-segmentation, which helps cloak a network from anyone who shouldn’t be able to see it. The Stealth product suite is unique in that it is hardware and infrastructure agnostic, because it focuses on identification rather than IP addresses. We believe it is also the only micro-segmentation platform running on both Amazon Web Services and Microsoft Azure.

Yesterday, we announced several key developments and wins with Stealth, including approval from the NSA’s Commercial Solutions for Classified program, opening the door to U.S. federal agencies to purchase Stealth within composite solutions that protect classified systems and data. This also enhances our credibility in the commercial and financial markets for Stealth because we believe we are the only micro-segmentation product to have this certification today.

Additionally, Stealth received certification by the National Information Assurance Partnership or NIAP as among the products eligible for use by governments in more than 20 countries to protect their sensitive systems and information. NIAP certification, established by the United States NSA and the United States National Institute of Standards and Technology is recognized by governments in countries such as Australia, Canada, Germany, India, Malaysia, New Zealand, and the United Kingdom, each of which are key geographies for us.

Our security offerings are by no means, though, limited to Stealth. As the middle ring on this chart shows, we have a number of existing products we are working on scaling, as illustrated in the middle of the circle. For instance, almost all of the UK police forces rely on a Unisys provided investigation solution known as HOLMES for major crime investigations. Earlier this year, 70 percent of the forces migrated to our SaaS version, hosted from our secure data centers in the UK. The remaining 30 percent use the HOLMES solution in an on-premise model. The latest version of HOLMES is built on our U-LEAF platform, our flagship investigation management solution and available in a SaaS model. Similar to HOLMES, we also have other enforcement solutions, such as Jail Management and Intelligence Management both built on our U-LEAF platform. Together these create a broad range of capabilities specifically created for law enforcement.

Additionally, the work we are doing on the security front has helped us develop leading capabilities in advanced algorithms and predictive analytics, specifically as it relates to work around border security. We are now working on applying these capabilities to create analytics solutions for our clients in other targeted industries and have appointed a leader internally to drive this business for us going forward.

One example of this work in our analytics business is that Unisys provides end-user support services worldwide for a leading global software provider. As part of that engagement, we’re applying advanced analytics to information about service events, such as spikes in application demand that can slow response in order to predict, preempt, and reduce future incidents and reduce the cost of service delivery for Unisys and for our client.

We consider these security and analytics offerings to be leading edge. We have seen increasing demand globally for these types of products and services, especially with respect to increasing worldwide focus on terrorism and border control. These concerns also extend to securing airports and cargo shipments, along with cyber security in general both in the government and corporate environments.

As we evaluate the recent decision by the United Kingdom to leave the European Union, putting aside political opinions on the matter, we see another example of increasing focus on many of these issues. Specifically the redefining of borders creates additional need to secure those borders in different ways from what is currently required.
Even prior to the Brexit vote, we were in discussions with Frontex, which is the border control unit for the European Union and euLISA, which manages large scale IT systems for the European Union related to border management and migration, about helping secure borders across Europe. We expect those discussions to continue.

In conclusion, we’re pleased to be seeing increased profitability as a result of our cost-cutting efforts and increased technology sales and overall with the results of the quarter, which Janet will now take you through in more detail.

Janet Haugen, CFO

Thanks, Peter. Hello, everyone, and thank you for joining us this afternoon. In my comments today, I will provide comparisons on a GAAP and non-GAAP basis. The non-GAAP results exclude our pension and cost reduction charges.

Please turn to slide six for a discussion of our second quarter 2016 financial results. As you can see looking across the slide, we saw a positive trend this quarter for revenue, operating profit, EPS and cash flow. We reported revenue of $749 million in the quarter, which was down 2 percent on a reported basis year-over-year, but down less than 1 percent on a constant currency basis.

Our operating profit improved year-over-year in the quarter for both GAAP and non-GAAP. Non-GAAP operating profit improved to $81 million from $30 million in the year ago quarter, showing the benefit of our ongoing operating cost reduction.

In the quarter, we continue to execute against our cost reduction program. Our actions in the quarter generated approximately $30 million in annual run rate savings, which raised our program to date savings to $155 million against our target of $200 million as we exit 2016 with a possibility of an additional $30 million in annualized savings in 2017. We remain on track.

Our diluted earnings per share was $0.36 versus a diluted loss per share of $1.17 in the prior year period. Non-GAAP diluted EPS improved to $0.81 from $0.33 a year ago. The shares used in the second quarter diluted earnings per share calculations were 49,927 shares in the second quarter of 2015. And 71,786 shares in the second quarter of 2016, which reflect 50,069 of outstanding shares plus 21,550 shares for the incremental shares from the 'as-if' conversion of the convertible note in the fully diluted EPS calculation. We have included a schedule in the appendix to illustrate the impact of the convertible note on the EPS share count.

Moving to cash flow. On higher adjusted EBITDA, we generated $35 million of operating cash flow in the quarter, compared to an operating cash usage of $21 million in the second quarter of 2015. Adjusted free cash flow, which is the free cash flow generated from the business excluding the impact of cash payments for our cost reduction program and for pension funding, increased $78 million to $54 million for the second quarter of 2016 when compared to the second quarter of 2015.

Turning to slide seven for an overview of our revenue in the second quarter of 2016. This chart shows a breakdown of our revenue based on segment, geography, sector, and revenue type. On our investor relations page, we also provided a similar overview of revenue for the first half of 2016.

Turning now to revenue by geographic region and sector on slide eight, as we look at the regional geographic breakdown, U.S. and Canada was down 9 percent year-over-year. This was largely attributable to lower services revenue, particularly lower Cloud and Infrastructure revenue. EMEA had a good technology revenue quarter, which contributed to the revenue growth of 6 percent year-over-year. And Asia Pacific grew 10 percent, 13 percent on a constant currency basis, driven by strength in our Australian and New Zealand public sector where we are viewed as a key industry player related to the increased digitization of government.

On the sector breakdown, Financial Services had a strong quarter particularly for technology sales. Public Sector revenue declined against a tough comp partially due to the completion of some low margin
government contracts. This aligns with our direction to focus on winning and executing higher-margin deals.

The pipeline for the second half of 2016 is strong within the public sector.

U.S. Federal saw a slight revenue decline after seven consecutive quarters of growth. As we discussed in prior quarter’s earnings call, last year’s second quarter had a lot of project-based work on new contracts.

Moving on to our segment results, please turn to slide nine. Services revenue declined 7 percent in the second quarter, largely attributable to weakness in Cloud and Infrastructure Services. We are pleased with the increased Services gross margin, which were up 110 basis points primarily as a result of our cost reduction effort. We saw improved gross margins in every geographic region. However, we are seeing margin pressure in EMEA. While we made improvement in EMEA services gross margin, it was not at the rate we planned.

Offsetting the improvement in Services gross margin was increased SG&A expense. As Peter mentioned, we are increasing our investments in advisory and consulting skills to help accelerate the speed of our improvement in our Services gross margin. This resulted in Services operating margins of 2.1 percent, which were down 10 basis points year-over-year.

We ended the quarter with Services backlog of $3.8 billion, which was down both year-over-year and sequentially, of the $3.8 billion in Services backlog, approximately $537 million is expected to convert into third quarter 2016 Services revenue.

The Technology business had a very strong ClearPath Forward quarter and the increased revenue helped drive significantly improved Technology gross margins and operating margin. We are pleased that the ClearPath Forward family have had a strong start to the year. We currently anticipate that this strong start will result in a different first half, second half seasonality than we typically experienced with first half 2016 Technology revenue higher than second half 2016. So for 2016, it looks like first half 2016 revenue would be about 54 percent to 55 percent of full year Technology revenue. This is different from the last four years where second half revenue was greater than the first half Technology revenue.

Lastly, in terms of the second quarter results, slide 10 highlights the significant improvement we saw this quarter in operating cash flow. As a result of continued cost cutting measures focused on contract renewal and extension profitability, operating cash flow was positive at $35 million relative to a usage of $21 million in the second quarter last year.

CapEx was lower than in the second quarter of 2015, which saw elevated levels of investment in outsourcing assets. This decline in CapEx coupled with higher operating cash flow led to free cash flow improving to a positive $1 million generation versus a usage of $75 million in the second quarter of 2015.

Additionally, adjusted free cash flow increased for the third consecutive quarter to $54 million, which is an increase of $79 million relative to the prior year period. A large driver of that expansion is increased EBITDA, which for the second quarter of 2016 was $124 million versus $72 million in the prior-year quarter.

As we look at the second half of this year, Q3 is normally, seasonally weaker than Q4. And in addition, we anticipate continuing our increased investment spend in both the third quarter and the fourth quarters. As Peter and I both discussed, we anticipate these investments will yield results in future periods. And additionally, our cost saving strategy in Europe is proving to take longer than we had hoped, although we still believe that our target cost savings are achievable. We expect this to weigh on our Q3 and Q4 results.

As we look at the full year, our guidance is for revenue in the range of $2.775 billion to $2.875 billion consistent with our prior guidance. For non-GAAP operating profit margin, given the increased investment spending and the pressure on EMEA services gross margins that I just discussed, we are guiding to the low end of our previous non-GAAP operating profit margin guidance of 7 percent to 8 percent. Adjusted free cash flow in the range of $160 million to $200 million is consistent with our prior guidance.
Turning now to slide 11, in addition to the overview of the second quarter financial result, I also wanted to take this opportunity to briefly cover our tax attributes and their value to the company. We’ve discussed our tax attributes in some of our past earnings call. We have summarized our tax attributes on slide 11. This information is also found in our tax footnote in our annual financial statement.

Before valuation reserves, we have $2.1 billion in deferred tax assets. Under GAAP, most of these tax attributes are fully reserved. As you can see on slide 11, this results in net deferred tax assets of only $114 million on the 12/31/2015 balance sheet. Based on our understanding of current tax regulations, if Unisys generates future taxable income in jurisdictions where we had net operating loss carryforwards and other favorable tax benefits, and depending on the timing of that taxable income, the gross value of $2.1 billion could be available to reduce or eliminated the related income tax.

In closing, during the second quarter, we were very pleased with our strong Technology revenue and margin. We also demonstrated continued progress towards improving our cost structure to increase our profitability and strengthen our cash flow generation. 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. We increased our services investment in advisory and consulting skills for longer-term benefit on Services revenue and gross margin rate.

We are focused on enhancing the competitiveness of our offering and building the go-to-market and delivery capabilities that will enable us to generate sustainable revenue growth in the future.

With that, I would like to thank you all for your time, and I will turn the call back over to Peter.