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PRESENTATION

Giles Goodburn - *Conduent Incorporated - VP of Corporate FP&A and IR*

Thank you, operator, and thanks, everyone, for joining us today to discuss Conduent's Third quarter 2023 earnings. We hope you had a chance to review our press release issued earlier this morning.

Joining me today is Cliff Skelton, our President and CEO; and Steve Wood, our CFO. Today's agenda is as follows: Cliff will provide an overview of our results and a business update; Steve will then walk you through the financials for the quarter as well as providing a financial outlook. Cliff will then provide his closing comments.

This call is being webcast, and a copy of the slides used during this call as well as the press release were filed with the SEC this morning on Form 8-K. This information as well as the detailed financial metrics package are available on the Investor Relations section of the Conduent website. During this call, we may make statements that are forward-looking. These forward-looking statements reflect management's current beliefs, assumptions and expectations and are subject to a number of factors that may cause actual results to differ materially from those statements. Information concerning these factors is included in Conduent's annual report on Form 10-K filed with the SEC.

We do not intend to update these forward-looking statements as a result of new information or future events or developments, except as required by law. The information presented today includes non-GAAP financial measures. Because these measures are not calculated in accordance with U.S. GAAP, they should be viewed in addition to and not as a substitute for the company's reported results. For more information regarding definitions of our non-GAAP measures and how we use them, as well as the limitations to their usefulness for comparative purposes, please see our press release.

And now I'd like to turn the call over to Cliff.

Clifford A. Skelton - *Conduent Incorporated - President, CEO & Director*

Thank you, Giles. Welcome, everyone, to Conduent's Q3 earnings call. Well, these are certainly interesting and not always positive times we live in, so I hope you and your families are well. I'll turn it over to Steve in a moment for the detailed financials. But let me first say that today march my 18th quarterly earnings since arriving here at Conduent.

I can tell you we've come a long way since August of 2019. It will always feel like work-in-progress. But since then, we've accomplished a lot. We upgraded our systems and stabilized our environments. We optimized our infrastructure, including reducing our data center footprint by 80% with around 29 data center closures. We've reengineered our sales team, sustaining 2020's 2x improvement in TCV.

We now retain and sell more business than we lose as demonstrated by our net ARR number each quarter. Our Net Promoter Score increased by 30 points, and we received several supplier excellence awards from clients. Our tech and ops availability is 3 9s plus, and we're now almost entirely a cloud-enabled company. We upgraded and continue to upgrade talent.

We have a healthy culture built on teamwork and personal accountability. And we're finally beginning to outrun the revenue lost from the days of poor quality. The journey has now shifted to new challenges not yet satisfied. We need a more nimble portfolio of solutions and go-to-market capabilities, and that is underway. We need to double down on our best technologies and solutions and continue to grow in areas we've always excelled at.

We're on that. We need to capitalize on breakthrough capabilities like immediate payments and we're certainly on that. We communicated these imperatives in March of this year, and we continue to execute on those commitments, but we have more to do before the fruits of our labor will be rewarded further.

We are systematically executing on the strategy we outlined to make Conduent a more nimble technology-led business solutions provider, known for delivering experience, performance and value for our Commercial, Government and Transportation clients. Each quarter brings with it timing issues, episodic events, macro trends and more. That said, we're fortunate to have a more healthy portfolio diversity than most of our competitors, which is necessary to weather those issues.

This quarter was no different. Overall, our revenue and EBITDA exceeded expectations for Q3 and $932 million and $92 million, respectively, with a strong quarter in our Government segment, offset by milestone timing in Transportation. Contract-directed milestone attainment in both Government and Transportation can bring with it variation.

Based on a combination of needs of the client, implementation performance and a jointly held clear understanding of requirements. Some of that played out positively and negatively in Q3. Our Commercial business is less influenced by backload and milestones, but is more correlated to volume and buying trends, often associated with macroeconomic conditions and circumstances.

In that regard, sales in Commercial lagged slightly, offset by a strong and consistent sales quarter in Transportation and Government. When it comes to sales, strong quarters are often buoyed by a single large deal as we've seen in the past. However, consistent singles and doubles are critical, and Q3 reflected that theme with $154 million of ACV and a continued positive net ARR of $103 million.

The mission is to continue our trajectory of strong sales, better retention and outrunning the long tail of past losses while at the same time, focusing on pipeline. Our new business pipeline is stronger than ever and grew 13% quarter-over-quarter. Now as I mentioned, the toll hold for our future is in what we described back in March at our investor briefing, where we outlined 3 key themes, among other things.

First, rationalize and optimize the portfolio to create a more nimble and constantly growing company. The end goal of this rationalization is to create a more synergistic portfolio of technology-led business solutions. As you are aware, we recently announced the disposition of our BenefitWallet business, which is scheduled to close beginning in Q1 2024. And our work continues with focus and rigor.

Second, we described our confidence in our Government Healthcare suite of solutions and the uniqueness of that cloud-native platform. We continue to see traction there, exemplified by our award by the state of Texas for the CMDS solution. The horizon is bright for continued success. Third, we described a very unique capability for immediate payments utilizing both the real-time payment network rails as well as the FedNow network with a unique switching capability in partnership with BNY Mellon.

We're the only company of our kind with such capabilities. Where there are bills or disbursements, there are opportunities, and we're beginning to capitalize across all 3 segments with the first wins coming from Government and Transportation. More to come there as states, municipalities and a few large companies begin to socialize and operationalize their plans.

Immediate payments is a bit like Gen AI, which were also driving, especially in our customer experience business. Everyone sees the value, but the systemization and monetization of the concepts take time. Now Steve will go deeper on the financials to include cash flow timing and the outlook for the rest of the year as well as provide explanations for the lumpiness here and there.

As the situation is for all public companies, the publicly described quarter is important, but belief in the journey and tactics are critical. It's now clear to me that we had the right previous tactics in place, whereby shoring up the foundation first had to be exactly that, first. It remains a journey and will continue to stay the course.

Our culture remains strong. We continue to refine our structure and our talent set for the future, while at the same time, driving improvements in partnerships and excellence. Our leadership team received recognition from comparably demonstrating that cultural strength, and we launched a very important partnership with Charles Schwab in our benefits outsourcing space.

Meanwhile, retention in our workforce is the strongest since I arrived and improving. We must be and are focused on efficiency across the business as we rationalize our portfolio, starting with the divestiture of BenefitWallet. As we progress along this journey, I'd like to recognize our 60,000 strong workforce for their resilience and resolve along the way.

I'd like to now turn it over to Steve for a deeper dive on the financials. We won't have the opportunity today for follow-on analyst questions, but please feel free to reach out to our IR team for questions. Steve, over to you.

Stephen Henry Wood - *Conduent Incorporated - Executive VP, CFO & Principal Accounting Officer*

Thanks, Cliff. As we have done in the past, we are reporting both GAAP and non-GAAP numbers. The reconciliations are in our press release and in the appendix of the presentation. Let's turn to Slide 5 and go over some of the key themes from our sales metrics. The punchline for Q3 is that our sales performance mirrored what we saw in the first 2 quarters of 2023, with the Government and Transportation segments generally outperforming the prior year compares. And offsetting this, we've continued to see some softness in parts of Commercial segment sales.

As Cliff mentioned, there's plenty of deal activity in Commercial, but they're smaller deals. Cliff referred to them as singles and doubles. And at least to date, this year, we're lacking the same quantity of larger deals we saw in 2022. As I said last quarter, in the Commercial segment, we're seeing longer decision-making cycles and slightly more cautious buying behavior, we think driven by broader macro concerns consistent with others in our industry.

The pipeline is still strong, but deals are taking a little longer than expected to close and it's changed our likely mix of full year sales as we don't necessarily see this correcting itself in the next couple of quarters. In Q3, overall ACV was $154 million as compared to $191 million in Q3 2022. Year-to-date, we're at 91% of last year's ACV attainment through the first 3 quarters. TCV was $316 million in the quarter as compared to $347 million in Q3 2022 and for TCV year-to-date, we're at 160% of last year's attainment through the first 3 quarters of 2023, driven primarily by the large long-term transit deal in Australia, which we announced in the second quarter, at which we are now underway with implementing.

We had a very strong fourth quarter in 2022 with some large Government deals signing late in the quarter. And this year, our path to a strong Q4 will also depend on the timing of a couple of these larger Government deals, where there can be some unpredictability around time between award and signing of deals. The net ARR activity metric, our combined measure of wins, losses, pricing effects and other contractual changes was again positive for the quarter at $103 million. As a reminder, this trailing 12-month measure does not predict the timing of revenue, but is based on timing of notification and as such, will fluctuate from quarter-to-quarter.

Overall, we're pleased with the sales and pipeline development in the Government and Transportation segments and segment level variability is a function of the breadth of our business. We believe our Government and Transportation businesses have strong defensive characteristics against some of the broader macro trends we're seeing impacting our Commercial segment in the short term. And as a reminder, as Cliff said earlier, our overall ACV pipeline stands at approximately $4.2 billion, which is its highest level for some time with strong representation in some of our key strategic growth areas like Government Healthcare.

Very briefly on Slide 6. As a reminder, you can see the impact of the Australian deal in transit and what that had on our second quarter sales results. It represented around $1 billion of TCV, $65 million of ACV, and we expect to recognize approximately $200 million to $250 million in implementation revenues over a period of up to 4 years with most of that benefiting 2024 through 2027.

Let's now look at the financial results for the quarter. Turning to Slide 7. Adjusted revenue for Q3 2023 was $932 million as compared to $977 million in Q3 2022, down 4.6% year-over-year or 5.3% in constant currency. This was slightly better than how I laid it out for you in last quarter's earnings due to a stronger performance in the Government segment.

As always, our quarters have discrete items that impact the individual segments, and I'll cover those when we double-click into the segment results individually. In total, there's about $30 million of headwinds from these items in the compare this quarter. Putting those aside, overall wins and revenue ramped from new clients and expanded client relationships outpaced lost business. But consistent with the last couple of quarters, this was offset primarily by lower CX volumes from some larger clients where we continue to see softness in specific verticals like travel, logistics and telecom.

We continue to believe these are predominantly macro related and as such, should reverse over time. Thinking about our revenue holistically, we're in the period now where we're transitioning from a long downward trajectory through a period that will take us into the early part of next year where we expect wins and ramped revenue to generally outpace lost business.

And we're seeing these losses begin to normalize into the ranges we outlined in our March investor briefing. Meanwhile, we expect volumes from installed clients to be a headwind in the short term, while there's the macro-related pressures that we and others are seeing. But over time, they should dissipate. Adjusted EBITDA was $92 million for the quarter as compared to $105 million in Q3 2022. And the adjusted EBITDA margin of 9.9% was down 80 basis points year-over-year as compared to Q3 2022. This was in line with our expectations and how I laid it out at our last earnings call.

Most of the year-over-year impact was driven by the discrete items I'll cover when we go through the segments. Before I move on to discuss the segments, there are a couple of other comments on the GAAP results for the quarter. First, on September 26, we announced that we've entered into a definitive agreement for the transfer of our BenefitWallet HSA portfolio for an approximate purchase price of $425 million.

The transaction which is treated as an asset sale is expected to close during the first half of 2024 in several tranches. Consequently, this was identified as a triggering event that required us to evaluate the Commercial segment goodwill for impairment and resulted in an impairment charge of $287 million, primarily due to this deal. When the deal closes in 2024, we will record an approximate pretax gain of $425 million.

Secondly, as we continue to evaluate and refine our capital portfolio strategy, we took a noncash impairment charge of $25 million related to 2 software projects. Both items are consistent with our strategic priorities to rationalize the portfolio and narrow our investment focus. Let's turn to Slide 8 and go over the segment results.

For Q3 2023, Commercial segment adjusted revenues were $465 million, down 7.7% as compared to Q3 2022. BenefitWallet drove a $12 million increase year-over-year and nonrepeating items were a combined headwind of $28 million. New business ramp and add-on sales outpaced losses for a combined $21 million benefit to revenue. The balance of the work on revenue was negative volume impacts from some large clients, predominantly in the CX space where we're continuing to see softer outlooks in industries, including travel, logistics and telecom, which we believe are macro related and therefore, likely temporary.

Adjusted EBITDA for the Commercial segment in Q3 2023 was $57 million, down 16% as compared to Q3 2022. And the adjusted EBITDA margin of 12.3% was down 120 basis points year-over-year. The margin impact on the nonrepeating items in the prior year compare as well as the noted volume impacts were both headwinds and they were partially offset from increased fall-through on BenefitWallet along with continuing work on operational efficiency.

For the Government segment, Q3 2023 adjusted revenues were $290 million, down 0.3% as compared to Q3 2022. Included in that was the year-over-year impact of the runoff of government stimulus of $11 million in the quarter. We had strong volumes in our Government Payments business and sales ramp from implementations in our Government Healthcare business, where a contractual change to a client implementation also drove an incremental revenue benefit.

This discrete item was worth $7 million in the quarter, top and bottom line. Adjusted EBITDA for the Government segment in Q3 2023 was $95 million, up 8% year-over-year. The adjusted EBITDA margin was 32.8%, up 260 basis points year-over-year and benefited from the margin fall-through on the contract change.

Moving on to Transportation and before we get into the numbers specifically, you'll recall that I said in prior quarters that we expect to see a sequential improvement during the year both in revenues and margin outcomes as we transition certain clients on large long-running implementations through go-live. From a timing perspective, this proved a little too optimistic.

Some of these programs have gone live during the second and third quarters. However, others are experiencing extended completion time lines, many times driven by increased or changing client scope and requirements as we near the end of these multiyear programs, which caused more of a drag on revenue and margins during the third quarter. Transportation segment adjusted revenues in Q3 2023 were $177 million, down 2.7% year-over-year, driven by losses and the aforementioned impacts of lower implementation revenue as compared to Q3 2022.

For the Transportation segment, adjusted EBITDA for the quarter was $7 million as compared to $25 million in Q3 2022. And the adjusted EBITDA margin was 4%, significantly down on Q3 2022 because of these extended implementation time lines. We're intently focused on the implementation discipline and our new senior leadership within this segment continues to work to return the business to more predictable revenue and more acceptable margin trajectories.

Let's now turn to Slide 9 and discuss the balance sheet and cash flow. Our total liquidity position continues to remain strong with around $1 billion in cash and available revolving credit facility. We ended the quarter with approximately $455 million of total cash on the balance sheet and our $550 million revolving credit facility is almost completely unused at this point.

Our net leverage ratio increased slightly to 2.3 turns, but it remains comfortably within our range of 2 to 2.5 turns. Our debt maturities are long dated, and we have no significant debt repayments until 2026. Capital expenditure in third quarter was 3% of revenue. We're continuing to find opportunities to drive efficiencies in our capital investment programs. And as you'll see on the next slide, we've again revised down our full year expectations on capital spend.

We're still expecting our $29 million federal tax refund related to 2018 to be received this year. We launched our initial share buyback program late in the second quarter and repurchased approximately 2 million shares during the quarter. And as of the end of Q3, we purchased approximately 2.2 million shares at an average price of $3.32.

As a reminder, the initial approved scheme is a 3-year program for an aggregate of $75 million. Let's now turn to Slide 10 to look at our 2023 outlook. We expect fourth quarter adjusted revenue to be in the range of $935 million to $945 million, resulting in a full year outlook of between $3.7 billion and $3.72 billion. As I said last quarter, there's a mix shift of new business bookings in our backlog now with a higher relative share of Government and Transportation deals that will take slightly longer to come out of backlog as compared to Commercial deals, which ramp to revenue more quickly.

For adjusted EBITDA margin, we expect the full year outcome to be approximately 10%. We are revising down our expected full year outcome for adjusted free cash flow as a percentage of adjusted EBITDA. The extended completion time lines I referenced in the segment results are now likely to result in some significant milestone payments moving into the early part of 2024.

I'll give more detail on that when we guide expected 2024 cash flow outcomes. But we're in a period now where we have several large implementations across Government and Transportation and a higher relative share of our cash flows is now tied into billing milestones, which is creating more unpredictability than usual.

By way of an example of this, in our Transit business, excluding the recent Australia deal, we're completing several large implementations that have been ongoing for some time. And we've got approximately $70 million of revenue left to recognize on these deals and $150 million of billing milestones to both invoice and collect on. So this $80 million gap is larger than usual and is a function of where we are in the latter stages of these implementations. And that's creating these milestone gaps.

And there's some of this going on in larger Government implementations as well. As I said before, there's more ongoing implementations than for some time, including the large Transit project in Australia. And so that's going to create some lumpiness that we'll need to lay out carefully for you when we think about guiding 2024.

So Cliff, with that, I'll conclude my financial review for Q3 2023, and I'll hand it back to you for any closing comments.

Clifford A. Skelton - *Conduent Incorporated - President, CEO & Director*

Thanks, Steve. As mentioned, we're pleased with the top line revenue and EBITDA in Q3 with more consistent performance expected ahead of us. Meanwhile, we appreciate your attention amidst very trying times in the world. As times like this where all you can do as a company is stay the course, execute against a stated strategy, focus and keep optimistic.

In fact, we do feel optimistic about the work we're doing in 2023 and how it impacts the remainder of the year into 2024 and our ability to hit the 2025 financial exit rate Steve articulated in our March investor briefing. The journey is in full swing. Thanks again for being here today as that concludes our Q3 2023 Conduent earnings call.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.
