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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Unisys Corporation Third Quarter 2022 Earnings Conference Call. All participants will be in a listen-only mode today. [Operator Instructions] After today's presentation, there'll be an opportunity to ask questions. [Operator Instructions] Please note that this event is being recorded today.

I would now like to turn the conference over to Ed Yuen, Investor Relations. Please go ahead.

Ed Yuen

Investor Relations, Unisys Corp.

Thank you, operator. Good morning, everyone. Thank you for joining us. Yesterday afternoon, Unisys released its third quarter 2022 financial results. I'm joined this morning to discuss those results by Peter Altabef, our Chair and CEO; Deb McCann, our CFO; and Mike Thomson, our COO, who will participate in the Q&A session.

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 presentation slides that we'll be using this morning to guide our discussion, as well as other information relating to our third quarter performance on our Investor Relations website, which we encourage you to visit. Third, today's presentation, which is complimentary 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 have provided reconciliations within the presentation.

I would also like to remind you that all forward-looking statements made during this conference call, including any references to guidance or call regarding expected future financial performance, are subject to various risks and uncertainties that could cause actual results to differ materially from our expectations. These factors are discussed more fully in the earnings release and the company's SEC filings. Copies of those SEC reports are available from the SEC and along with other materials I mentioned earlier on Unisys Investor website. Unisys does not assume any obligation to update the information presented on this call, except as Unisys deems necessary and then only in a manner that complies with regulation FD.

With that, I'd like to turn the call over to Peter.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Ed. Good morning, everyone, and thank you for joining us to discuss our third quarter results. We continue to make progress in shifting our business to higher value solutions in the high demand focus areas of Modern Workplace and Digital Platforms and Applications. Clients are seeing the value of our solutions in these focus areas, as evidenced by revenue growth approximately at or above in both of them. Our focus area solutions are also higher margin, an indicator of increased profitability over time.

As we discussed last quarter, we are providing more visibility into our Enterprise Computing Solutions segment, ECS, by differentiating our Specialized Services and Next Generation Compute solutions from our Licenses and Support, which will allow us to highlight each of their unique strengths. Our transformation is beginning to take hold. It will soon be fortified by a new brand identity and marketing campaign designed to increase awareness for our company and our key solutions. We believe this platform will influence consideration in the market and be a catalyst for growth.

Deb will provide detail on our financial results at the total company and segment levels. But, first, I'll give some insight into our transformation. Let's start with Digital Workplace Solutions or DWS. Our primary focus in DWS is on higher-growth, higher-margin solutions that help clients streamline and optimize collaboration to maximize employee productivity and engagement. And we refer to this as Modern Workplace.

We believe the Modern Workplace market is an approximately $40 billion market growing at a three-year compound annual growth rate CAGR of approximately 12%. We said last quarter that we plan to grow faster than the market and we did just that in the third quarter, driving revenue growth in excess of 50% year-over-year.

We also accelerated our Modern Workplace momentum in the quarter by securing a year-over-year increase in total contract value, or TCV, of signings of more than 50% and a year-over-year increase in annual contract value, or ACV, of signings of more than 50%.

An example of success in Modern Workplace is the expansion of our work in the third quarter of a large financial institution to provide digital workplace solution. This contract will help improve communication and collaboration between teams regardless of location. We also signed more than 20 new logos in Modern Workplace for specific scope solutions, which in time can lead to full service relationships.

Wins like these are helping shift our business mix toward Modern Workplace, which we expect to represent approximately 15% of DWS revenue in 2022 versus 7% for last year. We expect approximately half of our DWS revenues to be in Modern Workplace in 2025.

As we look to the future, our pipeline for Modern Workplace is more than $400 million as of the end of the third quarter, more than doubling year-over-year. We expect the margin in Modern Workplace to be in the mid-20% range by 2025. The more we move our DWS portfolio to Modern Workplace, the more profitable we expect to become.

We earned significant recognition in Modern Workplace from a leading industry analyst in the third quarter. ISG recognize Unisys as a global leader for every services quadrant in its 2022 Future of Work Provider Lens. We also continue to build partnerships with key players in the Modern Workplace market. For example, in the third quarter, we signed a new logo client through the partnership we recently announced with 1E. We feel very good about the prospects for this partnership.

In short, our Modern Workplace strategy is working. Our solutions align to a fast-growing and higher margin market, and one in which we are positioned to take share.

Turning to Cloud, Applications & Infrastructure Solutions, or CA&I, we continue to shift the mix of our CA&I business toward solutions in hybrid and multi-cloud management, cybersecurity, application modernization, cloud-native application development, and data analytics and insights. We refer to this focus area as Digital Platforms and Applications, or DP&A. This is the higher growth, higher value piece of our CA&I business. We believe the DP&A market is approximately $230 billion, growing at a three-year CAGR of approximately 19%. In general, we expect to grow this business as fast as the market over the next three years.

From a revenue perspective, in the third quarter, we saw a year-over-year revenue growth for DP&A of 18%. We expect DP&A to represent approximately 30% of CA&I revenue in 2022 versus 20% for 2021. We expect approximately 40% of our CA&I revenue to be in DP&A in 2025.

Clients are seeing the value of our DP&A solutions was also evidenced by more than 100% year-over-year growth in signings for ACV and more than 50% year-over-year growth in TCV signings for this focus area in the third quarter. Our DP&A pipeline is also growing. It was more than $800 million in the third quarter, a year-over-year increase of more than 50%.

As a third quarter example of success in this area, we signed a DP&A contract with a current DWS client that engineers consumer product goods. This contract enables Unisys to deliver and support secure access through Microsoft Azure to the client's domain including enterprise applications, an excellent example of what we call cross-selling.

Regarding profitability, we anticipate our DP&A margin to be in the mid 20% range in 2025. Again, as with Modern Workplace, the more we move our CA&I portfolio to DP&A, the more profitable we expect to become. The market continues to recognize our leadership and momentum in this area as well.

For example, during the quarter, industry analyst firm NelsonHall recognized us as a leader in its End-to-End Cloud Infrastructure Management Services 2022 report. Unisys was named as a leader in each of the report's five focus areas: Microsoft Azure capabilities, cloud orchestration services, cloud management services, AWS capabilities and overall capabilities.

In addition, our CA&I team has just achieved the AWS migration competency designation. To earn this designation, one must demonstrate deep AWS technical experience and proven client success in specialized areas across industries, used cases and workloads. AWS validates candidates against a high bar to achieve this designation and we expect it will accelerate our momentum in DP&A.

As we did with DWS and CA&I last quarter, we are introducing a new focus area for ECS this quarter in order to provide additional insight into our business. We call it Specialized Services and Next Generation Compute or

SS&C. This focus area covers managed application services, managed services, industry solutions and overall compute capabilities in each instance where we have significant intellectual property.

One area we are excited about within SS&C is our air cargo industry solution. We continue to provide comprehensive and robust air cargo management to our clients as we have for many years. We expect to enhance value for existing clients and attract new clients through the deployment of richer data analytics capabilities to further improve efficiency in cargo operations.

SS&C is already a $200-million annual revenue business. This represents approximately 30% of ECS revenue. But this percentage is more likely to fluctuate based on the size of the license and support business in any given quarter. We expect to grow the SS&C business between mid and high-single digits annually through 2025. Our margin in SS&C can also fluctuate depending on the mix of what we sell, but we expect it to be typically in the low-to-mid 30% range.

The remaining portion of ECS is Licenses and Support, or L&S, which is the part of our business that consists of ClearPath Forward and some other IP-related licenses and support. This is the portion of this segment that typically gets more attention in conversations with you because it's larger. But given its dependence on the timing of renewal schedules, it is more variable quarter-to-quarter and even year-to-year.

The market for our L&S business is unchanged and we do not expect significant growth. While it is possible that new capabilities and solutions could be classified and commercialized in a more traditional licensing model, we believe it is much more likely that we will drive growth in a services or as-a-service model as part of SS&C.

In the third quarter, L&S revenue was down 12.7% due to the timing of license renewals. Given the heavily weighted renewal schedule we saw in 2020 and in 2021, coupled with some client-driven early renewals in 2022 that were scheduled for 2023, we expect 2023 revenue will be down approximately 25% year-over-year. Based on the current renewal schedule, we expect 2024 to grow in the low-single digits with 2025 to grow low-double digits. With 2020 as its base, we expect a five-year CAGR of approximately negative 3.5%.

On the profit side, the margin percentage for L&S will fluctuate based on the volume because of a relatively fixed cost base. We expect margin in the mid-70% this year, approximately in the mid-60% in the next two years, and then returning to the low-70% by 2025. It is clear that SS&C and L&S have unique strengths, and we're pleased to be able to highlight them for you going forward; both are important for our business.

Moving to our brand identity, we expect the launch will occur in the fourth quarter of this year. Brand is the last mile of our transformation and the new brand will bring our solutions to life in a meaningful, compelling way. We believe our new marketing campaign will increase market awareness, which in turn will help drive key sales metrics such as leads, pipeline, wins, and ultimately revenue and margin. The new identity addresses how we help clients meet the changing needs of the market, while also serving as a key influential factor in our ability to retain, attract, and inspire talent.

This is the most significant brand transformation for the company since 1986. We are very excited about it and we believe the market will be too. The Unisys transformation is taking hold. At the same time, we experienced some unexpected challenges since the last earnings call that have led us to lower our revenue and profitability guidance for the year which Deb will provide color on in her remarks.

With that, I'll turn the call over to Deb to discuss our financial results.

Debra McCann

Chief Financial Officer & Executive Vice President, Unisys Corp.

Thank you, Peter, and good morning, everyone. In my discussion today, I will refer to both GAAP and non-GAAP results. As a reminder, reconciliations of these metrics are available in our earnings materials. Additionally, I will provide total company revenue on an as reported basis as well as in constant currency. I will provide segment level revenue on a constant currency basis.

I will now provide insight into our third quarter results. I will also highlight the changes in our guidance and provide an update on our defined benefit pension plans. As we look across the company, the transformation of our solution portfolio and go-to-market approach drove improvements in leading revenue indicators in the third quarter.

Qualified pipeline is approximately $6 billion representing growth of 25% year-over-year. Annual contract value, or ACV, in the quarter was up 20% year-over-year primarily driven by new business ACV growth of 41%. As we've mentioned before, we believe ACV remains a more informative metric than TCV for our business given the reduction in average length of contracts and clients preferences to move to SaaS-based offerings that we have seen in our industry.

Total contract value in the quarter was up 31% year-over-year. Backlog was down 1.9% sequentially, up 2% excluding foreign exchange. Total company revenue was $461 million in the quarter which was down 5.5% year-over-year and up 0.3% in constant currency. Foreign exchange had a 5.8% negative impact on our revenue this quarter.

The constant currency growth was primarily driven by revenue in our focus areas in Modern Workplace and Digital Platforms and Applications, and partially offset by the impact of non-strategic traditional workplace contracts exited in 2021 as part of the transformation that Peter described. Excluding the impact of these non-strategic contracts, total company revenue grew 4.7% in constant currency.

Now, I'll move to our segments, starting with Digital Workplace Solutions. DWS revenue declined 4%, primarily due to an approximately $20 million impact from non-strategic contracts exited in 2021. Excluding these, DWS grew 12.2%. The exited contracts will impact the fourth quarter by approximately $12 million. Revenue grew 5.4% sequentially, which demonstrated continued progress in the DWS business. We expect to see continued sequential growth in Q4. We are encouraged that we continue signing new logo contracts for our Modern Workplace solutions, as it highlights our ability to shift to the higher growth, higher aspect of the industry.

CA&I revenue in the third quarter was 8.1% year-over-year driven by growth in DP&A. We expect to see constant currency growth both year-over-year and sequentially for the fourth quarter. For ECS, the third quarter was a light ClearPath Forward license renewal quarter, which drove a 3% year-over-year decline. As a reminder, the majority of ECS revenue timing depends on the number and size of contracts up for renewal each quarter as opposed to renewal rates themselves which remain over 95%. Q4 will realize more license renewals resulting in positive year-over-year growth in that quarter. We still anticipate full year 2022 revenue to be down low-single digits year-over-year for total ECS.

I will now discuss the changes in our revenue guidance. Despite seeing positive momentum and encouraging leading indicators in our key focus areas this quarter, we also experienced some unexpected challenges since the last earnings call. A majority of these challenges were macroeconomic in nature, including foreign exchange and existing client budget constraints and economic impact that caused some renewal delays or in some cases, reduction in scope. Two of these challenges were client-specific, one for the modification of scope for client project and another for an existing client that shifted its new scope expansion to a SaaS contract which provides a more steady stream of revenue over time, but less upfront revenue in 2022 than we had anticipated.

Similar to the challenges in our existing client base, we are experiencing an impact in our revenue estimations related to new logo signing delays. These have led us to lower our revenue growth guidance for the year to negative 1% to positive 1% growth on a constant currency basis or from negative 5.5% to negative 3.5% as reported.

Moving to profitability, total company gross profit margin was down 340 basis points year-over-year to 22.6% versus 26% in the prior-year period, primarily because we had more ClearPath Forward license renewals in the third quarter of last year versus this year.

Now, moving to the segment level, again, starting with DWS, our efforts to drive productivity expanded DWS's margin by 270 basis points year-over-year from 12.4% to 15.1%. This was an improvement of 210 basis points sequentially. We expect productivity improvements to continue and more efficient staffing models, stabilizing cost of labor, and our ongoing mix shifts to drive improvement in DWS margin both year-over-year and sequentially in the fourth quarter.

Moving to CA&I, margin was 5.6% versus 5.9% in the prior-year period. As we increase awareness of our capabilities in CA&I, we expect profitability upside both year-over-year and sequentially for the fourth quarter as we continue to execute labor and asset productivity improvements.

ECS margin was down 650 basis points year-over-year primarily because we have more ClearPath renewals in Q3 last year versus this year. As a reminder, ECS costs are relatively fixed both year-to-year and throughout the year given that the key components of costs are the labor to support the platform and the amortization of software development costs. So, the timing of license renewals has an impact on profitability.

Total company non-GAAP operating profit margin was 3.1%, down 260 basis points year-over-year, primarily because we had more ClearPath forward renewals in Q3 last year versus this year. Adjusted EBITDA margin was 11.4%, down 390 basis points year-over-year. We expect non-GAAP operating profit and adjusted EBITDA margin to be up year-over-year in the fourth quarter, driven by automation and labor productivity improvements and higher ECS license revenue.

Based on the revised revenue guidance and ongoing economic pressures, we are revising our full-year non-GAAP operating profit margin guidance to 6% to 8% and adjusted EBITDA margin guidance to 14.5% to 16.5%.

We reported a net loss of $40.1 million or $0.59 per diluted share versus a net loss of $18.7 million or $0.28 per diluted share in the prior-year period, primarily driven by timing of ClearPath Forward renewals. One-time charges related to cost reduction activities and other nonrecurring expenses, in part offset by a tax benefit due to the partial reversal of valuation allowance. Non-GAAP net income was $3.1 million or $0.05 per diluted share versus $6.9 million or $0.10 per diluted share in the prior-year period.

With regards to fourth quarter expectations, we plan to implement a cost reduction program to further improve our cost structure, continue to right-size our real estate footprint to accommodate our hybrid working environment, and write-off certain assets for which we expect to take a pre-tax charge between $50 million and $60 million in the fourth quarter.

Turning to cash flow, third quarter free cash flow was $23.8 million, down $15.6 million year-over-year, impacted by lower adjusted EBITDA and changes in working capital. We continue to expect to be free cash flow positive this year. We now anticipate a range of $5 million to $25 million for the full year. Also, we expect capital expenditures to be between $85 million and $95 million. For the fourth quarter, free cash flow is highly dependent on the timing of ECS license renewals, which earn revenue and typically collect cash in the same quarter. We had a cash balance of $351 million as of the end of the third quarter, which is above our working capital needs.

I will now turn to our defined benefit pension plan. During each year-end, Unisys reports its estimated US qualified defined benefit pension plan cash contributions based on expected asset returns and funding discount rates as of that year-end, while noting that the future funding requirements are likely to change based on, among other items, market conditions and changes in discount rates.

We reported during our full-year 2021 earnings call that we did not anticipate required contributions for our qualified US-defined benefit pension plans for at least the next 10 years. However, given the material deterioration in the capital markets since December 31, 2021, we are providing you with an interim estimate based on the September 30, 2022 market conditions that has become increasingly likely that contributions to the US qualified defined benefit pension plans will be required during this 10-year period.

Our current estimates are based upon updated plan assets and estimated discount rates as of September 30, 2022, but do not incorporate updates to any of the actuarial assumptions such as expected return on assets, projected future interest rates or mortality, along with several other actuarial assumptions which are updated only at year end. While no contributions are expected in 2023 or 2024 to the US-qualified benefit pension plans, we currently estimate cash contributions to these plans will be required beginning in 2025. The markets can significantly change between now and 2025 when payments are expected to begin and continue through 2032, the end of our estimate period. However, for the US-qualified defined benefit plans, we estimate that starting in 2025, annual contributions for each of the subsequent eight years will average approximately $100 million for these plans.

Please note that these contributions are in addition to the other defined benefit plan funding requirements which are still estimated to average approximately $30 million per year for each of the next 10 years. As we always do, we continue to work closely with our actuaries to assess pension liability reduction transaction opportunities.

Now, let's turn to GAAP-defined benefit pension plan liabilities. Rising interest rates result in lower GAAP-defined benefit pension plan liabilities. Accordingly, the US GAAP-estimated defined benefit pension deficit this year to-date has narrowed as the increase in interest rates reduced our estimate of the defined benefit pension liability to a greater degree than the decline in assets. We estimate a total GAAP deficit liability reduction of almost $100 million from the $750 million deficit reported at the end of 2021. At the year-end, we will provide an update to all these estimates based on final asset values and actuarial estimates at that time and we plan to return to our annual update cadence thereafter.

I also want to speak to the Form 12b-25 that Unisys filed yesterday and mentioned in our earnings press release. The audit and finance committee of our board is conducting an internal investigation regarding certain disclosure controls, procedures matters including, but not limited to, the dissemination and communication of information within certain parts of the organization. Due to the ongoing investigation, which as we disclosed in the filing, may determine there are one or more material weaknesses in Unisys' internal control over financial reporting, Unisys requires additional time to file our third quarter 10-Q; and as such, filed the 12b-25.

Importantly, we do not expect the investigation to result in any changes to the results in the financial statements we released yesterday or any previous financial statements. We are working to complete these processes as soon as possible, but do not expect to be in a position to file the Form 10-Q within five calendar days of the prescribed due date.

As Peter noted upfront, despite setbacks primarily driven by macroeconomic conditions, we continue to make progress in shifting revenue through our higher-value solutions in the high-demand focus areas of Modern Workplace and Digital Platforms and Applications that we introduced last quarter. Clients are seeing the value of our solutions in these focus areas, as evidenced by revenue growth approximately at or above market in each of them, our focus area solutions, are higher margin, an indicator of increased profitability over time.

With that, I'll turn the call back over to Peter. Peter?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Deb. I would note that for the Q&A session, in addition to Deb and myself, we are joined today by Chief Operating Officer, Mike Thomson. The three of us will be pleased to respond to any questions you may have. Joe, would you please open the call for questions?

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question here will come from Anja Soderstrom with Sidoti. Please go ahead.

Anja Soderstrom Q

Analyst, Sidoti & Company, LLC

Hi and thank you for taking my questions. So, first, I'm just curious about the slowdown in the revenue guidance. Are you seeing the customers delaying contracts or are they rather taking smaller contracts or what are you seeing there?

Peter A. Altabef A

Chair & Chief Executive Officer, Unisys Corp.

So, Anja, let me answer that. And obviously, Deb and Mike can join in. It's a little bit of both. We have seen some contracts. We saw one contract which we expected to sign in the third quarter. We now expect it to sign in the fourth quarter; so that's a slippage. We've seen some contracts that, really, I think because of the economic uncertainty out there, have come in a little smaller than we expected. And we've actually seen the makeup of some contracts change. So, for instance, Deb mentioned a contract which actually we thought was going to be a license contract. And instead, working with the client and what the client really wanted to get out of that, it has become more of a SaaS contract. So, that will be paid over time and we'll recognize the revenue over time instead of recognizing the revenue upfront. So, it's a little bit about all of that. I defer to Mike for a little more answer there.

Michael M. Thomson A

President & Chief Operating Officer, Unisys Corp.

Yeah, no, Peter, I think you've hit on all of the pertinent points there. I'd say, Anja, that from a market-facing perspective, we've been very happy with the engagement of the client base. And in general, I think, I would characterize it as more of a deferral than anything else. The pipeline remains strong. The conversations continue. And as Peter mentioned, with the exception of a couple contracts where the scope was de-scoped slightly, we've seen others that have actually increased their scope, right? So, I think there is a good mix out there and I really think it's a lot more macroeconomic concerns than it is anything to do with solutions.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Anja, thank you for the question.

Anja Soderstrom
Analyst, Sidoti & Company, LLC

Q

Okay. Also just curious, how much of the guidance revision is due to currency versus this contract pivoting?

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Yes. So, thank you for the question. The foreign exchange had about 100-basis-point impact on the as reported revenue guidance.

Anja Soderstrom
Analyst, Sidoti & Company, LLC

Q

Okay. Thank you. And can you also talk to the verticals? Where do you see most challenges, if any? Are there any stand out there or any verticals that are holding up better than others?

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

I'm sorry. Can you repeat the question? I couldn't hear what you were asking.

Anja Soderstrom
Analyst, Sidoti & Company, LLC

Q

Is there anything you can comment based on the verticals you serve?

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

You seem to be cutting...

Anja Soderstrom
Analyst, Sidoti & Company, LLC

Q

Any verticals that are better than others?

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

The verticals are you saying? I'm sorry.

Anja Soderstrom
Analyst, Sidoti & Company, LLC

Q

Or end-markets?

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Okay.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. What I would say there is none come to mind as specifically either higher or lower than expectations. Mike, anything there?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. No, look, I don't see any differentiation, frankly, Anja, in the verticals. I think the demand and the margin profile that we've been able to maintain and actually improve, has been pretty consistent. So, I wouldn't say any one stands out, to be honest.

Anja Soderstrom
Analyst, Sidoti & Company, LLC

Q

Okay. Thank you. That was all for me.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Thanks, Anja.

Operator: Our next question will come from Rod Bourgeois with DeepDive Equity Research. Please go ahead.

Rod Bourgeois
Analyst, DeepDive Equity Research

Q

Hey, guys. So, it makes sense that macro is having impact on some of your deal activity and your pipeline commentary sounds good. You seem encouraged about what you're seeing in the pipe, and also even in your recent signings. But I want to ask, in the pipeline, has the pipeline become more ripe in terms of the deals that are immediately in front of you in the upcoming months, or is the pipe becoming more back-loaded, or any other noteworthy changes in the composition of the pipe as you're wrestling with some of these macro things?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Hey, Rod, it's Mike. I'll take that one. Thanks for the question. No, I would say, Rod, the pipeline is actually more ripe. We're really encouraged, as you mentioned, about the increase in TCV and in backlog and in pipeline in general. And again, I think in actually both of our focus areas, we had significant growth. And so, not only is it ripe in the sense of volume; I think it's ripe in the sense of the types of deals that we want to pursue, and I think the client expectations of us, which is great, we're having the dialogues we want to have, which is about Modern Workplace and about DP&A. So, not only ripe in volume but I think rich in the quality of what's in there.

Rod Bourgeois
Analyst, DeepDive Equity Research

Q

Okay. And then, you mentioned a cost reduction plan for the fourth quarter. And I guess I'm wondering is can you talk a little more about the latest cost reduction plan? Is that plan overall more aggressive today than it would have been three months ago due to the macro challenges that you're seeing or are there other factors that are causing you to sort of update your cost reduction plan?

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Yeah. Thanks for the question. I mean, as you know, we're always evaluating opportunities to further reduce our cost structure. But you're right in that there is some impact from the macro as well, but we are always looking at that. As far as the impact, about 35% or about a third is related to real estate rightsizing, about 40% asset retirement, and then the balance to workforce actions.

Rod Bourgeois
Analyst, DeepDive Equity Research

Q

Okay. Got it. And then just a final one on the clarification side, it was helpful that you provided some outlooks even in terms of some of the growth opportunities and the mix changes through 2025. In your ECS business, I think you mentioned your ClearPath Forward licensing model. And I just want to ask about any changes that you've considered to your licensing model and any color on that would be very helpful.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. So, Rod, this is Peter. Again, thanks for all of the questions. So, as we have segmented those two areas between SS&C and L&S, L&S is licensing and support. So, that licensing model is in the L&S piece of that segment. Historically, much of the ClearPath Forward revenue has come from Licenses and Support. It's always possible and we're always open to clients moving to a more as-a-service model. As they move to a more as-a-service model, you could see revenue moving out of L&S which is a type of contract to SS&C, which is where we have the as-a-service. I don't think – and that's been true for years and years.

The nature of our clients is such. If you think about large banks, think about governments, they're sensitive to the time value of money, which means that they tend to have lower cost of capital than we do, which means they're not too interested in deferring always in the way a commercial client might be to get to more of a SaaS pricing model. That doesn't mean it can't happen. Government changes and financial services change; so we're always open to that. It's part of our offering set and has been for a long time. And so, I guess, we'll have to see if much of that changes over time.

Rod Bourgeois
Analyst, DeepDive Equity Research

Q

Got it. Thank you.

Operator: Our next question will come from Joseph Vafi with Canaccord. Please go ahead.

Joseph Vafi
Analyst, Canaccord Genuity LLC

Q

Hey, guys. Good morning and thanks for the extra segment color. Just a thought maybe, turning to your rebranding or your reinvigorated brand campaign, any thoughts there on perhaps delaying that given the macro or how did the macro play into your decision here to keep moving forward that because obviously there's a cost there, too? And then I have a follow-up.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah, Joe, really, thanks very much for the question. It's a really interesting question and I want to use your question to just make sure everybody understands what we're actually doing with this new branding and marketing campaign. I mentioned that it is the most important one, I believe, we have done since 1986.

In 1986, the Unisys' name came into place. That was a merger of the old Burroughs and the old Sperry Rand. We are not going to change the name of Unisys. So, we're keeping the Unisys name. We have done a lot of research about the Unisys name and that name has equity. That name has value. What this campaign will really do we'll attach more meaning to the name and more association with our specific modern solutions and the name.

Now, with respect to your specific question about timing, we have worked throughout really the last – we were out this for I think 15 months. And we have been working on when the right timing would be. I mentioned in my remarks that we expect to launch in the fourth quarter. That is still our expectation. Whether we might change that or not, is up to us. But as we sit here, we're still expecting to launch in the fourth quarter. Mike, any thoughts on that?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Hey, Joe, thanks for the question. I would – I mean, I'm in the camp of not delaying and it's not so much about the cost aspect of it, Joe. But, as Peter mentioned, this has been part of our strategy really since early 2021. The connection to the selling, the connection to the industry analysts, the connection to the third-party advisors, all of that is intertwined here, right. So, we've been prepping this for a long time. It is a catalyst for continued growth. And granted, the macro economic conditions are what they are. But the services that we provide actually provide benefits to our clients that we think will help in the macroeconomic scenario that we're in. So, to me, it's all hands forward here. I think it is a real important aspect of our strategy and, as Peter mentioned, kind of the last mile to pull all this together. And I know from an internal perspective, we're super excited about it.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah, and just to add one more comment onto that if I could, Joe, I had mentioned in my remarks there are two elements to this. One element is all of the stuff that Mike just covered: clients, prospective clients, third party advisors, analysts, industry experts. We think that this will appeal to them. The other aspect of this is people. And by that, I mean people who currently work at the company, people who would be attracted to work at the company. We really think that this will enhance the value of Unisys as a place to work and that people who are considering whether to join the company will be more likely to and people who are at the company will frankly be more likely to stay. So, there is a people element to this that we're also very excited about. And as Mike said, we've been previewing this with some focus area groups, both internally and externally. And I got to tell you, the reaction has been incredibly positive. So, we're looking forward to it.

Joseph Vafi
Analyst, Canaccord Genuity LLC

Q

Yeah, that's great. I'm looking forward to seeing it myself. And then maybe just one follow-up. I know you've exited some contracts that you deemed not profitable enough to continue last year. Is there any risk that perhaps the macro kind of results in more of those types of contracts evolving here or popping their head up on some renewals as you look into next year if the macro is still a tough environment? Thanks, guys.

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.
A

Hey. Thanks, Joe. Look, we obviously look very closely at our renewal schedule. There are only two contracts of that ilk coming up in the remainder of this year as far as renewal schedule is concerned. Both are extremely positive dialogs right now, so we expect no impact of anything like that.

Looking out a year to the entire renewal schedule for next year, again, nothing on the horizon, Joe, that gives us concern in regards to those contracts. So, pricing power has been steady and we've been comfortable with the relationships that we've got in that area. So, I would say, at least for the next 12 to 16 months or so in that renewal cycle, we're not seeing anything that gives us concern.

Joseph Vafi
Analyst, Canaccord Genuity LLC
Q

Great. Thanks, Mike. Thanks, everyone, for taking my questions.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.
A

Thank you, Joe.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.
A

Thanks, Joe.

Operator: Our next question will come from Jon Tanwanteng with CJS Securities. Please go ahead.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.
Q

Hi. Good morning. Thanks for taking my questions. I was wondering if you could talk about the headwinds to your growth expectations in DWS and CA&I a little bit more. How much of that, I guess, weaker uptake is a slower-than-expected ramp on contracts that have already been signed? You've obviously had strong ACV over the past couple of quarters. I'm just wondering what the disconnect is there.

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.
A

Yeah. Jon, how are you doing? It's Mike. I wouldn't say – you used the term uptake, I don't think it's really much to do with contracts already signed. The volumes that we see for the contracts we're working is really been no different. In fact, we've seen some increases. What we're seeing is kind of new logo contracts being delayed and pushed out to another quarter, right? So, I think it's more a deferral of decision-making or what we're seeing is even on the renewable cycle, instead of necessarily renewing for the full term of three or five years, maybe it's a one year extension on the backs of a contract we already have. And in that case, perhaps even a little bit of de-scoping.

But I mean if you think about our strategy in general, we're actually bringing to market solutions that are providing value to the client. And so, our dialogue is about how they can actually end up paying even a higher margin and saving money because of ultimately what we're doing from a productivity perspective through the experience play, specifically in DWS. So, I wouldn't say it's anything to do with uptake on the existing base, more a deferral of decision-making. And again, I think that's something we're seeing industry wide.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Okay. Understood. And are the margins on new the signings where you want them today?

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Yes, we've been pleased with the margins we're getting, especially as we are moving more towards those higher-value Modern Workplace and DP&A.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Got it. One last one, just any thoughts on your long term-targets and your ability to drive free cash flow and earnings, just especially with the new, I guess, the preliminary expectations for the pension and contributions that you need to make.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. So, that's a great question, Jon. This is Peter. What we tried to do in these remarks was to really highlight kind of our growth expectations around those focus areas. And now, we have three, right? Like we told you last quarter, we were going to add one from ECS and now we have. So, we've kind of highlighted our expectation through 2025 with those focus areas.

We've tried to highlight what we expect in terms of margin as well as revenue in those focus areas. We do expect in the first quarter of next year to have a full Investor Day. And so, we do expect to go beyond just talking about those three focus areas and really giving our view of the company as a whole going out three years or so. So, you can put that on your calendar for some time in the first quarter of 2023.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Okay. Great. Thank you. I'll jump back in the queue.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Thanks, Jon.

Operator: [Operator Instructions] Our next question here will come from Matthew Galinko with Maxim Group. Please go ahead.

Matthew Galinko
Analyst, Maxim Group LLC

Q

Hey. Good morning. Thanks for taking my questions. Can we start with – I think you touched on the labor environment, but can you go a little bit more at the depth of how you see that rolling into your plans and expectations for 2023?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. Matt, thanks very much for the question. So, our voluntary attrition is down slightly in the third quarter. So, our voluntary attrition in the third quarter is 18.9%. That's down about 0.3% sequentially. And that's down really across the board in geographies. I don't think there is any geography that is significantly moving up while the rest is going down. So, the geographies are a little different, but they're all kind of moving slightly down.

I think it's a combination of a couple of things. First, there has been an inflationary development in our sector that has affected our margins, but that does appear to be hitting a contrary act right now, and that contrary act is a view of a recessionary environment, both in geographies, across industries and particularly in the tech industry. So, rather than earlier this year, where there was just kind of one force, which was inflation, there's kind of a push me pull you now, and you kind of have two different forces going against each other. And I think that that is a more – and the result of that is you're seeing a decrease in attrition, you're seeing a decrease in some of the wage pressure, you're seeing an increased understanding about the value of actually staying with the company. And so, we're seeing a modest decrease in attrition because of that.

Outside those macro environments, we have been very focused as a company, at really increasing our sense of community and belonging. We've really worked pretty hard, not just this year, but I'd say over the past couple of years of really creating an identity of what it means to be part of Unisys, why you would want to join, why you would want to stay. You noticed in the question about branding, I was very quick to say this is not just about clients and prospective clients, although it is, and it is not just about third-party administrators or advisors and analyst, although it is, it's also about our people. It's about making our people really feel part of something they're excited about. And we think that the new branding and marketing will help that. But again, that's not overnight. That's been in the works for a long time. So, we're working all angles to that. I hope, Matt, that that's helpful for you. It's certainly important to us.

Matthew Galinko
Analyst, Maxim Group LLC

Q

Yeah, Peter. Thank you. That was very helpful. I guess my follow-up question would be I think you talked about one cross-sell or sizable cross-sell. I think that went from DWS to CA&I but can you go back and maybe cover what the genesis of the cross-sell was? How you identify opportunities to cross-sell and what the pipeline looks like for those sorts of deals?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Hey, Matt. It's Mike. I'll take that one. Thank you for the question. Look, I think, in general, if we talk about cross-sell, we're really talking about across BU embedded and it's primarily between CA&I and DWS. If I look at the data set, roughly about 30% of our business is already in a cross-sell arena. So, when we look at our client base and we look at white space opportunities, clearly, if I'm looking at the white space on an existing DWS client, the cross-sell opportunity is in CA&I.

And we specifically have, I'll say, early entry offerings in either of those scenarios, right? So, if you're an existing CA&I client, we have early entry offerings in DWS and vice-versa. So, the targeted approach is really generated at the client level through white space looking at what we're doing well and what the entry, I'll say, offering is for the cross-sell opportunity.

As you well know, that cross-sell opportunity creates a better margin profile, a stickier client, and a happier client, right? So, there's a tremendous amount of opportunity embedded in our current client base to continue doing that, considering we've only got 30% penetration that way today. So, we think that's a big part of our strategy going forward.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. And what I would add to that is we've been aware of that for a while. We've obviously been attempting for a while to get clients to use more than one of our business units. We do find, in general, at least the last time we did this analysis and it was a few years ago that we did it, the clients that have more than one business unit tend to be more profitable and tend to be stickier, if you will. But the work we have done this year really has taken that to a new level. And underneath what Mike is talking about and you saw him really rush to answer that question because he's been so involved in that.

So, Mike, do you want to give just a little more update on kind of exactly what we've done really this year, because you say it better than I, about how we really are focusing on that white space?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Yeah, I definitely will. Matt, I want to just give one other color point first. The white space analysis that we've been talking about here is in our existing base. The interesting thing is the new logos that we've been signing throughout the year are coming in multi-BU. I would say at least on top of mind, the last four or five significant ones have all had a piece of those two BUs embedded in them and some even to a third BU.

So, it's really interesting the way we're going to market and the connectivity between our solutions on the new logo side are almost naturally tied so you'd get a multi-BU relationship. And then, it's the deeper focus in the white space analysis for the existing base. And, as I mentioned, I think if you look at something like a cybersecurity offering that is locating rogue assets, that's an easy entry way into an existing DWS client that we want to begin to bring our CA&I offering into, right?

So, there's a real strategy there. It's tailored to the client and what they already have, and also tailored to whatever their renewal schedule looks like and how we want our entry into that client to look like. So, it's a big focus of our selling team. It's a big focus of our client executives and our client delivery executives. And we've got all of those components aligned at this point, right. So, we're really excited about what that can bring for 2023.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Thanks for the question.

Matthew Galinko
Analyst, Maxim Group LLC

Q

Thank you.

Operator: And our next question is a follow-up from Jon Tanwanteng with CJS Securities. Please go ahead.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Hi, guys. I was just wondering about the ECS segment. You mentioned that the license renewals are coming down over the next couple of years. I was wondering how much pricing power you have there just because it seems essential to their businesses to run the systems. Help me understand how you set the pricing every year for this.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. Just to be clear and I'm going to defer to Deb on this, I think we're expecting lower L&S revenue next year, but then slightly higher L&S revenue in 2024 and 2025.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Yes, that's right.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

And I think Deb gave you some specific numbers on that. It really is tied to the expected license renewal cycle and I want to underline the word expected. We don't always know how that's going to work. There are, as we've had this year, some clients that we thought were going to renew next year that are renewing this year. There are so many variables that go into that. We cannot understand all of those in advance, but it's the best we can do.

With respect to pricing power, I think I'll defer that one to Mike. I will say that it is complicated and we think we know the clients pretty well. We think we know the value of what we're bringing to them pretty well. And many of these clients have been our clients for a very long time and we want them to stay our clients for a very long time and we really treat them like an extended relationship. It's not a transactional relationship. But, Mike?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Look, and, Jon, I would say that the pricing has held for sure. In fact, in some cases, we've been able to drive some of that pricing up but I think what Peter just closed there with is this is not a let's gouge the client and go that route. We're actually looking at the penetration to those ClearPath Forward clients in another way. So, not only are we able to maintain the pricing related to the licensing, but we're using that as an entry to talk about application modernization, managed services of applications that are modernized, managed services related to the ClearPath Forward ecosystem, right?

So, there's a lot of other opportunity that we can grow that relationship, again, make it stickier and not have to just deal with it from a perspective of we need to increase price every time. So, I think we've been pretty consistent with the pricing model. We get our normal, I'll say, cost of living increase type of thing. And again, we're really looking at ancillary services as a means to continue to grow that base.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Got it. That's helpful. Did you say what your expectations were for that application and services side just in terms of growth rate?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

We did. And, Deb...

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Yes.

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah, it was low-single digits in 2024 and I think double-digits in 2025 [indiscernible] (00:59:34).

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

I think it was – go ahead, Deb. [indiscernible] (00:59:36).

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Yeah. For revenue, we said we expected it to be about 40% of revenue in 2025. I don't know if we gave a revenue growth rate as well.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

We did.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

We did.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

And so that...

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Oh, yeah. Well, we gave Q3 revenue.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Let me pull that, Matt (sic) [Jon], because it was in my remarks. I just want to make sure that I give it to you exactly.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

It's okay. We can [indiscernible] (01:00:02) follow-up.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

You have the margin, that's mid-20% range.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Hold on. Anybody have that? It's...

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Yes. We said the three-year CAGR was approximately 19% and we expect to grow as fast as...

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

I'm sorry, that's DP&A.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

I though he asked DP&A.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. Matt (sic) [Jon], just a quick clarification, are you asking for the SS&C part of ECS? I thought that's what your question was.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

The non-licensed part.

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yes.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Oh, Okay.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

I'm sorry. I thought you said CA&I.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

And so, for that, because I'm pulling my data out.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

We said we expect it to grow mid- and high-single digits annually through 2025.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

There we go. That's right.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

I apologize, yes.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Yes, got it. Thank you. Sorry for the – my question.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Not at all. There's a lot of...

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

Yeah, we gave a lot of numbers.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

We did.

Debra McCann
Chief Financial Officer & Executive Vice President, Unisys Corp.

A

[indiscernible] (01:01:07) more insight.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

And, again, we're hopeful that by breaking this out and really giving some very specific information on the three focus areas, that that really gives you a good indication of where we are focusing on the company and how we're driving. But it does mean we've got a lot of numbers. And so, I apologize in advance for that, but that is an effort to really provide more information to you.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

No worries. That's all. Thank you.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Peter Altabef for any closing remarks.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

I'd like to thank, everyone, for joining the call. I'd like to thank, particularly, the folks who asked questions that I thought helped us enlighten everybody about the business and how the business is evolving. And I want to welcome everyone to the next call in advance.

And as always, we have a bunch of information on our Investor Relations website and really on our website in general. We put a lot of information on that website, and I will tell you that as we launch the new branding effort and campaign, you will see changes in that website and I think you'll be very inspired by the level of change and the way we're telling our story and some of the information we put on there.

So, I hope you pay some attention to that and you'll know it when you see it. Thanks again for joining us today.

Operator: The conference has now concluded. Thank you very much for attending today's presentation. You may now disconnect your lines.