Third Quarter 2018 Earnings

John Visentin, CEO
Bill Osbourn, CFO

October 23, 2018
http://www.xerox.com/investor

Non-GAAP Financial Measures

We have reported our financial results in accordance with generally accepted accounting principles (GAAP). In addition, we have discussed our financial results using the non-GAAP measures described below. We believe these non-GAAP measures allow investors to better understand the trends in our business and to better understand and compare our results. Accordingly, we believe it is necessary to adjust several reported amounts, determined in accordance with GAAP, to exclude the effects of certain items as well as their related income tax effects.

A reconciliation of these non-GAAP financial measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are set forth below as well as on our website at www.xerox.com/investor.

These non-GAAP financial measures should be viewed in addition to, and not as a substitute for, the company's reported results prepared in accordance with GAAP.

Adjusted Earnings Measures
- Net income and Earnings per share (EPS)
- Effective tax rate

The above measures were adjusted for the following items:

- *Amortization of intangible assets*: The amortization of intangible assets is driven by our acquisition activity which can vary in size, nature and timing as compared to other companies within our industry and from period to period. The use of intangible assets contributed to our revenues earned during the periods presented and will contribute to our future period revenues as well. Amortization of intangible assets will recur in future periods.

- *Restructuring and related costs:* Restructuring and related costs include restructuring and asset impairment charges as well as costs associated with our strategic transformation program beyond those normally included in restructuring and asset impairment charges. Restructuring consists of costs primarily related to severance and benefits paid to employees pursuant to formal restructuring and workforce reduction plans. Asset impairment includes costs incurred for those assets sold, abandoned or made obsolete as a result of our restructuring actions, exiting from a business or other strategic business changes. Additional costs for our strategic transformation program are primarily related to the implementation of strategic actions and initiatives and include third-party professional service costs as well as one-time incremental costs. All of these costs can vary significantly in terms of amount and frequency based on the nature of the actions as well as the changing needs of the business. Accordingly, due to that significant variability, we will exclude these charges since we do not believe they provide meaningful insight into our current or past operating performance nor do we believe they are reflective of our expected future operating expenses as such charges are expected to yield future benefits and savings with respect to our operational performance.

Non-GAAP Financial Measures (cont'd)

- *Non-service retirement-related costs:* Our defined benefit pension and retiree health costs include several elements impacted by changes in plan assets and obligations that are primarily driven by changes in the debt and equity markets as well as those that are predominantly legacy in nature and related to employees who are no longer providing current service to the company (e.g. retirees and ex-employees). These elements include (i) interest cost, (ii) expected return on plan assets, (iii) amortization of prior plan amendments, (iv) amortized actuarial gains/losses and (v) the impacts of any plan settlements/curtailments. Accordingly, we consider these elements of our periodic retirement plan costs to be outside the operational performance of the business or legacy costs and not necessarily indicative of current or future cash flow requirements. This approach is consistent with the classification of these costs as non-operating in other expenses, net as a result of our adoption of ASU 2017-07 - Reporting of Retirement Related Benefit Costs in 2018. Adjusted earnings will continue to include the service cost elements of our retirement costs, which is related to current employee service as well as the cost of our defined contribution plans.

- *Transaction and related costs, net:* Transaction and related costs, net are expenses incurred in connection with Xerox's planned combination transaction with Fuji Xerox, which was terminated in May 2018, as well as costs and expenses related to the previously disclosed settlement agreement reached with certain shareholders and litigation related to the terminated transaction and other shareholder actions. These costs are considered incremental to our normal operating charges and were incurred or are expected to be incurred solely as a result of the planned combination transaction and the related shareholder settlement agreement and litigation. Accordingly, we are excluding these expenses from our Adjusted Earnings Measures in order to evaluate our performance on a comparable basis.

- *Restructuring and other charges - Fuji Xerox*: We also adjust our 25% share of Fuji Xerox's net income for similar items noted above such as Restructuring and related costs and transaction and related costs, net based on the same rationale discussed above.

- *Other discrete, unusual or infrequent items:* In addition, we also excluded the following items given their discrete, unusual or infrequent nature and their impact on our results for the period:
  - 2017 - Loss on early extinguishment of debt in the first quarter of 2017.
  - 2017 - A benefit from the remeasurement of a tax matter in the first quarter of 2017 that related to a previously adjusted item.
  - An additional charge in third quarter 2018 related to a change in the provisional estimated impact from the 2017 Tax Cuts and Jobs Act (the "Tax Act").

We believe the exclusion of these items allows investors to better understand and analyze the results for the period as compared to prior periods and expected future trends in our business.

Non-GAAP Financial Measures (cont’d)

Adjusted Operating Income/Margin

We also calculate and utilize adjusted operating income and margin measures by adjusting our reported pre-tax income and margin amounts. In addition to the costs and expenses noted as adjustments for our Adjusted Earnings measures, adjusted operating income and margin also exclude the remaining amounts included in Other expenses, net, which are primarily non-financing interest expense and certain other non-operating costs and expenses. We exclude these amounts in order to evaluate our current and past operating performance and to better understand the expected future trends in our business. Adjusted operating income and margin also include Equity in net income (loss) of unconsolidated affiliates. Equity in net income (loss) of unconsolidated affiliates primarily reflects our 25% share of Fuji Xerox's net income. We include this amount in our measure of operating income and margin as Fuji Xerox is our primary product supplier and intermediary to the Asia/Pacific market for distribution of Xerox branded products and services.

Constant Currency

To better understand trends in our business, we believe that it is helpful to adjust revenue to exclude the impact of changes in the translation of foreign currencies into U.S. dollars. We refer to this adjusted revenue as “constant currency.” This impact is calculated by translating current period activity in local currency using the comparable prior year period's currency translation rate. This impact is calculated for all countries where the functional currency is the local country currency. The constant currency impact for signings growth is calculated on the basis of plan currency rates. Management believes the constant currency measure provides investors an additional perspective on revenue trends. Currency impact can be determined as the difference between actual growth rates and constant currency growth rates.

Free Cash Flow

To better understand trends in our business, we believe that it is helpful to adjust operating cash flows from continuing operations by subtracting amounts related to capital expenditures. Management believes this measure gives investors an additional perspective on cash flow from operating activities in excess of amounts required for reinvestment. It provides a measure of our ability to fund acquisitions, dividends and share repurchase.

Summary:

Management believes that all of these non-GAAP financial measures provide an additional means of analyzing the current period’s results against the corresponding prior period’s results. However, these non-GAAP financial measures should be viewed in addition to, and not as a substitute for, the company’s reported results prepared in accordance with GAAP. Our non-GAAP financial measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures and should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. Our management regularly uses our supplemental non-GAAP financial measures internally to understand, manage and evaluate our business and make operating decisions. These non-GAAP measures are among the primary factors management uses in planning for and forecasting future periods. Compensation of our executives is based in part on the performance of our business based on these non-GAAP measures.

A reconciliation of these non-GAAP financial measures and the most directly comparable measures calculated and presented in accordance with GAAP are set forth on the following tables:

Net Income and EPS reconciliation

(in millions, except per share amounts)	Three Months Ended September 30, 2018		Three Months Ended September 30, 2017		Nine Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	Net Income	Diluted EPS	Net Income	Diluted EPS	Net Income	Diluted EPS	Net Income	Diluted EPS
As Reported [1]	$ 89	**$ 0.34**	$ 176	**$ 0.67**	$ 224	**$ 0.83**	$ 388	**$ 1.47**
Restructuring and related costs	29		35		91		192	
Amortization of intangible assets	12		12		36		41	
Transaction and related costs, net	(33)		-		63		-	
Non-service retirement-related costs	33		35		83		129	
Loss on extinguishment of debt	-		-		-		13	
Income tax on adjustments [2]	(10)		(30)		(69)		(122)	
Restructuring and other charges - Fuji Xerox (3)	7		6		90		9	
Tax Act	95		-		95		-	
Remeasurement of unrecognized tax positions	-		-		-		(16)	
Adjusted	$ 222	**$ 0.85**	$ 234	**$ 0.89**	$ 613	**$ 2.33**	$ 634	**$ 2.41**
Dividends on preferred stock used in adjusted EPS calculation[4]		-		-		-		-
Weighted average shares for adjusted EPS [4]		261		263		263		263
Fully diluted shares at end of period [5]		255						

(1) Net Income and EPS from continuing operations attributable to Xerox.
(2) Refer to Effective Tax Rate reconciliation.
(3) Other charges in 2018 represent costs associated with the terminated combination transaction.
(4) For those periods that exclude the preferred stock dividend, the average shares for the calculations of diluted EPS include 7 million shares associated with our Series B convertible preferred stock.
(5) Represents common shares outstanding at September 30, 2018 as well as shares associated with our Series B convertible preferred stock plus potential dilutive common shares as used for the calculation of diluted earnings per share for the third quarter 2018.

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Effective Tax Rate reconciliation

(in millions)	September 30, 2018			September 30, 2017			September 30, 2018			September 30, 2017		
	Pre-Tax Income	Income Tax Expense	Effective Tax Rate	Pre-Tax Income	Income Tax Expense	Effective Tax Rate	Pre-Tax Income	Income Tax Expense	Effective Tax Rate	Pre-Tax Income	Income Tax Expense	Effective Tax Rate
Reported[1]	**$ 192**	**$ 142**	**74.0%**	**$ 167**	**$ 18**	**10.8%**	**$ 459**	**$ 220**	**47.9%**	**$ 344**	**$ 37**	**10.8%**
Non-GAAP Adjustments[2]	41	10		82	30		273	69		375	122	
Tax ACT	-	(95)		-	-		-	(95)		-	-	
Remeasurement of unrecognized tax positions	-	-		-	-		-	-		-	16	
Adjusted[3]	**$ 233**	**$ 57**	**24.5%**	**$ 249**	**$ 48**	**19.3%**	**$ 732**	**$ 194**	**26.5%**	**$ 719**	**$ 175**	**24.3%**

(1) Pre-Tax Income and Income Tax Expense from continuing operations.
(2) Refer to Net Income and EPS reconciliation for details.

(3) The tax impact on the Adjusted Pre Tax Income from continuing operations is calculated under the same accounting principles applied to the As Reported Pre-Tax Income under ASC 740, which employs an annual effective tax rate method to the results.

Operating Income/Margin reconciliation

(in millions)	Three Months Ended September 30, 2018			Three Months Ended September 30, 2017			Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
	Profit	Revenue	Margin	Profit	Revenue	Margin	Profit	Revenue	Margin	Profit	Revenue	Margin
Reported [1]	**$ 192**	**$ 2,352**	**8.2%**	**$ 167**	**$ 2,497**	**6.7%**	**$ 459**	**$ 7,297**	**6.3%**	**$ 344**	**$ 7,518**	**4.6%**
Adjustments:												
Restructuring and related costs	29			35			91			192		
Amortization of intangible assets	12			12			36			41		
Transaction and related costs, net	(33)			-			63			-		
Non-service retirement-related costs	33			35			83			129		
Equity in net income (loss) of unconsolidated affiliates	43			30			(6)			90		
Restructuring and other charges - Fuji Xerox [2]	7			6			90			9		
Other expenses, net	24			17			43			105		
Adjusted	**$ 307**	**$ 2,352**	**13.1%**	**$ 302**	**$ 2,497**	**12.1%**	**$ 859**	**$ 7,297**	**11.8%**	**$ 910**	**$ 7,518**	**12.1%**

[1] Pre-Tax Income and revenue from continuing operations.

[2] Other charges in 2018 represent costs associated with the terminated combination transactions.

Other expenses, net

(in millions)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Reported	**$ 57**	**$ 52**	**$ 126**	**$ 234**
Non-service retirement-related costs	(33)	(35)	(83)	(129)
Loss on early extinguishment of debt	-	-	-	(13)
Adjusted	**$ 24**	**$ 17**	**$ 43**	**$ 92**

Equity in net income (loss) of unconsolidated affiliates

(in millions)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Reported	$ 43	$ 30	$ (6)	$ 90
Restructuring and other charges - Fuji Xerox[1]	7	6	90	9
Adjusted	**$ 50**	**$ 36**	**$ 84**	**$ 99**

(1) Other charges in 2018 represent costs associated with the terminated combination transaction.

Free Cash Flow reconciliation

(in millions)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Reported[1]	**$274**	**($443)**	**$725**	**($30)**
Add: Voluntary contributions to U.S. defined benefit pension plans	—	500	—	500
Add: Collections on beneficial interests received in sales of receivables	—	60	—	170
Operating Cash Flows from Continuing Operations - Adjusted	**$274**	**$117**	**$725**	**$640**
Less: Capital expenditures	(23)	(23)	(73)	(70)
Free Cash Flow from Continuing Operations	**$251**	**$94**	**$652**	**$570**

[1] Operating cash flow from continuing operations