Xerox Corporation (XRX)

Updated April 27th, 2024, by Josh Arnold

Key Metrics

Current Price:	$14	**5 Year CAGR Estimate:**	12.2%	**Market Cap:**	$1.7 B
Fair Value Price:	$16	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	06/28/24[1]
% Fair Value:	90%	**5 Year Valuation Multiple Estimate:**	2.2%	**Dividend Payment Date:**	07/30/24
Dividend Yield:	7.1%	**5 Year Price Target**	$20	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Rating:**	Buy

Overview & Current Events

Xerox Corporation traces its lineage back to 1906 when The Haloid Photographic Company began manufacturing photographic paper and equipment. Through a series of mergers and spinoffs, the Xerox we know today was formed. Xerox spun off its business processing unit in 2017 (now called Conduent) and now focuses on design, development, and sales of document management systems. The company produces less than $7 billion in annual revenue and has a market capitalization of $1.7 billion.

Xerox reported first quarter earnings on April 23rd, 2023, and results were very weak, as management noted it was a quarter of intense reorganization. Adjusted earnings-per-share came to 29 cents, which missed estimates by six cents. Revenue was off more than 12% year-over-year to $1.5 billion. It was down 13.2% in constant currency, with forex translation helping the top line by 80 basis points on a reported basis.

Operating margin on an adjusted basis was 2.2% of revenue, plummeting 470 basis points lower year-over-year. Operating cash flow came to a loss of $79 million, worsening by $157 million from the year-ago period. Free cash flow was -$89 million, $159 million lower than last year's Q1.

The company now expects revenue to fall between 3% and 5% for the year, adjusted operating margin to be at least 7.5% of revenue, and for free cash flow to be at least $600 million. We note that given the move lower in the share price, the stock is trading for less than three times forecasted free cash flow for this year.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$3.84	$3.20	$2.32	$3.48	$3.46	$3.55	$1.41	$1.51	$1.12	$1.82	***$1.95***	***$2.49***
DPS	$0.98	$1.09	$1.25	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	***$1.00***	***$1.00***
Shares[2]	279	253	254	255	230	213	198	159	156	123	***115***	***90***

Xerox has had a difficult time growing revenue and profits and we do not see that changing moving forward. Given that the new base of earnings for 2024 is $1.95 per share, we expect 5% growth moving forward. We see the restructuring program as a net positive for the stock given Xerox continues to see revenue and guidance weakness. In addition, rapidly improving free cash flow should help continue to reduce the float.

We think the revenue and margin outlooks for Xerox look much better than they have in the recent past, and its buyback program should be able to help alleviate some of the burden when it comes to growth, provided free cash flow recovers as planned; it certainly appears that it will given recent guidance, and despite the big miss in Q1.

The dividend is $1.00 per share today and we do not forecast any increases coming anytime soon. The dividend was cut after the Conduent spinoff in 2017 and given the above, we do not see management taking the risk of a higher dividend, particularly given the yield is currently in excess of 7%.

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[1] Estimated date

[2] Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	13.0	14.3	16.8	8.5	8.0	9.0	15.5	15.1	13.0	10.1	***7.2***	***8.0***
Avg. Yld.	2.0%	2.4%	3.2%	3.4%	3.6%	3.1%	4.6%	4.4%	6.8%	5.5%	***7.1%***	***5.0%***

Xerox's average price-to-earnings ratio in the past decade has been ~11, but we estimate fair value at 8 times earnings given continued revenue weakness and volatile margins. That is ahead of the 7.2 times earnings the stock trades for today, implying a small tailwind to annual total returns should the valuation normalize over the next five years. We expect the stagnant dividend and higher valuation to produce a yield around 5% in the future and note that the 7.1% yield today is extremely high. The guidance for 2024 free cash flow suggests dividend safety concerns are no longer an issue, and in fact, that the company can pay the dividend and deleverage quite easily while buying back shares.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	26%	34%	54%	29%	29%	28%	71%	66%	89%	55%	***51%***	***40%***

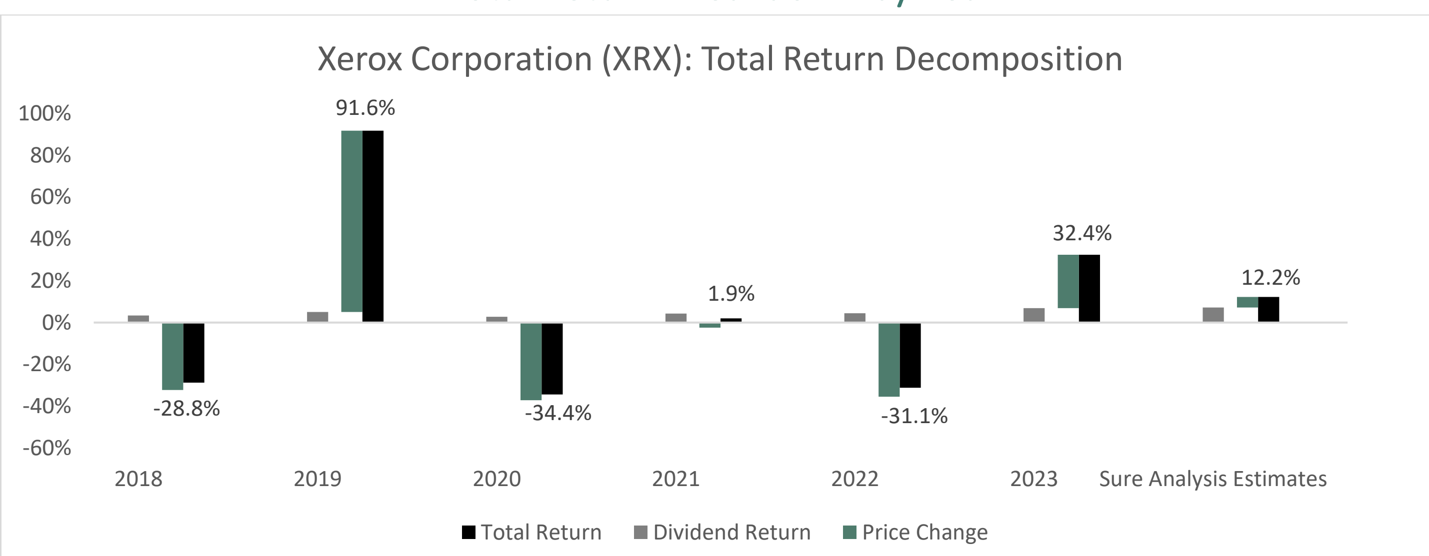
The payout ratio is 51% of earnings now that estimates are higher for 2024. Xerox hasn't said it plans to cut the dividend, and we believe it's sustainable at the current level. We continue to think that Xerox will have a difficult time raising the payout anytime soon given relative earnings weakness, but deleveraging and share repurchases have taken precedence in recent years anyway.

Xerox suffered immensely from the COVID recession, but is showing signs of improvement. Its competitive advantage is in its pure-play focus on document management systems and its very long history in the industry. In addition, it has a highly diversified, global customer base.

Final Thoughts & Recommendation

In total, we forecast Xerox producing 12.2% annual total returns in the coming years, which is double our last update. The yield will contribute 7.1%, but growth could be modest, aided by a 2.2% valuation tailwind. The stock is now undervalued in our view with a massive yield, but with a deteriorating earnings outlook. We're boosting the stock from hold to buy after Q1 results.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	12,679	11,465	10,771	9,991	9,662	9,066	7,022	7,038	7,107	6,886
Gross Profit	5,110	4,582	4,305	4,071	3,869	3,650	2,626	2,403	2,318	2,314
Gross Margin	40.3%	40.0%	40.0%	40.7%	40.0%	40.3%	37.4%	34.1%	32.6%	33.6%
SG&A Exp.	3,133	2,865	2,636	2,514	2,379	2,085	1,851	1,718	1,760	1,696
D&A Exp.	639	590	563	527	526	430	368	327	270	251
Operating Profit	1,381	1,146	1,148	1,080	1,045	1,147	417	320	212	346
Op. Margin	10.9%	10.0%	10.7%	10.8%	10.8%	12.7%	5.9%	4.5%	3.0%	5.0%
Net Profit	1,013	448	(471)	195	361	1,353	192	(455)	(322)	1
Net Margin	8.0%	3.9%	-4.4%	2.0%	3.7%	14.9%	2.7%	-6.5%	-4.5%	0.0%
Free Cash Flow	1,887	1,463	660	(372)	1,050	1,268	474	561	102	649
Income Tax	198	193	62	468	247	179	64	(17)	(3)	(29)

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	27,658	25,541	18,051	15,946	14,874	15,047	14,741	13,223	11,543	10,023
Cash & Equivalents	1,411	1,228	2,223	1,293	1,081	2,740	2,625	1,840	1,045	519
Acc. Receivable	2,531	838	741	1,160	1,097	1,091	834	912	2,011	1,763
Inventories	934	901	841	915	829	694	843	696	797	661
Goodwill & Int.	11,577	4,291	4,077	4,407	4,232	4,221	4,426	3,498	3,028	2,924
Total Liabilities	16,556	16,075	13,090	10,439	9,621	9,239	8,931	8,556	8,180	7,465
Accounts Payable	1,584	1,342	1,126	1,108	1,073	1,053	983	1,069	1,331	1,044
Long-Term Debt	7,741	7,279	6,316	5,517	5,230	4,282	4,444	4,246	3,726	3,277
Total Equity	10,678	9,074	4,709	5,256	5,005	5,587	5,592	4,436	3,343	2,538
LTD/E Ratio	0.70	0.77	1.28	1.01	1.00	0.74	0.77	0.91	1.11	1.29

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	3.6%	1.7%	-2.2%	1.1%	2.3%	9.0%	1.3%	-3.3%	-2.6%	0.01%
Return on Equity	8.8%	4.5%	-6.8%	3.9%	7.0%	25.5%	3.4%	-9.1%	-8.3%	0.03%
ROIC	5.1%	2.5%	-3.4%	1.7%	3.4%	13.2%	1.9%	-4.7%	-4.0%	0.02%
Shares Out.	279	253	254	255	230	213	198	159	156	149
Revenue/Share	43.29	42.61	42.08	38.94	38.39	38.88	33.21	38.42	45.56	46.18
FCF/Share	6.44	5.44	2.58	(1.45)	4.17	5.44	2.24	3.06	0.65	4.35

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.