21-Feb-2024

Unisys Corp. (UIS)

Q4 2023 Earnings Call

CORPORATE PARTICIPANTS

Michaela M. Pewarski
Vice President-Investor Relations, Unisys Corp.

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

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

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

OTHER PARTICIPANTS

Rod Bourgeois
Managing Partner & Head-Research, DeepDive Equity Research

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Unisys Fourth Quarter 2023 Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Michaela Pewarski, Vice President, Investor Relations. Please go ahead.

Michaela M. Pewarski
Vice President-Investor Relations, Unisys Corp.

Thank you, operator. Good morning, everyone. Thank you for joining us. This morning, Unisys released its fourth quarter and full year 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 President and COO, who will participate in the Q&A session. As a reminder, certain statements in today's conference call contain estimates and other forward-looking statements within the meaning of the securities laws. We caution listeners that the current expectations, assumptions, and beliefs forming the basis of our forward-looking statements include many factors that are beyond our ability to control or estimate precisely. This could cause results to differ materially from our expectations.

These items can also be found in the forward-looking statements section of today's earnings release furnished on Form 8-K and in our most recent Forms 10-K and 10-Q as filed with the SEC. We do not, by including this statement, assume any obligation to review or revise any particular forward-looking statement referenced here and in light of future events. We will also be referring to certain non-GAAP financial measures such as non-GAAP operating profit or adjusted EBITDA that exclude certain items such as post-retirement expense, cost reduction activities, and other expenses the company believes are not indicative of its ongoing operations as they may be unusual or non-recurring. We believe these measures provide a more complete understanding of our financial performance. However, they are not intended to be a substitute for GAAP.

The non-GAAP measures have been reconciled to the related GAAP measures and we have provided reconciliations within the presentation. The slides accompanying today's presentation are available on our investor website.

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

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Michaela. Good morning and thank you all for joining us to discuss the company's fourth quarter and full year results. Our fourth quarter performance caps a successful year for the company. Despite ongoing macroeconomic uncertainty, we delivered on our targets and progressed toward our long-term goals. In 2023, we grew full year revenue by 1.8% as reported and 1.6% in constant currency. Our non-GAAP operating margin was 7% for the year and adjusted EBITDA margin was 14.2%. All of these metrics were above our original guided ranges and above the upwardly revised ranges we provided last quarter. Excluding License and Support, revenue grew 4.9%, both as reported and in constant currency in 2023.

During the year, we strengthened our foundation for growth in multiple ways. First, we demonstrated strong client loyalty, renewing 96% of the contracts with more than $1 million in TCV that came up for renewal in 2023. We also improved our new business signings and pipeline in 2023. New business TCV grew 18% from the prior year and we grew our new business pipeline by 19%. During the year, we also built awareness for our solutions portfolio with clients, partners, industry analysts, and advisors. For instance, we improved our ranking in nearly half of the major 2023 analyst and advisor reports that have included Unisys in the prior year. We also forged several new partnerships, including two arrangements with consulting partners that are expected to drive referrals to Unisys as their preferred solution integrator.

At the same time, we strengthened and expanded key relationships with hyperscalers, OEMs, and other alliances. Finally, we made investments in innovation to expand our next-generation solutions and advance industry-specific solutions such as Unisys Logistics Optimization. These accomplishments support future growth and advance us toward our long-term goals. Before Deb reviews our fourth quarter and full year financial results, I will provide an update on some of our leading indicators and key strategic initiatives, beginning with client signings. Fourth quarter TCV increased more than 300% sequentially and more than 50% year-on-year, resulting in a full year TCV increase of 3%. Excluding L&S, fourth quarter TCV was up more than 300% sequentially and 135% year-over-year, bringing full year ex-L&S TCV growth to 27%.

Fourth quarter new business TCV, which consists of expansion, new scope, and new logo, increased approximately 50% sequentially and 80% year-over-year. New business TCV during both the quarter and the year was primarily driven by growth with existing clients. Among our notable client wins for the fourth quarter was a five-year renewal and new scope contract with a leading biotechnology company encompassing both DWS and CA&I solutions. This contract includes new scope elements, including communication and collaboration technology support, software asset management, and mobile expense management. Turning to our pipeline, our total company and ex-L&S qualified pipelines are relatively flat year-over-year, a strong result given healthy fourth quarter signings and the headwinds from fewer expected scheduled renewal signings in 2024.

Ex-L&S new business pipeline grew 19% year-over-year. Within our new business pipeline, we're seeing encouraging signs with prospective clients. Our new logo pipeline is up 32% year-over-year. Several key 2023 go-to-market initiatives have contributed to the quality and strength of our pipeline, especially our new logo pipeline. In our direct sales teams, we introduced new pricing tools, training, and standardization that has brought increased rigor and speed to our proposal, pricing, and review processes. For 2024, we have further refined our commission structures to better align incentives with key objectives such as cross-selling and growing certain next-generation solutions. Our marketing efforts are another key contributor to new business pipeline growth.

Our digital marketing campaigns have improved visibility to both our portfolio and our thought leadership. This is most evident in the rankings and sentiment toward Unisys among analysts and advisors that influence client purchasing decisions. As I mentioned earlier, our 2023 ranking improved in nearly half of the major analyst reports in which we appeared in the prior year, and we received new leader rankings from highly regarded firms such as Avasant, Everest, and ISG. We were also included as a leader or major player in new IDC reports in digital workplace and application modernization. The results of our annual analyst and advisor perception survey, which we commissioned through an independent research firm, further validate our gains with industry influencers.

For example, this year more than half of respondents view Unisys Digital Workplace's market vision as better than our competitors, up 28 points. And almost three-quarters of respondents recently recommended Unisys to a client, an increase of 14 points in influencer advocacy. I'll now discuss ex-L&S pipeline and client activity in each of our segments. DWS pipeline is up 15% year-over-year, including more than 100% growth in our modern workplace pipeline. We're seeing growing interest in intelligent solutions such as our smart PC refresh offering. We also have several large new opportunities in traditional workplace services. We believe our commitment to delivery excellence in mission critical services is differentiating Unisys within the DWS market.

Our CA&I pipeline is also progressing, up 3% year-over-year despite more than 80% growth in 2023 signings. Demand tied to public sector digitization is leading to new opportunities. For example, we have several prospects seeking to modernize licensing and permitting as well as identity access and management platforms. We also have several opportunities to help clients modernize healthcare, higher education, and justice-related record management systems. EMEA is an emerging bright spot within CA&I where pipeline grew nearly 60% year-over-year. We deployed client technology officers on key accounts in the region, replicating a model we rolled out in DWS in that region. Incorporating client technology officers brings thought leadership to the forefront of our conversations with these clients.

In the Specialized Services and Next-Generation Compute portion of ECS, we expanded our product portfolio in 2023 with enhancements to our existing Cargo Portal and the launch of Unisys Logistics Optimization. We also advanced development of more early-stage industry offerings for banking and financial services clients. Earlier this year, we integrated Unisys Logistics Optimization with our first pilot client's cargo management system and completed a successful pilot using live data within a test environment. Currently, we are moving into production with our client's live environment. Given the early signs of success and strong market demand, we are rapidly accelerating our commercialization efforts and formalizing our partner, pricing, and channel strategy.

Across the company, clients are continuing to adopt, explore, and experiment with artificial intelligence, including generative AI. Our effort here centers on using AI to advance business outcomes such as accelerating revenue and product development, reducing R&D and SG&A expenses, and improving customer or employee satisfaction. We're also supporting our clients' efforts to develop their own AI strategies and upskill their talent. For example, in DWS we are consulting with clients on their training, measurement, and business case creation for generative AI tools. We view AI as a powerful tool to help our clients and ourselves achieve breakthroughs faster, better, and more efficiently than before. We are focused on expanding and infusing AI into new and existing solutions rather than selling standalone AI solutions.

At a high level, there are three key elements to our approach to data and AI. The first is what we call insights and relationships. We have many high-quality clients, many of which have decades-long relationships with Unisys. Intimate understanding of our clients' most important business aspirations and challenges coupled with an eye to emerging industry trends relevant to the client are critical to identifying the highest-value use cases for AI and helping our clients navigate AI investment opportunities. This is complemented by our deep industry domain expertise. Second is capability creation where we accelerate solutions that yield the greatest impact for our clients. This approach also includes techniques to make data actionable to enable faster realization of benefits of AI and data analytics.

We continue to evolve and utilize the best tools, engineering talent, advanced models and architectures as well as those of our alliance partners. The final element is delivery and realization. Here, our clients embrace the AI-powered solutions we deliver to achieve their strategic objectives and ambitions. Some solutions we're seeing client interest in are delivering personalized content to improve customer interactions, leveraging data and analytics and predictive modeling to increase factory or cargo productivity, or synthesizing law and regulations to increase compliance. Internally, we're applying the same approach. We're focused on using generative AI tools to speed delivery of solutions and to improve productivity within our delivery and corporate functions.

For example, our legal team deployed a new AI tool in the fourth quarter for initial document review which has already reduced the document review resources required for certain matters. Regardless of the application, responsible AI, ethics, and compliance are strong guiding principles underlying our approach. Let's talk for a minute about Unisys Logistics Optimization. In general, we believe we're entering into a new period where companies such as Unisys that are nimble, have an engineering core, and combined capabilities such as AI and quantum in innovative ways will bring more relevant and compelling solutions to clients. Accessible data is critical to successful application of generative AI, and many of our clients are challenged by the complexity of disparate data sets siloed within their infrastructure estates.

We believe we can bring clients economic value by helping them modernize their applications, minimize their technical debt and CapEx, and unlock the value inherent in their data. Unisys Logistics Optimization is an example of that. We can leverage a unique combination of advanced quantum computing expertise; AI; acumen developed through our work in structuring and building datasets; and decades of experience optimizing workflows within industries. We believe Unisys Logistics Optimization can serve as a blueprint for delivering tangible business value for our clients and for generating new revenue streams for Unisys. I would like to conclude with a brief update on how we are attracting, retaining, and developing our associates.

In 2023, initiatives included global AI training and increased internal fulfillment which sped up sourcing and helped reduce our trailing 12-month voluntary attrition to 12.4% at year end, down from 18% last year. In 2024, we are strengthening our winning culture and sense of community. A top priority this year is the launch of a new career pathing program to empower associates to take control of their career development. It will also enhance our mobility platform by matching associates with roles that advance them towards their career goals. We're also modifying and enhancing our recognition and rewards programs to encourage associates to acknowledge each other's successes and career milestones. Lastly, we are launching a year-long events program to provide space for open discussions about our workforce (sic) [workplace] experiences and challenges.

With that, I'll turn the call over to Deb.

Debra McCann

Executive Vice President & Chief Financial Officer, Unisys Corp.

Thank you, Peter, and good morning, everyone. My discussion today will refer to slides in the supplemental presentation posted on our website. I will refer to revenue as reported as well as in constant currency but with segment revenue growth only in constant currency. I will also provide information excluding License and Support or ex-L&S to allow investors to assess progress we are making outside the portion of ECS where revenue and profit recognition is tied to license renewal timing which can be uneven. As Peter highlighted, we exceeded our upwardly revised 2023 revenue and profitability guidance and laid a strong foundation to support our future growth. Our performance this year progressed us towards our longer-term goals and demonstrates the resilience of our recurring revenue in an uncertain macroeconomic environment.

We also furthered our cost initiatives which will remain a priority in 2024 and will lay the groundwork for continued profitability and cash flow improvement. Looking at our results in more detail, you can see on slide 5 that fourth quarter revenue was $558 million, up 0.1% year-over-year or a negative 2.1% decline in constant currency. The decline was expected and driven by license renewal timing in our ECS segment. For the full year, revenue was $2.02 billion, up 1.8% year-over-year as reported and up 1.6% in constant currency. Excluding License and Support, fourth quarter revenue was $413 million, up 6.8% year-over-year as reported or 4.3% in constant currency. For the full year, ex-L&S revenue was $1.59 billion, up 4.9% year-over-year as reported and in constant currency.

These ex-L&S solutions accounted for 79% of total company revenue and had a next-gen solutions mix of 38% in 2023. Now let's look at our segment revenue which you can find on slide 6. A reminder that the segment revenue growth rates I'm about to discuss are in constant currency. In the fourth quarter, Digital Workplace revenue grew 6.3% year-over-year to $139 million driven by new business with existing clients. For the full year, DWS revenue was up 7% to $546 million. Growth resulted from new business signed during 2022 and strong in-year project revenue particularly in the United States, Canada, and Europe. Key solutions in 2023 included modern device management as well as traditional workplace services.

Fourth quarter CA&I revenue declined 0.5% to $139 million due to a prior-year benefit from the sale of surplus IP addresses. Excluding this impact, segment growth would have been more than 2% with strong sales in our digital platform and application or DP&A solutions. Full year CA&I revenue was $531 million, up 2.2% year-over-year. We had a good year of growth with both commercial and public sector clients, offsetting some softness we have seen in the banking and financial services sectors where budgets have been more challenged. Many of our commercial and public sector clients embraced higher-value DP&A solutions in hybrid infrastructure, cybersecurity, and application modernization which leverages our engineering core.

More of our clients view the future as hybrid, taking multi-cloud approaches to infrastructure, incorporating private cloud, colocations, and public clouds for tailored flexibility and security. Our balance of expertise in mission critical services; hyperscaler partnerships; and next-generation capabilities in data, artificial intelligence, and application modernization align us well with these hybrid strategies. We are optimistic about the opportunities to further grow the CA&I segment in 2024. In our Enterprise Computing Solutions segment, fourth quarter revenue was $203 million, a decline of 12.2% due to lower License and Support revenue. This was partially offset by modest growth in Specialized Services and Next-Gen Compute.

For the full year, ECS revenue was $648 million, down 3.9% from 2022; again, with strength in Specialized Services and Next-Gen Compute partially offsetting a decline in L&S revenue caused by the renewal schedule timing. License and Support revenue was $144 million in the fourth quarter and $429 million for the full year, exceeding our upwardly revised guidance of $420 million due to closing some small renewals earlier than anticipated. Notable fourth quarter renewals included signings with commercial and public sector clients in the United States and Canada and in Latin America. It is important to remember that ClearPath Forward license revenue is highly dependent on the specific client contracts up for renewal and the term and consumption levels of those renewals.

Backlog was $3 billion at year end versus $2.4 billion at the end of third quarter and $2.9 billion last year. Sequential and year-over-year backlog growth was due to both the timing of renewals as well as strength in new business signings in our Digital Workplace segment. Turning to slide 7, we can see the fourth quarter gross profit was $181 million, a 32.5% margin, down 160 basis points from the prior year due to the timing of higher-margin L&S solution renewals. Excluding L&S, our fourth quarter gross margin was 16.5%, up from 11.8% in the prior year. Most of the expansion was due to the realization of savings from the prior year quarter's cost reduction charges which we include in ex-L&S gross margin.

Full-year gross profit was $551 million, an increase of more than $22 million. Gross margin expanded 70 basis points to 27.4%. Improved delivery and pricing in our ex-L&S solutions and the realization of savings from prior-year cost reduction charges allowed us to generate $22 million of incremental gross profit despite a $50 million headwind from L&S solutions. Full-year ex-L&S gross profit grew by 42% in 2023 to $240 million. This reflects a 15.1% gross margin compared to 11.2% last year. This improvement was largely driven by improvements in the CA&I segment and SS&C solutions within ECS, including the realization of savings from prior-year cost reduction charges partially offset by a revenue reversal associated with the previously exited contract within All Other.

I will now touch briefly on segment gross profit which you will find on slide 8. Fourth quarter DWS gross margin was 15.3%, up slightly from 15.1% driven by new business with existing clients partially offset by investments we've made to modernize field service dispatch systems that were implemented late in the year and will help drive future delivery efficiency. Full year DWS gross margin was flat year-over-year at 14%. As we scale, we expect rising utilization, improved pricing power, growth in modern workplace, and our delivery investments to drive steady gross margin improvement in 2024 and beyond. Fourth quarter CA&I gross margin was 16.3%, down from 19% in fourth quarter 2022 primarily due to a benefit in the prior year from the sale of surplus IP addresses.

Full-year CA&I gross margin was 15.4%, up from 9.1% or 630 basis points in the prior year. More than 200 basis points of this improvement resulted from our cost initiatives such as labor market and contingent labor optimization and increased use of automation. The remaining 400 basis points was due to delivery improvement of certain accounts from 2022. Our focus on these key accounts helped derisk the segment from future losses and strengthened key client relationships for future growth. In 2024, our CA&I team is building out more standardized solution architectures and increasing the use of generative AI to accelerate solution development and speed revenue generation. Fourth quarter ECS gross margin was 67.4% compared to 73.3% in the prior year, again due primarily to L&S renewal timing.

Full year ECS gross margin was 61.2% compared to 64.5% in the prior year driven by lower L&S revenue partially offset by a 370-basis point improvement in SS&C margins driven by improved pricing as well as expansion signings with existing clients in sectors like life sciences and financial services. Turning to slide 9, fourth quarter non-GAAP operating margin was 11.5%, compared to 20.2% in the prior year with adjusted EBITDA of $100 million, a margin of 18% compared to 26.7% in fourth quarter 2022. This was driven by lower L&S profit due to license renewal timing and higher compensation costs. Full year non-GAAP operating margin was 7% versus 8% in 2022 and adjusted EBITDA was $286 million, a margin of 14.2% compared to 16.5% in 2022.

The full year decline was largely due to lower gross profit contribution from our License and Support solutions. Fourth quarter GAAP net loss was $165 million or a diluted loss of $2.42 per share compared to diluted earnings of $0.12 per share in fourth quarter 2022. On a non-GAAP basis, fourth quarter net income was $35 million or non-GAAP diluted earnings of $0.51 per share compared to $1.22 per share in fourth quarter 2022. Our full year net loss was $431 million or a diluted loss of $6.31 per share compared to a $1.57 per share loss in 2022. On a non-GAAP basis, full year net income was $42 million or non-GAAP diluted earnings per share of $0.60 compared to $1.10 per share in 2022.

The fourth quarter and full year net losses were largely driven by actions we took to reduce our US pension liabilities by approximately $500 million in total using pension assets, not corporate cash. These actions resulted in two non-cash pension settlement losses in the first and fourth quarters which totaled $348 million and reflect accelerated recognition of accrued pension expense associated with the pensioners that were transferred as part of the two transactions. These annuity purchases reduce the volatility in our GAAP pension deficit and our projected future cash contributions as well as the future cost of a full pension risk transfer of our US qualified defined benefit pension plans as they lower the annuity purchase premium that is based on total liabilities.

Capital expenditures totaled approximately $19 million in the fourth quarter and $79 million for the full year. In 2024, we expect capital expenditures of approximately $90 million to $100 million, supporting both L&S and ex-L&S growth while keeping in line with our CapEx-light strategy. Turning now to slide 10, free cash flow. We generated $4 million of free cash flow in the fourth quarter, bringing our full year free cash flow to negative $5 million compared to negative $73 million last year. This put us ahead of the expectations we provided last quarter of negative $25 million to negative $30 million which is largely the result of improvements in working capital and higher than expected profitability. In 2024, we expect to be free cash flow-positive by approximately $10 million.

This reflects expectations for cash taxes to decline to approximately $50 million compared to approximately $63 million in 2023, for net interest payments that are in line with 2023 levels of approximately $20 million, pension contributions of approximately $20 million, as well as environmental, legal and restructuring and other payments of $75 million to $80 million, relatively in line with 2023. Turning now to slide 12. Our cash and cash equivalents balance was $388 million at year end, relatively consistent with $392 million at the end of 2022. Our net leverage ratio, including all defined benefit pension plans, was 2.9 times, up from 2.1 times at the end of 2022. Leverage was higher primarily due to the increase in the GAAP pension deficit which I will discuss shortly.

Our liquidity is strong and cash balances are well-ahead of where we anticipated they would be when we started the year with no major debt maturities in 2024 and no borrowings against our revolver. I will now provide an update on our global pension plans. Our global GAAP pension deficit, which can be seen on slide 13, was approximately $700 million compared to approximately $540 million at the end of 2022. About $70 million of this $160 million increase was related to the purchase of insurance contracts by our overfunded UK plans as a first step in eliminating the plans from our corporate balance sheet, effectively eliminating the surplus associated with these overfunded plans. The remaining roughly $90 million increase was due to the net impact of lower discount rates partially offset by returns in plan assets.

At the end of the year, we report a detailed estimated 10-year expected cash contribution forecast which you can see on slide 14. Expected contributions to our global pension plans for the five-year period beginning in 2024 are $484 million, $48 million lower than our projections at the beginning of 2023. We will continue to evaluate opportunities for additional reduction in our global defined benefit pension obligations depending on overall market conditions, which could result in material non-cash settlement charges like those we have incurred over the past few years. I will now discuss our guidance ranges and provide additional 2024 color which can be seen on slide 15. Looking ahead, the revenue growth upside we captured in 2023 in both our ex-L&S and L&S solutions creates a more difficult comparison for 2024.

Specifically, we had nearly $40 million of incremental revenue and profit in 2023 from signing a multi-year L&S renewal that had been expected to be a single-year renewal. It is important to note that even with this contract signing in 2023, we see positive trends in the continued and, in some cases, expanding use of our platforms. And so we now expect $370 million average annual L&S revenue for the three years beginning in 2024, a $10 million annual increase from our previous projections of $360 million. For total company revenue, we expect a guidance range for constant currency revenue growth of negative 1.5% to positive 1.5%. Revenue growth in constant currency equates to revenue growth of negative 1% to [positive] 2% as reported.

This revenue guidance also assumes approximately $375 million of License and Support revenue and growth in our ex-L&S solutions of 1.5% to 5.0% in constant currency. 2024 non-GAAP operating profit margin is expected to be 5.5% to 7.5%. The midpoint is slightly below our 2023 margin due to lower L&S gross profit due to renewal timing, partially offset by improvement we expect in our ex-L&S solutions where we expect to expand our gross margin by 150 to 200 basis points in 2024. Delivering on our 2024 guidance will position us for accelerating profitability and free cash flow in 2025, which is when we also expect to see a larger impact from SG&A cost savings and additional margin expansion from continuing delivery actions we are taking to improve our gross margins.

Looking at the first quarter specifically, ex-L&S revenue is expected to be approximately $385 million to $390 million, which translate to low single digits growth. Due to renewal timing, we expect L&S revenue of approximately $70 million to $75 million compared to $137 million in the prior-year period. The first quarter is expected to be our lowest L&S revenue quarter of the year and we expect 45% of L&S revenue in the first half of the year, with the remaining 55% in the second half. Given the cadence of L&S renewal timing, this translates to our expectation for first quarter total company revenue decline of approximately 10%. We also expect a first quarter non-GAAP operating margin in the low single digits.

I am pleased with the performance we have delivered this year and excited for what's to come in 2024 as we progress further towards achieving our operational and financial goals. I will now turn it back to Peter.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Deb, thank you very much. With that, we'll turn the call over to questions. Operator?

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question today comes from Rod Bourgeois with DeepDive Equity Research. Please go ahead.

Rod Bourgeois
Managing Partner & Head-Research, DeepDive Equity Research

Q

Okay. Great. Thank you. So first, I want to ask about the bookings and pipeline activity, and it's a two-part question. So, your quarter-to-quarter and year-to-year bookings surges were very strikingly strong there, and it also enabled some backlog expansion. So my first question on that is how did you pull that off? And essentially, in your turnaround progress, what's the main effort that's enabled that level of bookings activity? And then I'll ask a follow-up on that as well.

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

A

Yeah. Rod, so thanks for the question. I'll take the first part of that and then let Mike take the second part. We have consistently said there is lumpiness particularly in our renewal timing. And so what we had in the fourth quarter was simply a very strong quarter of renewals and also a strong quarter of what we consider new business, which is new logos, expansion, and new scope of existing clients. As I said in my discussion earlier, much of our success in 2023 was really a very, very strong new business year, and we have indications of a much stronger new logo year in 2024. So I would say we are pleased with the fourth quarter performance. It is lumpy, but that's kind of the way our business is.

But the most important element I would say to answer your question is really the growth and the pipeline quality for ex-L&S. So if we take L&S out and say that's going to go up and it's going to go down, we had strength in L&S in 2023, we increased our guidance for L&S in 2024, all that is good. And obviously, that's very important for cash flow and profit as well. But long-term, that strength of ex-L&S and increasing the profitability, increasing the revenue, increasing the quality of pipeline, that will give us more – we hope that will give us more breathing room going forward. Mike, any thoughts on that?

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

A

Yeah. Hey, Rod. Thanks for the question. Yeah, look, Peter, I think you covered a good chunk of it. But, Rod, I would say that is the byproduct of a lot of the hard work that we've been doing all year. You know the macros have been a little tough and folks have been a little delayed in signing, and some of those renewals came in the fourth quarter for the ex-L&S business. I think the things that I would call out that I would want you to take away is not only were they signing but they ultimately signed at higher value, so our pricing power was really strong in regards to the offerings that we brought forth. There was new scope associated with those signings. The expansion and consumption of those accounts were strong as well.

So not only did we do 96% signing for the year and had a very strong fourth quarter, we saw cross-selling, we saw expansion, we saw pricing power contained and embedded in that. So we ended up increasing revenue and increasing margin on those renewals which, as you know, makes a stronger backlog and booking for the subsequent year or 2024 as well. So we're really pleased with the execution, we're pleased with the ability for us to kind of differentiate in the market and see the acceptance of our next-gen solution by that existing base. So, a byproduct of a lot of hard work, I think.

Rod Bourgeois
Managing Partner & Head-Research, DeepDive Equity Research
Q

Okay. Great. And then the follow-up on that is when you have that level of bookings it detracts some from the pipeline, at least in the near-term. From your commentary, it sounded like the pipeline with new logos is still strong even after the Q4 bookings. And so, I guess what I want to ask here is in your pipeline with existing clients, do you expect that pipeline to re-expand in upcoming months? In other words, it seems like you should be heading into a period of pipeline replenishment and I'm looking for any outlook on that front.

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

Mike?

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

Yeah, Peter. To your point, I'll take that one and then flip it back to you or Deb if you want to add some additional commentary. So, Rod, I guess the short answer is we're happy, too, with the base of our prospecting portion of the pipeline. You're exactly right; even though we increased our backlog year-on-year, signing that level of renewals and new business certainly depletes that pipeline. But we've got a great line of sight into the prospecting aspect of that and we have a new logo-strong pipeline. We talked about some of the increase there as well, so both in new logo and in expansion, and we fully expect the same kinds of levels of increases in the existing base for the things that are up for renewal in the current year as well.

So, again, I think pretty consistent – to your question, pretty consistent with our prospects for growth in 2024.

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

Yeah.

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

Yeah, right. I don't have anything to add. Yeah, Deb and I will yield to Mike on that.

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

Right.

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

I guess the only thing I would add is when we do talk about pipeline, Rod, the fact that we have 18% new business growth in the pipeline – and you're right, a lot of that is new logo – I do expect the new scope to increase over time. There is a little bit of reloading of that, but I'm really happy with where the pipeline is from a quality standpoint as well. So when we look at where we are in the kind of staging, we think that we're significantly better off than we were last year at this point.

Rod Bourgeois
Managing Partner & Head-Research, DeepDive Equity Research

Q

All right. If I can slip one more in. I've got to ask the L&S average revenue outlook, you've upped that. That's really important. Can you just talk about what's enabling that? We might have seen some of the early signs of that brewing last year, but it's nice to see it coming through in your actual outlook now. So can you talk about the enabler of the L&S revenue outlook uptick?

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

A

Yeah. So, Deb...

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

A

I'll take that one.

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

A

...if I can take that?

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

A

Oh, you want to start? Okay.

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

A

Okay, go ahead. Yeah, I was going to start and then let you follow up on that.

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

A

Okay. Great.

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

A

The – when we look at what happened in 2023, there were a couple of things that happened in the L&S. We had a better L&S year in 2023 than we thought we would have. Now, part of that was due to a contract that we thought would be a one-year renewal and it turned out to be a five-year renewal, so that was the client's doing, not ours. We were happy to make that five-year renewal instead of a one-year. But beyond that, you saw increases in revenue on L&S kind of in several of our relationships due really to consumption patterns. And so, this was kind of an example of what we've been talking about, Rod – you're right – and we were able to see that in actuality in 2023.

Now, the interesting thing about 2024 is one would assume because we had a five-year renewal instead of a one-year renewal in 2023 that our L&S revenue would take a hit in 2024 for that. The reality is we're increasing our L&S expectations for 2024 and increasing the three-year average for 2024, 2025, and 2026. And so, that overcomes, first of all, the renewal, right? We got to fill that that gap, if you will, and it goes beyond that. And that is really largely because of those consumption patterns, so we're pleasantly looking at the numbers for L&S. It still will be lumpy from year-to-year, but we do believe that's a nice sign to see. Deb, over to you.

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

Right. And I think, Peter, you covered it. I think we're – in the past, often it would be L&S performed better but it impacted the next years. And so, we're happy to see that this – even though the events that happened in 2023 that had L&S overachieving isn't having an impact on future years. So, I think Peter said it all.

Rod Bourgeois
Managing Partner & Head-Research, DeepDive Equity Research
Q

Great. Thank you.

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

Welcome.

Operator: The next question comes from Anja Soderstrom with Sidoti. Please go ahead.

Anja Soderstrom
Analyst, Sidoti & Co. LLC
Q

Hi. Thank you for taking my questions. I have some follow-ups on the commentary. So you're saying the new logo has been strong. And what is – what has been driving the new logo and where are they coming from? Are you replacing someone else or...?

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

Yeah. So, thanks, Anja. Very, very good question. As I said in my remarks, the majority of our new business revenue in the year, which is both new logo, new scope, and expansion, came from existing clients which happens every year, frankly, but also the same this year. We do expect new logo revenue to increase in 2024. Now, to your question about where new logo revenue comes from, it really can only come from a couple sources. So one source is it's just brand new work, so think of generative AI, consulting work or those similar projects. They might not have existed before, so everyone in our business is kind of scrambling for that work. The second source is from clients that had work that was internal to their operations and they've decided to give it to an external provider like us.

And the third element is where we are competing for existing work that is with an external provider and we kind of take that work away through the competition process, so those are kind of the three elements. Mike, any thoughts on that?

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

Yeah. I think, Anja, the two that Peter mentioned are certainly the most prevalent. There is the first time, I'll say, outsourced managed service component and then there is obviously the market share component of that, and we have been aggressively active in all markets. We've seen a pretty nice uptick in EMEA as it pertains to new logo. The other piece I would add to that is also the cross-sell in our existing base, right? When we talk about new business, we're about 39-ish percent cross-sold, so we do have opportunity to grow new business in the existing base through cross-selling. But I would say the heavier two components are going after additional market share and first time outsource for managed service contracts as Peter alluded to.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Okay. Thank you. In terms of consumption patterns, what has been the biggest surprise to you?

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

A

Mike?

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

A

Yeah. So, I assume, Anja, you're talking about consumption pattern in L&S with that question. Look, I think when you look at what's going on in the market right now and obviously all of the efforts around CA&I and building out models and needing more compute and needing more power, we've been seeing probably over the course of the last 18 to 24 months continued increases in consumption. And that's one of the reasons why we ultimately upped our future three-year average by $10 million because it's a byproduct of what we've been seeing over the course of the last 18 to 24 months.

And I think it's frankly just a natural spin-off of the buildout of LLMs and then other more complex models and storage needs, things along that line from a compute power perspective. So really pretty consistent to what we're seeing in the market overall.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Okay. Thank you.

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

A

Anja, thanks for your comment.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Okay.

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

A

No. Go ahead, please.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

I have one more question in terms of the banking and financial services. It's been a big challenge you said during the past year. What are you seeing there now? Is that easing up or...?

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

A

Yeah. So, Deb, do you want to comment on that from a numbers standpoint and then Mike can provide some color in terms of market?

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

A

Yeah. So we discussed that in our CA&I section. Just saying that there is a little softness there where budgets have been a little challenged, and so a lot of our growth this year was really more commercial and public sector. So I don't have the specific numbers in front of me, but that's the color around some of that CA&I revenue. So I think as far as the softness, I'm not sure. Mike, if you want to comment on any trends you've seen different than that.

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

A

Yeah. Look, I think it's a little more just hesitancy in the macro. I don't view it as being something that is in perpetuity where they're just not spending. I think there is – we're just seeing more free-spending in commercial and public sector and I would say a little bit of hesitancy in banking and financial services. But I would echo or at least comment that when we look at the new logo pipeline in 2024, there are plenty of folks in those sectors embedded in that new logo pipeline. So, again, I think it's probably just an output of macroeconomics that we're starting to see loosen a little bit.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Okay. Thank you. That was all for me.

Operator: [Operator Instructions] The next question comes from Arun Seshadri with BNP Paribas. Please go ahead.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Yes. Hi, everybody. Thanks for taking my questions and appreciate all the details in the outlook today. Just wanted to understand if you look overall at ex-L&S revenue growth guide, given your signings it seems like you're being somewhat conservative. For 2023, I think you guided for a pretty wide range of outcomes on top line in ex-L&S and came in near the high end. Are you taking a similar conservative approach? Is that a result of, I guess, hesitancy in the macro on the broader enterprise side? Do you still expect to see more, I guess, spending from the commercial and public sector? Just some color would be helpful.

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

A

Yeah. So, Arun, thank you very much for that.

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

A

Hi.

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

A

I guess let me start and then turn it over to Deb. So the first thing I would say is we really do not ever try to give a conservative approach to our numbers, so our numbers are our expectations. In 2023, we thought that we were exceeding those expectations, and so we raised guidance during the year and then, of course, the ultimate numbers came out even better than the raised guidance. But I think that is just more a function of the uncertainty in the market, Arun. There was a lot going on in 2023 and, frankly, we're very pleased with the fact that we performed. L&S was better than expected, ex-L&S was better than expected. We kind of outperformed our guidance across the board.

In 2024, we are expecting healthy growth in ex-L&S and healthy growth in the profitability of ex-L&S, and that's part of really kind of what we hope to be a multi-year expansion. So turning it over to Deb, but I think we built in, for us, some pretty good numbers in ex-L&S for 2024. And Deb will go through those in detail, but I certainly hope that we excel over those, but we're starting from pretty good numbers. Deb?

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

A

Thanks, Peter. Yeah, so for 2023, like Peter said, we saw ourselves outperforming, we raised guidance. Even between Q3 and the end of the year, very specific items where a few smaller deals came in in L&S that we didn't anticipate. And then there were some uncertainties in our ex-L&S revenue that we were working through and were able to get all of that worked through, and so that enabled us to come in over guidance. So I think Peter said it well and I think we're very comfortable kind of where we're saying for 2024 with ex-L&S growth, continued growth, more than 150 to 200 basis points of ex-L&S gross margin expansion as we really look to the mix, change the mix shift towards more of the higher-margin solutions as we continue delivery improvements, automation, a lot of the work we're doing around SG&A to get that more normalized with our peers.

So a lot of the work we're doing is really – we feel makes us comfortable with our 2024 guidance.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Thank you. Just a follow-up for me. From a cost savings standpoint, it sounds like you still expect a fairly significant margin uptick in 2025 versus 2024. Just wanted to see if you could provide any context in terms of, I guess, numerically. Obviously, it's early to call, but just from a from SG&A, percent of revenue and from a gross margin perspective, how much additional upside do you think there is in 2025 versus 2024, obviously, as the pension contribution ramps in 2025 and that's sort of the baseline for the question?

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

A

Yeah. Arun, that's a really good question.

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

A

Okay. So, I can answer that. Do you want me to take that, Peter?

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

A

So, Deb, I will get it to you just one second.

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

A

Okay.

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

A

And that is – so we have put Deb in charge of kind of a multi-year SG&A effort. That effort started in earnest last year, relatively early last year, and will extend through this year and 2025 and 2026. So, Deb has put together a plan, working with the rest of our team, that we expect will lower SG&A as a percentage of revenue over that timeframe and continue to lower it over that timeframe. So it's not a one-time thing for us, Arun. It's very well-planned, it has its own project leader. And we are performing according to plan. We lowered what we thought would be SG&A spend. We will lower it again in 2024 and expect to continue to lower it in 2025 and 2026. That is, at the same time, making more investments that are SG&A investments in things like artificial intelligence.

So we think under Deb's leadership we've got a solid approach to this. And certainly, we'll let Deb outline how that approach works over time.

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

A

Right, yeah. So, Arun, I would say the gross margin expansion is a little more of a slow and steady, so we plan in ex-L&S to do $150 million to $200 million and that's what we had laid out, kind of a slow and steady margin improvement. That along with our L&S revenue of $370 million average a year and at about 65% gross margin, and then as well as the SG&A effort Peter talked about, I think you're right; that is a little more. We expect to achieve on an annualized basis about 70% of that by the end of this year, and so that does take because we have to do some investments in order to save. So that will – as opposed to the gross margin, that's more slow and steady. SG&A will kind of be more of a – you'll see that more in 2025.

So – and then in addition to that, to get to the free cash flow that we laid out, there's some other things on the free cash flow side that we're working such as improving our working capital dynamics. Some of the more one-time cash flow items will start to go down over these next [ph] few (00:58:31) years, and so that's another important part of the formula to get us to those free cash flow numbers we've laid out as part of our long-term target.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Thank you so much.

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

A

Maybe if I could jump in as well.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Yeah.

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

A

Just one quick comment. Deb mentioned $150 million. It was 150 to 200 basis points of improvement in gross margin.

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

A

Oh, basis points.

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

A

Yeah. And if you look at the Investor Day materials that we put out, you would see in there that it infers additional improvement in basis points in 2025 and 2026, kind of consistent in that manner. Now, we're not saying that is kind of a linear path and it's going to be the same amount every year, so it will ebb and flow a bit. But as Peter mentioned in his opening remarks, we're doing quite a bit in regards to the associate base, right-scaling, right-shoring, AI, automation, speeding up sourcing, all kinds of elements embedded in kind of managing that resource delivery. So we think that's going to yield additional benefits in the outer years to get us aligned with the projections that we put out in Investor Day.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Got it. Thank you, everyone. Can I ask one last thing? On the pension cliff, it sounds like you've made a good amount of progress reducing that cliff, the 2026 to 2029 cliff by some $10 million to $20 million a year. Any sort of high-level thoughts on sort of your plans for 2024 in terms of further progress there? Thank you.

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

A

Yeah. Deb, do you want to take that one?

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

A

Sure, yeah. So we're – the contributions came down and that's primarily driven by asset returns. And so, there's – we try to manage that. And we don't have full control over asset returns, and so we put in the slide deck sensitivity so you can understand that. But as we've spoken about and continue our plan to really look at – continuing to de-risk the plan, we took out – we had two annuity purchases in 2023. We'll continue to look at that given market conditions if another one makes sense. And so, the goal there is just to lower the amount of liabilities using plan assets, not corporate cash, to just overall lower the risk there and the volatility of the overall pension plan.

So that's our – one of our strategies, a key strategy for now. But we're always looking at all of our options as it relates to pension pending market conditions and what makes sense at the time.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Thanks very much.

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

A

You're welcome.

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.

Thanks, Betsy, very much. I'd like to thank everybody for joining the call. I know we went a little over today, but the questions were really good and so we wanted to give everybody an opportunity to ask them. When you review our materials on the website, you'll see some modernization. So kind of our one-pager has been updated, it's got a different format. And even the slides that we have showed over the course of this call have some different formatting, and we have even more information in the appendix to the slides. So I do hope that you take some time and look at the materials. And of course, our investor relations team is always available for any follow-on questions as is Mike and Deb and myself. With that, thank you very much and appreciate you joining the call.

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

Editor's Note: Texts in square brackets are added as a request from the Company to add clarification to the speaker's statements.