UNISYS

1Q16 Financial Release
CEO/CFO Statements
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Niels Christenson, IRO

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

Earlier today, Unisys released its first quarter 2016 financial results. With us this afternoon to discuss our results are Peter Altabef, our President and CEO, and Janet Haugen, our CFO. We're also joined today by Inder Singh, Chief Marketing and Strategy Officer, who leads our Global Marketing, Communications organization and Investor Relations, who joined the company at the end of the first quarter. So, we're very pleased to have him with us.

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. 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've provided reconciliations within the presentation.

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, Niels, and thank you all for joining us today to discuss our first quarter financial performance and the progress we're making to improve the company's profitability and increase our competitiveness and market differentiation. Our first quarter results demonstrated progress toward our objectives of improved profitability and cash flow. We had a non-GAAP operating profit margin of 2.9 percent, which was up from negative 0.3 percent or 320-basis points year-over-year. Our adjusted cash flow in the quarter was up $100 million year-over-year.

Our continued progress in improving our cost structure was a key driver behind the improved profitability and cash flow. In the first quarter of 2016, we achieved $25 million in incremental annualized savings, building on the $100 million in net annualized run-rate savings we achieved exiting 2015. This was a significant milestone and we remain on target with respect to our cost reduction initiatives.

In the first quarter of 2016, our revenue declined 3 percent on a constant currency basis, which was consistent with the guidance we provided. Services revenue declined 2 percent, also consistent with our expectations on a current currency basis. We're very pleased by the strong performance of our U.S. Federal business, which drove its sixth consecutive quarter of year-over-year Services revenue growth. Our Federal team continues to perform very well and distinguish Unisys in that market.

Services order bookings in the first quarter were down compared to the first quarter of 2015 and it was our second consecutive quarter of year-over-year declines. We have a strong pipeline for the remainder of 2016 and are aligning our sales and client executives to capitalize on the opportunities to drive bookings and grow backlog.

Our Technology business is lumpy quarter-to-quarter. And as expected, included fewer ClearPath Forward license renewals in the first quarter of 2016 than in the prior year. First quarter 2016 Technology revenue was down 10 percent on a constant currency year-over-year basis, which was also in line with our guidance.

We also completed a convertible note offering in March. While Janet will speak to the transaction in more detail, I am pleased that we were able to strengthen our balance sheet, provide the company with greater flexibility to meet our requirements, and expand our ability to invest in opportunities that can help build our business.

As much as our cost reduction efforts are an important element in improving our competitive position and enhancing the efficiency of our delivery engine, so too does the strong capital structure. The combination of a stronger balance sheet and cost structure creates a solid base for growth and enhances our go-to-market efforts. I believe we made significant progress with each of these foundational elements in the first quarter.

We worked aggressively throughout the quarter to strengthen our industry vertical go-to-market initiatives and to integrate our expanding and enhanced leveraged solutions into those initiatives.

In the quarter, we had success in extensions, expansions, and new logos. Within the Government sector, our Public business includes all government clients outside the U.S. federal government and accounted for 26 percent of our first quarter revenue.

During the quarter, we had a number of client wins. In Asia Pacific, the Australian Department of Immigration and Border Protection selected Unisys as its systems integration partner for the first phase of a new Traveler Border Clearance Platform that is designed to speed and automate the processing of lower risk travelers to focus resources on those of higher risk.

In EMEA, building on our expertise in justice and law enforcement, Unisys was selected by the Netherlands Ministry of Safety and Justice to implement and manage a new jail management solution for penitentiaries across the country. Unisys will use the Unisys Law Enforcement Application Framework, or U-LEAF, to help provide high quality modern jail management services to custodial institutions throughout the Netherlands.

In Latin America, PRODESP, the government owned provider of IT services to the state of São Paulo, renewed on our ClearPath Forward platform, which supports multiple applications, registration, records, and identification systems for that state's more than 27 million citizens.

In the U.S., the Washington State Department of Social and Health Services awarded Unisys a five-year $20 million contract to provide a private cloud solution. Unisys' ClearPath Forward services are a core part of this as a service solution, providing streamlined and cost effective management for the cloud infrastructure and associated application environment.

The Federal business, which represented 21 percent of our first quarter revenue had several impressive wins in the quarter as well. NASA's Langley Research Center renewed its Simulation and Aircraft Services contract to which Unisys provides analysis, design, development, testing, operations, and maintenance for NASA's Flight Simulation Facilities and Research Aircraft Systems.

We also won an application support contract with a law enforcement agency to support its detention services applications, which provide prisoner designation, housing, transportation, medical care, and detention information and analysis.

And we expanded an application services contract with an agency responsible for domestic security to provide new analytics, visualization, and common framework capabilities for passenger systems and redesign of cargo trade entity programs.

Moving on to the Commercial sector. The results of an active quarter in the Commercial sector, which represents 32 percent of our revenue. Air Canada in our Travel and Transportation industry extended and expanded its utilization of our cloud-based air cargo application.

In Asia Pacific, HubSky Network Company, a new client, appointed Unisys to provide end-to-end design and consulting activities including data center planning, design implementation and management services for HubSky's new cloud-based data center in Beijing.

Riverbed Technology, a leading provider of application performance infrastructure, selected Unisys as its partner in EMEA to provide on-site installation and maintenance services for key Riverbed products, including converged-infrastructure platforms for cloud-enabled server virtualization, storage management and wide area network optimization.

And Eli Lilly extended and expanded our long-standing global managed services relationship in support of its global IT operations and critical business functions.

Within the Financial Services sector, which represented 21 percent of our revenue in the first quarter, some key wins included, in Asia Pacific, a new banking client which chose Unisys to deliver check processing services to our BPO operations in the region.

In Latin America, Banco Nacional de Costa Rica renewed on our ClearPath Forward platform to run its core banking platform and the system that controls its ATM network.

As I mentioned before, security is a core focus for the company. I'd like to discuss security in three ways. Most broadly, our goal is to distinguish Unisys through a focused effort to build leading security protocols into all of our solutions company-wide.

Second, while security will be increasingly evident in all our solutions, our specific security project portfolio is receiving more emphasis including managed security, security consulting, and security infrastructure services, as well as our Stealth security business. A good example of new work in this broader area is the Australian Department of Immigration and Border Protection contract, I mentioned earlier.

And third, we are very focused on growing our Stealth business, which includes as a service, licensing, services, and maintenance. Our Stealth offerings are examples of market-leading innovative software-based security solutions and we have expanded our Stealth solution suite from three offerings, which include Stealth(mobile), Stealth(core) and Stealth(cloud) to five with the addition of Stealth(identity) and Stealth(analytics).

This week we announced the availability of Stealth(cloud) for Microsoft Azure to seamlessly deliver micro-segmentation security from clients' enterprises to the Microsoft Azure cloud. Stealth(cloud) provides an additional layer of security that leverages and easily integrates with Microsoft Azure's existing strong security. Enterprises can dynamically and simply extend their on-premise infrastructure to Azure using the extended data center capability of Stealth(cloud) that automates the shifting of secure workloads from their data centers directly into Azure. Stealth(cloud) for Azure enables clients to establish a single secure platform for both their data centers and their cloud environments, reducing complexity and cost in a hybrid environment, and removing roadblocks for many organizations looking to leverage the cloud.

During the quarter, new Stealth contracts included, a U.S. Defense Department agency that began using Stealth on Amazon Web Services, leveraging the extended data center capabilities to enhance security over sensitive data stored and analyzed in the public cloud. This is indicative of the interest we have seen in the Stealth-Amazon Web Services model, from the U.S. defense and intelligence community.

Our direct sales team which has also seen significant interest across our geographic base within the banking, energy, government, and retail industries, and we had number of wins including engagements with a large retailer and a multinational supplier of products and services to the oil, gas, and power generation industries.

In addition, earlier this week, we announced that ANGKASA has implemented the Unisys Stealth solution to secure personal information and account details accessed via its self-service kiosks across Malaysia. This solution secures communication between the self-service kiosks and ANGKASA's data center from hackers or unauthorized access, protects critical IT assets and secures sensitive customer data.

And yesterday, we announced that Mitel Networks Corporation, a business communications leader, is teaming with Unisys to offer Stealth security to protect mobile communications and cloud access for Mitel's 60 million users in 100 countries around the world. Unisys will provide new security-enabled offerings to Mitel's mobile and enterprise customers based on our Stealth(mobile) security product. This will provide Mitel with a highly differentiated security offering for its diverse global client base, which can be easily integrated into its product line of voice-over-IP, mobility and cloud services. In addition, Mitel will be using Stealth to protect its own systems data and intellectual property.

In sum, we're seeing improved market penetration with Stealth, including improvements in the quality of the pipeline and a reduction in the average sales cycle.

As a follow-up to a comment from an earlier call, I also wanted to discuss that we have now completed our evaluation of our software portfolio to identify and focus investment in a select group of offerings that are aligned to our integrated go-to-market priorities.

Finally, we have also continued to build our leadership team, and I'm very pleased that Inder Singh has joined the company as Chief Marketing and Strategy Officer. Inder leads our Global Marketing and Communications Organization, which as Niels mentioned, now includes Investor Relations. In just a month, Inder has enhanced our thinking on Unisys' branding, marketing and our outreach to investors and analysts.

In addition, Andy Stafford joined the company earlier this week as the leader of our global Services delivery organization. Andy will play a critical role in both advancing our next generation offerings and in executing our cost optimization program.

So, I'd like to thank everyone again for joining us and I'll now turn the call over to Janet before we open up for questions.

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, unless otherwise mentioned, any comparisons are on a GAAP basis.

Please turn to slide three for a discussion of our first quarter 2016 financial results. We reported revenue of $667 million in the quarter, which was down 8 percent year-over-year, 3 percent on a constant currency basis. The overall decline in revenue reflected a 2 percent constant currency decline in Services revenue and a 10 percent decrease in Technology revenue. I will discuss our segment results in more detail shortly.

The success of our ongoing operating cost reduction action was evident as operating expenses declined $21 million or 14 percent. Non-GAAP operating expenses declined 25 percent.

Our non-GAAP operating margin of 2.9 percent, rose 320 basis points year-over-year, reflecting the benefit of the cost reduction actions taken by the company. In the quarter, we continued to execute against our cost reduction program. Our actions in the quarter generated approximately $25 million in annualized run rate savings, which raised our program-to-date savings to $125 million against the target of $200 million as we exit 2016. We remain on track.

Our first quarter 2016 diluted loss per common share was $0.80, which included $0.49 for cost reduction charges and $0.42 for pension expense. This compares to a diluted loss per share of $0.87 in the year ago quarter, which included $0.55 for pension expense.

Non-GAAP diluted earnings per common share was $0.11 in the first quarter of 2016, versus a loss of $0.32 in the year ago quarter.

In the first quarter, we recorded a tax provision despite recording a pre-tax loss. As I have said previously, our effective tax rate varies significantly quarter-to-quarter based on the geographic distribution of our income in that quarter. Based on our current tax position, future quarterly results with a comparable geographic distribution of income would likely include a tax provision even in periods with a pre-tax loss.

Adjusted EBITDA for the first quarter of 2016 was $60 million versus $43 million in the prior-year quarter. Adjusted free cash flow improved $100 million year-over-year to $38 million in the first quarter of 2016.

Moving to slide four, which shows our first quarter 2016 revenue by segment, geography, industry and revenue type. From a segment view, Services represented 89 percent of our first quarter 2016 revenue. Looking at some of the Services revenue in more detail, Cloud and Infrastructure Services revenue was 50 percent of our overall revenue, and decreased 7 percent on a constant currency basis, reflecting lower contract volume on Public Sector accounts in the U.S.

Application Services were 32 percent of our overall revenue and increased 10 percent on a constant currency basis, on the strength of Justice Law Enforcement and Border Security work, particularly in our U.S. Federal business.

BPO revenue was 7 percent of our overall revenue. All of which is delivered outside the U.S. Half of the year-over-year decline was due to currency with the other half a result of lower revenue from our iPSL joint venture in the UK.

Moving to a geographic view. Revenue from the U.S. and Canada, which represented 51 percent of our first quarter revenue, declined 3 percent in constant currency, principally reflecting lower year-over-year Technology revenue. Incremental project work in our U.S. Federal business drove the sixth consecutive quarter of year-over-year U.S. Federal services revenue growth. But we do not expect to see that level of project work to extend into the second quarter of 2016.

Our EMEA region reported an 8 percent constant currency revenue decline due largely to the lower BPO revenue, I mentioned a moment ago.

Asia Pacific and Latin America regions reported constant currency growth of 9 percent and 8 percent, respectively. In Asia Pacific, Services revenue growth, which largely reflected the benefit of the recent New South Wales government contract win and higher BPO volumes, offset lower Technology revenue in the quarter. In Latin America, we saw growth both in Services and Technology revenue.

To discuss our first quarter segment results in more detail, please turn to slide five. Services revenue declined 2 percent in constant currency as declines in Cloud and Infrastructure and BPO offset the growth in Application Services.

Services gross profit margin rose 10 basis points year-over-year to 14.2 percent. We continue to pursue higher margin services to improve the aggregate margin profile of our Services business. Our Services operating margin of 0.7 percent in the first quarter of 2016 rose 200 basis point year-over-year, reflecting the benefit of the operating cost reductions we have taken over the past 12 months.

Technology revenue decreased 10 percent in constant currency, reflecting reduced ClearPath Forward revenue, which can vary significantly from quarter-to-quarter based on the timing of license renewal. Technology operating margin percent more than tripled year-over-year to 18.1 percent due to the benefit of the operating cost reduction.

For some comments on Services order bookings and backlog, please turn to slide six. The first quarter of 2016 was a soft booking quarter overall with orders of approximately $300 million. From an industry vertical perspective, the Financial and U.S. Federal sectors had order growth, while Commercial and Public Sector declined.

As Peter mentioned, we have a strong pipeline for the balance of 2016 and are focused on executing against the opportunities we have to improve our order bookings and build backlog. We ended the first quarter with $4.1 billion in Services backlog. Of that Services backlog, approximately $545 million is expected to convert into second quarter 2016 Services revenue.

Moving to cash flow, please turn to slide seven for an overview of our performance in the quarter. Our cash flow performance improved year-over-year. We generated cash flow from operations of $24 million in the first quarter of 2016, compared to cash usage of $43 million in the first quarter of 2015.

Free cash flow improved by $89 million year-over-year as a result of the increased operating cash flow, and lower capital expenditures. Adjusted free cash flow improved by $100 million year-over-year to $38 million in the first quarter of 2016.

At the end of the first quarter, the company had $514 million in cash. The debt balance at March 31, 2016 was $465 million.

Please turn to slide eight, for a discussion of our recent convertible notes offering. On March 15, we issued $190 million of five-year 5.5 percent coupon, unsecured convertible senior notes with approximately $160 million in net proceeds after fees associated with the transaction and the cost of the capped called transaction.

About a week ago, we issued an additional $23.5 million of the notes with the exercise of a portion of the underwriter’s over-allotment. These notes have the same terms and conditions as the notes we issued in March. In connection with the issuance of these additional notes, we entered into further capped call transactions at a cost of $3 million, which raised the total cost of the capped call transaction to about $27 million.

The total value of the offering was $213.5 million and Unisys received net proceeds of $180 million in total. The proceeds of the offerings are for general corporate purposes. This additional liquidity provides the company with more flexibility to address future capital requirements, including the August 2017 maturity of $210 million of 6.25 percent senior notes.

In light of the uncertainty within the high-yield debt market and our evaluation of other financing alternatives available to us, we felt it was in the best long-term interest of the company to secure financing, which provides Unisys with a stronger balance sheet to address the near-term maturities, support our business, and enhance our ability to invest in the company as we execute against our business strategy.

With respect to our pension obligations, there has been no change to our previous estimates on pension expense or contribution for 2016. Returns on the assets associated with the U.S. plan were approximately 1 percent for the first quarter 2016.

On our fourth quarter 2015 earnings call in late January, we provided financial guidance for 2016. We continue to expect overall 2016 revenue in the range of $2.775 billion to $2.875 billion. We anticipate a non-GAAP operating profit margin of between 7 percent and 8 percent in 2016. And we anticipate our adjusted free cash flow for the year will be in the range of $160 million to $200 million.

During the first quarter, we demonstrated significant progress toward our objective of 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 continue to focus 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.

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