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# EDITED TRANSCRIPT

NCR - Q4 2017 NCR Corp Earnings Call

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**OVERVIEW:**

Co. reported 4Q17 revenue of \$1.78b and non-GAAP EPS of \$0.92 also reported FY17 non-GAAP diluted EPS of \$3.20. Expects FY18 revenue growth to be 3%, GAAP EPS to be \$2.08-2.48 and non-GAAP EPS to be \$3.30-3.45 also expects 1Q18 revenue guidance to be down 1% to up 2% and non-GAAP EPS to be \$0.41-0.47.



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## PRESENTATION

### Operator

Good day, and welcome to the NCR Corporation Fourth Quarter Fiscal Year 2017 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Michael Nelson, Vice President of Investor Relations. Please go ahead.

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### Michael Gary Nelson - NCR Corporation - VP of IR

Good afternoon, and thank you for joining our fourth quarter 2017 earnings call. Joining me on the call today as our host is Bill Nuti, Chairman and CEO; along with Mark Benjamin, President and COO; Bob Fishman, CFO; and Paul Langenbahn, EVP, Software. After prepared remarks, Bill, Mark, Bob and Paul will take your questions.

Before we get started, let me remind you that our presentation and discussions will include forward-looking statements. These statements reflect our current expectations and beliefs, but they're subject to risks and uncertainties that could cause actual results to differ materially from those expectations. These risks and uncertainties are described in our earnings release and our periodic filings with the SEC, including our annual report.

On today's call, we will also be discussing certain non-GAAP financial measures. These non-GAAP measures are described and reconciled to their GAAP counterparts in the presentation materials and on the Investor Relations page of our website. A replay of this call will be available later today on our website, ncr.com.

With that, I would now like to turn the call over to Mark.

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### Mark D. Benjamin - NCR Corporation - President & CEO

Thank you, Michael, and thanks to everyone for joining us today for our fourth quarter and full year 2017 earnings call. I'll begin by highlighting key developments and performance metrics for our business. Bob will then walk you through the financials in further detail as well as discuss our updated outlook. Then Bill, Paul, Bob and I will take your questions.



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Q4 marked a good finish to a challenging year as our results largely finished at the high end of the expectations we provided on our last call. While the full year fell short of our original expectation, this quarter demonstrates our focus around key areas of our strategy, including cloud growth, modernizing our Services business and accelerating our transformational efforts across the entire enterprise.

First, with regard to our cloud business, revenue accelerated and finished up 6% compared to the fourth quarter last year. For the full year, cloud revenue was also up 6% while we increased our net ACV by 46% to \$67 million. Given our strong net ACV growth, along with the consistent progress we have made in expanding our cloud solutions and increased customer demand, we believe we are on track to approach double-digit top line cloud growth in 2018.

Second, our focus on driving improved productivity and efficiency in our Services business continues to deliver margin expansion. Service margins were up 280 basis points in the quarter and finished up 310 basis points for the full year. We have talked often over the past year about our business improvement initiatives, particularly in terms of the efficiency and productivity gains we believe we can capture in our Services segment. Q4 showed a continuation of that trend, and we see a growing number of opportunities moving forward to accelerate our Mission One or M1 Services transformation.

Our focus on driving our Services transformation continues to deliver increased efficiency and productivity of our roughly 13,000 customer engineers. I couldn't be more pleased with the Services performance during the critical important holiday season. NCR experienced the best year-end Services performance in company history as measured by improved SLAs, increased availability and reduced service costs.

Building on the success we have achieved in our Services business, we are accelerating the transformation. You will hear me talk in a couple of minutes about some very exciting initiatives we are working on around our Hardware strategy, which we expect will have a significant impact on our cost structure and margin profile going forward.

Today, we are also introducing our full year 2018 financial targets, which Bob will address in a moment. The confidence we have in our business, combined with our strong 2017 free cash flow, has led us to announce our intention to repurchase up to \$300 million of shares during 2018.

Now to Slide 4, an overview of our Q4 financial performance. We generated revenue of \$1.78 billion in Q4, which was down 1% as reported and 3% on a constant currency basis. This came in at the high end of the guidance range we provided on our Q3 call. Revenue this quarter was driven by growth in our Services business, which was offset by lower Hardware sales.

Recurring revenue continues to increase, up 4% in the quarter and comprised 42% of total revenue. This speaks to the ongoing success we're having in growing our cloud revenues. Our non-GAAP gross margin rate expanded 20 basis points as reported and contracted 10 basis points on a constant currency basis.

Margin decreased in our Software and Hardware segments, which were partially offset by further ongoing margin expansion in Services. Our business process initiatives continue to drive efficiency gains.

Non-GAAP EPS was \$0.92, which finished at the high end of the guidance range we provided. Free cash flow was strong at \$402 million, but was lower than the prior year due to a \$100 million working capital improvement in 2016.

Slide 5 shows our financial highlights for the year. Revenue was flat as reported and up 1% on a constant currency basis. Revenue growth for the year was driven by 3% constant currency growth in both the Software and Services segments, which were partially offset by lower Hardware revenue. Similar to Q4, we made progress during the year in expanding our recurring revenues on the back of increased cloud revenue, which was up 6% in 2017.

For the full year, our non-GAAP margin rate increased 70 basis points driven by growth in higher-margin Software revenues as well as the impact of improvement initiatives in our Services business. Non-GAAP diluted EPS was \$3.20 for 2017, up 6%. Free cash flow for the year was \$453 million, and we achieved a 92% conversion rate in the year.



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Moving to Slide 6, which is an overview of NCR's strategic offers within the omni-channel market. NCR has a clear solution-driven strategy as we continue to execute on our vision to become a software and services-led data-driven business.

You have heard us talk about branch transformation for some time. We are seeing positive signs of the physical channel becoming increasingly more relevant to our financial institutional customers as they embrace their retail branch network. For example, a key customer of NCR's, JPMorgan Chase, recently announced its intention to open up 400 new branches and expand to 15 to 20 new markets. This is indicative of the importance of the branch network and the transformation taking place in the market.

Branch transformation provides a combination of Hardware and Software products to achieve the right strategic mix of personnel-assisted and self-service channels to evolve the branch environment. The transformation of the branch allows a financial institution to evolve their service offering to their customers while managing costs, and NCR solutions sit in the epicenter of this transformation.

We also continue to advance our market leadership position within self-checkout, where we expanded our offerings into Israel. Bitan Wines Group, one of the largest supermarket chains in Israel, will begin installing NCR FastLane SelfServ checkouts. Our FastLane mobile shopper, which creates a frictionless, scan-as-you-shop experience was deployed by Woodman's in the U.S. and Globus in Russia. We also introduced new innovations like Picklist Assist, which use computer vision with artificial intelligence software to automatically recognize the fruits and vegetables that the shopper is purchasing.

Altogether, NCR strengthened our leadership in store transformation and the reinvention of checkout with self-checkouts and mobile shopping powered by intuitive software that creates a quick and easy way for shoppers to scan, pack and pay, allowing retailers to free up resources to take on new higher-valued services like Click & Collect.

Our global leadership and superior innovation is evidenced by the strong third-party industry accolades. To highlight just a few, RBR's latest Global Point-of-Sale Software 2017 report identifies NCR as the #1 global point-of-sale software provider in the retail and hospitality industries for the second consecutive year.

NCR's Financial Services and Retail Solutions were recognized for excellence in product design with 4 GOOD DESIGN Awards, including for our 80 Series ATM and FastLane self-service checkout solution. And finally, NCR was recognized as a 2018 top 100 global technology leader by Thomson Reuters.

On Slide 7, I thought it was important to provide you with a progress report on the productivity initiatives we laid out at our Investor Day 2 years ago. We discussed initiatives to drive \$300 million to \$400 million of savings by 2020 or \$100 million per year, with half reinvested into the business and half dropping to the bottom line.

We are on track to achieve our goals. We have accelerated our cloud revenue growth, expanded Services margin by over 300 basis points, improved our customer service experience scores by 500 basis points and created an industry solutions group to help drive improved sales execution. We are encouraged with the progress we've made thus far and expect significant savings to continue going forward.

As a sign of that confidence, we are evaluating a multiyear restructuring program that will accelerate our transformation, and I look forward to providing more details on these initiatives on our Q1 earnings call and at our Investor Day on May 14 in New York.

Slide 8 provides a high-level view of the key areas. We are looking at a number of initiatives to continue to drive Services margin expansion and transform our Hardware supply chain and manufacturing network to drive sustainable higher long-term margins.

We are making tough decisions, which are the right decisions, and we are very excited about the future. This restructuring is consistent with our focus on strengthening our global competitive position, best utilizing our resources and accelerating our transformation to a software-led solutions company.



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We will build on our progress to date and seek to hasten our efforts to drive market share and focus investment on the most attractive revenue opportunities while increasing operating efficiencies. This will allow us to continue to transition into a leaner, more efficient organization that is better positioned to drive margin expansion and create long-term shareholder value.

Looking at each of the components, starting in Software, our focus is centered on evaluating our current offerings to product life cycle management and realigning resources, best optimizing our portfolio. This strategic focus will ensure our offerings, sales organization and development teams are focused on the software applications that represent the highest growth potential for NCR.

In Services, we will build upon our success by accelerating the structural changes we are making around key service areas, such as remote and predictive, streamlining our offerings, simplifying our internal processes and increasing our customer engineer utilization rates. We believe addressing and improving these areas will strengthen the long-term growth potential of our Services business and drive further margin expansion.

Lastly, we are taking a very hard look at our Hardware business to identify where we can streamline our operations and determine how we can build products better and more efficiently. We are extremely excited about this opportunity. We are focused on driving costs out of our products and processes, further stabilizing operations and optimizing our facilities and infrastructure. We are evolving our Hardware manufacturing strategy aimed to shift costs from a largely fixed structure to a more variable cost structure and reduce our exposure to hardware cycles.

We are also focused on increasing our global utilization rates and optimizing our supply chain network through localization, minimizing inventory, improving on-time delivery and having a rigorous focus on quality, all of which are expected to improve working capital and margins.

While we are still finalizing the restructuring programs across our entire enterprise, we expect the cash cost of the initiatives to be in the \$150 million to \$200 million range over the next 2 years and generate approximately \$150 million of annual run rate savings by 2020.

We assume \$60 million per year of transformation costs associated with \$100 million per year of savings outlined at our last Investor Day. This accelerated transformation that we are discussing now will require \$30 million to \$80 million of incremental investment over the next 2 years to drive \$50 million more annual savings by 2020, an attractive payback.

We believe our actions across each of our segments will allow us to further strengthen our competitive position, accelerate our transformation and enhance our margins.

With that, I'll turn it over to Bob, who will walk through the financial performance and outlook in more detail. Bob?

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### **Robert P. Fishman** - NCR Corporation - Executive VP, CFO & CAO

Thank you, Mark. Slide 9 shows a summary of our segment results for the fourth quarter with flat Software revenue, an increase in Services revenue of 2% and a decrease in Hardware revenue of 9% constant currency, all of which are in line with previous expectations. Gross margin in our Services segment expanded 280 basis points, mostly offsetting the impact of margin declines in our Hardware and Software segments. We will go into the details as we walk through each segment.

In the supplementary pages, we include our GAAP to non-GAAP reconciliations. The GAAP results for the quarter included a mark-to-market pension adjustment of \$28 million compared to \$85 million for the prior year. The decrease was primarily due to more favorable results with our international plans in 2017.

Additionally, the GAAP results include a provisional charge of \$130 million in the fourth quarter to reflect the impacts of U.S. tax reform. The charge is primarily related to 2 noncash items: first, a \$94 million charge to write down our net U.S. deferred tax assets to the lower 21% corporate tax rate; second, a \$36 million charge as a result of the deemed repatriation of earnings from our non-U. S. subsidiaries. We expect to be able to utilize available foreign tax credits to settle the charge as a result of the deemed repatriation, resulting in no cash impact.



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Slide 10 shows our Software results. Software revenue in Q4 was flat, excluding FX year-over-year. Cloud revenue was up 6%, with sequential cloud revenue growth of \$7 million, demonstrating the strength in our cloud business. We are also pleased with the continued momentum of new cloud bookings in the quarter as reflected by full year net ACV of \$67 million, up 46% from the prior year.

Software licenses declined by 10% on a constant-currency basis due to lower software license revenue associated with decreased ATM hardware sales, which was down 22%, a better result than expected. Professional Services revenue increased 1% on a constant-currency basis due to strength in channel transformation and digital enablement solutions. Software maintenance also showed sequential growth.

Software gross margin rate was down due to lower software license revenue. The decrease from lower software license revenue was partially offset by our continued execution on strategic priorities to improve efficiency and scale in our software maintenance and cloud businesses. We expect margins for the Software segment to increase over time as we see improved performance in cloud revenues and we continue to expand software maintenance and cloud margins.

Turning to Slide 11. Services had another strong quarter, where gross margin rate expanded 280 basis points and operating income as a percentage of revenue expanded 260 basis points on a constant currency basis in addition to 2% top line growth, excluding FX. The revenue increase was driven by expansion in our annuity services with continued Hardware maintenance growth, reflecting channel transformation trends and demand for managed and implementation services.

We are pleased with the higher file value, which is the backlog metric for our Services business. Services gross margin rate continues to expand due to sustainable profit improvements achieved through our M1 initiative. M1 is centered on modernizing our Services business in terms of how we face and service our customer base and identifying the areas where we can improve our structural efficiency. We are also focused on driving higher managed services, which helps achieve stronger margins.

Our investment in big data analytics, predictive monitoring and customer onboarding continued to reduce the number of repair dispatches and allow customer service cases to be resolved more efficiently, increasing margins in the Services segment. Sustainable Services margin expansion remains a key focus as we execute our strategy.

Turning to Slide 12. Hardware revenue was down 9% on a constant currency basis. Our point-of-sale hardware portfolio continued to show strength, growing 20%, reflecting market share gains and the introduction of a new 4-core omni-channel solution in the petroleum and convenience market. ATM revenue was down 22% in the fourth quarter after being up 29% in Q4 of the prior year. ATM revenue was down in the quarter due to lower backlog beginning the quarter, but was better than previous expectations.

Self-checkout revenue was down slightly in the quarter due to a difficult comparison of up 140% in Q4 of last year. However, self-checkout increased significantly from the prior quarter, driven by large customer rollouts amid global demand. Hardware gross margin rate declined due to lower ATM volume and new product introductions. Improving Hardware margin rates is a significant focus of ours as we accelerate our transformation.

Slide 13 shows our segment results for the full year. Software revenue was up 3%, Services revenue was up 3% and Hardware revenue was down 2% constant currency. The Software segment is still our highest gross margin business at roughly 51% and represents the largest component of our operating income at 66% of our total operating income in 2017. Cloud revenue continued to accelerate, up 6%, driven by prior period bookings. We remain pleased with the momentum of new SaaS bookings in the year, as reflected by an increase in net ACV of \$21 million year-over-year.

On attached software licenses or software sold independent of a hardware sale grew 12% in 2017. The Services segment significantly expanded their margins by 310 basis points in 2017, led by sustainable improvements achieved through M1. Our recurring revenue streams continued to grow and increased 100 basis points year-over-year, providing better future revenue visibility and higher margins.

On Slide 14, you can see free cash flow for the quarter and the full year. Free cash flow was \$402 million in Q4 and \$453 million for the full year. Both Q4 and full year 2017 represents strong free cash flow performance, but are lower than the prior year due to a \$100 million working capital improvement in Q4 of 2016. We are pleased with our full year free cash flow conversion rate of 92% and expect a consistent trend as we move forward into 2018.



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Slide 15 shows our net debt to EBITDA metric with a net debt leverage ratio of 2.2x for full year 2017, which represents continued improvement when compared to the 2.4x at Q4 2016. The reduction in financial leverage provides the board with increased optionality regarding capital allocation. We will continue to return cash to shareholders, evaluate M&A transactions and pay down debt.

As noted in our earnings release, we plan to repurchase up to \$300 million of our stock under our existing share repurchase programs during 2018. To date, we have purchased approximately \$125 million.

On Slide 16, you will find full year 2018 guidance. Revenue growth is expected to be flat to up 3%. In terms of our revenue guidance by segment for the full year, our expectation is consistent with the strategic mix shift in the business and will help drive operating margin improvement.

Software is expected to grow low- to mid-single digits with cloud growing approximately 10%. Services is expected to grow low-single digits and include an improved mix of higher value services. And Hardware is expected to be flat to down mid-single digits.

Our GAAP EPS is expected to be \$2.08 to \$2.48 and includes an estimated \$100 million to \$150 million pretax charge related to our restructuring plan.

Annualized savings are expected to reach \$150 million by 2020. Our non-GAAP EPS is expected to be \$3.30 to \$3.45 for the year, up 3% to 8% versus the prior year. Operating margins are expected to expand 40 basis points at the midpoint, driven by gross margin improvements in all segments.

We are estimating that our 2018 tax rate will be 24%, a 1% improvement over the 25% effective tax rate in 2017. Approximately 45% of our earnings or roughly \$300 million will benefit from the lower U.S. tax rate, which would imply a 6% benefit in the effective tax rate. However, several of the revenue raisers in the law change will impact our tax rate, primarily the loss of the domestic manufacturing deduction, other domestic provisions, limitations on our ability to use foreign tax credits and the international provision aimed at broadening the U.S. tax base. The impact of these items offsets the benefit by approximately 5%, resulting in our 24% effective tax rate in 2018.

We expect free cash flow to be approximately 90% of non-GAAP net income. We expect free cash flow linearity to follow a similar pattern to previous years with the majority of free cash flow generated in the fourth quarter and higher working capital requirements earlier in the year. Our free cash flow guidance includes approximately \$100 million for the accelerated transformation initiatives we discussed earlier. Also included in our free cash flow guidance is an expected 2018 cash tax rate of approximately 16% versus our effective tax rate of 24% in 2018. As in prior years, the cash tax rate is well below our expected 2018 effective tax rate.

NCR has been a strong supporter of U.S. tax reform and is encouraged by the significantly reduced rate to repatriate overseas earnings, elimination of the second layer of tax on dividends back to the U.S., lower U.S. corporate income tax rates and more appealing investment environment in the U.S., which this legislation enables.

Next, we have our Q1 2018 guidance. We expect revenue to be down 1% to up 2%. Our non-GAAP EPS is expected to be \$0.41 to \$0.47. We are starting the year with backlog roughly flat. This is impacting our software license revenue and hardware revenue in the first half of the year.

We expect lower profits in the first half of the year and improved performance as we build the backlog for the second half, expand gross margins and face easier comparisons versus the prior year. Our recurring revenue, including cloud revenue, continues to perform well.

With that, I'll turn it over to Mark for closing comments.

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### **Mark D. Benjamin** - NCR Corporation - President & CEO

Thanks, Bob. In summary, today, NCR remains a global leader in the delivery of solutions aligned with the megatrends impacting our end markets around the world. We finished 2017 as a \$2 billion software company with accelerating cloud revenues, an increasingly profitable services organization and global leadership in critical hardware applications, including ATM, point-of-sale and self-checkout.



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Our recurring revenues are growing, and we are converting over 90% of our free cash flow. We remain confident that our strategy, market approach and diversified solutions portfolio are aligned with the long-term trends in each of our markets and position us to continue our transformation into a software-led enterprise.

We enter 2018 excited about our future and our market position. We believe our focus on innovation, efficiency and enabling customer success best positions NCR to generate sustainable long-term growth and margin expansion.

We are evaluating initiatives aimed to increase margins in our lower-margin Hardware and Services segments while strategically aligning our resources with the highest growth, highest margin opportunities we see across our Software segment. These initiatives will accelerate our transformation and provide a very attractive payback.

That concludes our prepared remarks. Joining Bob and me for Q&A are Bill Nuti and Paul Langenbahn, Head of our Software business.

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) We'll go first to Katy Huberty with Morgan Stanley.

#### **Kathryn Lynn Huberty** - Morgan Stanley, Research Division - MD and Research Analyst

I have a couple of questions on ATMs that I'll lump together. You brought up the JPMorgan headline around expanding branches by 400. Curious as to whether you've heard other banks tie increased earnings and free cash flow from tax reform to the idea of accelerating investments in either Branch Transformation or expanding branches, whether you think that, that's a broad-based trend. And then if you just parlay that into a discussion around what you saw as it relates to order trends in the fourth quarter for ATMs specifically, how did that perform versus what you expected? And then more importantly, do you think that you can grow orders for ATMs in the first half, rebuild backlog? And is there a shot of ATMs growing as we move into the second half of the year? So I know there's a lot in there, but figured it's easier to just tie it all together.

#### **Mark D. Benjamin** - NCR Corporation - President & CEO

All right, Katy. Thanks for the questions. It's Mark. So in regards to the JPMorgan, obviously, we're thrilled with their partnership. They've been a long-time partner of NCR's. I think their announcement to expand the number of branches and additional markets really speaks to the Branch Transformation we've been talking about for many years, certainly serving their customer in more modern ways, the digital experience becoming very prominent. Certainly, our solutions enable that to occur with really automating the functions that once took a teller or a retail representative -- really becoming highly automated. So I think it's not just a JPM opportunity. I think we've been talking about this. We've been doing this with financial institutions around the globe. Do I think that tax reform is helping the banks in as far as accelerating their transitions? I think that's possible. I think there are a number of opportunities facing the ATM market regarding what we've talked about in the past, regarding Windows 10 upgrades, refresh cycles. So I think there's a number of drivers to why banks will continue to position themselves and plus keep them competitive in the market. As far as the Q4 comment, and maybe Bob will follow up. On the Q4 orders for ATMs, we actually did have a pretty good quarter in Q4. We really had tough compares when we looked at 2016 Q4 because we really did have an incredible Q4 '16. You remember the backlog story coming into '17, we were up 22% versus flat this year. So I think in a tough compare, we did see some good momentum in the order front for Q4. As far as the follow-up to overall 2018 ATM growth, while we modeled in some growth in the business, of course, Katy, we do think that there's some upside to the growth story for ATMs. The Windows 10, we're -- every month that goes by, every quarter that clicks by, we will get closer to decisions having to be made as far as the upgrade. The recyclers that are going into modern ATMs today gaining share. We talked to you about our 80 Series, which has really been a market leader for the last 18, 24 months. It continues to expand, enter new geographies. We'll see very good growth with that this year. So there's just a number of drivers we see, the refresh cycle of the fleet. We've talked about roughly 1 million ATMs that are NCR out in the field. Those will face refresh cycles really in these next 12, 24 months kind of time frame.



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**Robert P. Fishman** - *NCR Corporation - Executive VP, CFO & CAO*

And Katy, this is Bob. I would agree with Mark in terms of -- if you look at -- that the main pressure point in 2017 was ATM revenue. It was down 17% and then had a ripple effect on attached software license. Implicit in our hardware guidance for 2018 is an ATM business that's roughly flat. So a significant improvement for us, and it includes a lot of the items that Mark mentioned as well as some of the upside around Windows 10.

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**Kathryn Lynn Huberty** - *Morgan Stanley, Research Division - MD and Research Analyst*

Great. And if I may, just to follow up on Software. Unattached license was flat to down the last 2 quarters. Can you just talk about what's driving that? Understand the attach issues around ATM weakness. But why is unattached license down? And then when you think about double-digit growth in cloud in 2018, is that linear through the year? Does the growth rate build as you move into the second half? And then that's it for me.

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**Robert P. Fishman** - *NCR Corporation - Executive VP, CFO & CAO*

This is Bob. I'll make a quick comment on unattached software license and then hand it over to Paul. Unattached software license for 2017 was up 12%. So that's a number that we were proud of. It can be a lumpy business quarter-to-quarter as deals bump up against the prior year. But overall, I would say we're pleased with the 12% up number for '17. We have confidence going into '18. There's a number of new strategic offers that have been launched that give us the confidence that it will continue momentum in the back half of the year.

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**Paul Langenbahn** - *NCR Corporation - EVP of Global Software*

Yes. And Katy, this is Paul. I think the thing I'll just double down on a little bit there is, as we've modernized our portfolio of products on the software side, we're starting to see good funnel growth in the things that will drive future growth. You heard Mark mention FastLane Mobile Shopper, which is our frictionless self-checkout solution, all start to drive significant growth for us. We're seeing really good performance of our authentic transaction processing, Software and Financial Services. And these are new offers that are, if you will, in the portfolio, starting to kind of replace some of our more aged offers. The other thing I'd say is we are pushing the envelope on converting more and more deals to cloud. And you saw that in the ACV bookings in 2017, we continue to expect that to accelerate in 2018. And so we're orchestrating that as well where we think we can start to really perform better on the cloud side. And so we'll be managing our way through that as well.

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**Operator**

We'll go next to Paul Coster with JPMorgan.

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**Paul Coster** - *JP Morgan Chase & Co, Research Division - Senior Analyst, Alternative Energy, and Applied and Emerging Technologies*

First up, the ATM margins are kind of hitting new trough levels. Is it a function of volume versus capacity? Or is it pricing in the market? What's changed there? And can you talk to us a little bit about how this restructuring is going to change that particular dynamic?

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**Mark D. Benjamin** - *NCR Corporation - President & CEO*

Yes. I mean -- so Paul, thanks for the question. On the ATM margin side, it's largely a volume issue for us, and that really speaks to the second point, which I know in my opening comments I spoke to. We really had a chance last year, with disappointment in the ATM growth, to really step back and examine how we face the market and how our operations are structured certainly relative to fluctuations around ATM volumes and even SCO volumes for that matter. So it gave us a chance to do that. We're speaking today around really the transformation around our hardware, manufacturing and our network footprint as far as how we lower the fixed cost nature of our business today -- model today and really drive a variable cost model. How do we get greater utilization rates out of our factories? As an example, Paul, we manufacture in 5 different factories across the globe, and we



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have significant opportunities to improve utilization. We also have a new leader over our hardware organization that joined us really midway through the calendar year last year with a great experience coming from GE. So I think what you're seeing here in the restructuring programs really drive now to really change the way we face the market, how we produce our goods. It will give us a chance to lower costs, lower fixed costs, get closer to the customers and really be able to handle the variability of the swings that can occur with us.

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**Paul Coster** - *JP Morgan Chase & Co, Research Division - Senior Analyst, Alternative Energy, and Applied and Emerging Technologies*

Okay. The other thing, which I think is going to concern people is, it's another back-end loaded year and significantly so. I think it's about midpoint, what, 13%, 14% of revenue in the first -- or EPS rather in the first quarter, relative to the rest of the year guidance. That's kind of a trough level in terms of what the first quarter is contributing. Talk to us a little bit about -- you talked about product innovation that drives the second half visibility year-on-year comps. But what is there in terms of the order flow or early-stage client discussions that should give us confidence that, that second half is going to come through in the manner that you forecast?

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**Mark D. Benjamin** - *NCR Corporation - President & CEO*

Yes. So I'll make a couple of comments and then Bob can follow up. I mean, certainly, Paul, it needs to be a show-me story for this year. We understand that. We were incredibly disappointed last year that the back half didn't materialize as we thought it would. So we have in this Q1 some software license pressure that is obviously not helping us with the [skewing] of the year, if you will. But the backlog will expand as we have orders come through the system. Again, it was a flat backlog into '18, but again, on an absolute dollar basis, a good backlog to bring with us. The recurring lines of the business are performing and growing. So that includes cloud revenues. So I think when we also look at the historical trends around front half, back half as far as revenue composition, it's not a very significant departure from what we've averaged in the previous year. So again, we have a lot of confidence in the year. We have a lot of confidence in the guidance we're giving you today. The comps also get easier in the back half for us. So that obviously helps and derisk the story where last year, that wasn't the case. So Bob, I don't know if you want to follow up.

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**Robert P. Fishman** - *NCR Corporation - Executive VP, CFO & CAO*

Yes, I will. If I could speak quickly about Q1. In terms of Q1 being down versus Q1 of '17, we have about \$0.05 of pressure below the line, so think of that as OIE and tax rate. To Mark's point, we come into the year with software license and self-checkout backlog down, which is causing pressure in Q1. And then we do have the higher expenses in Q1 as we invest in selling and R&D to drive that growth in the back half of the year. So that would be my comment around Q1. But when I look at first half versus back half, actually, revenue and EPS are very similar to 2016. The revenue linearity in our guidance has 46% of the revenue in the first half of the year and 54% in the back half. That's only 100 basis points off of our historical average and again, right on top of 2016. From an earnings per share perspective, we typically do, over the last 3 years, 40% of our EPS in the first half, 60% in the back half. This year, our guidance is 35% in the first half and 65% in the back half, again, right on top of 2016. But when you look at the trend, you can get quite comfortable with the guidance. To Mark's point, backlog grows, gross margin rates improve, including the cost takeout and the mix of software improves. So we're very comfortable with the linearity, again, very similar to what we've done in the past and confident in the guidance.

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**Operator**

We'll go next to Dan Kurnos with Benchmark Company.

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**Daniel Louis Kurnos** - *The Benchmark Company, LLC, Research Division - MD*

Just a couple first on ATM. At the end of last -- on the call -- last call, you guys talked about ATM kind of looking up low single for '18. Now you've guided to flat. I don't know if that's just conservatism on your part or it has to do specifically with the backlog issue. You were obviously optimistic around the JPMorgan announcements. I don't know if the punishment for Wells has anything -- any impact on sort of your outlook. But just any thoughts on sort of the delta there, if it's really just kind of the backlog issue where you're starting the year. And then separately, obviously, you've



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been taking some share from Diebold, but now they lost the CEO and activists want them to sell the company effectively. Do you think there's any room for you guys to go after market share as the operation -- or operationally, there's really no change even with kind of the chopping of the head?

**Robert P. Fishman** - *NCR Corporation - Executive VP, CFO & CAO*

This is Bob. I'll take that one to start. It was my comment on the last call that talked about low-single-digit growth in the ATM business. Again, we're guiding to flat growth for 2018. Again, a huge improvement over the down 17% in last year. I would say that there is upside that is possible within the ATM business. But at this point in the year, we want to build responsible guidance around the revenue numbers. So from my perspective, when I look at Windows 10, and Mark alluded to this, when we look at the opportunity from an upgrade perspective, there's roughly 300,000 ATMs that we service that are less than 5 years old that have the possibility of driving upgrade revenue from Windows 10. The average upgrade is about \$1,400. So when you do the math, there's a \$200 million to \$300 million opportunity to -- for NCR over the next 3 years, and we've not factored anything in for 2018 when our experience with Windows 7 would suggest some might come to us in the back half of the year. Mark also talked about recycling and the trend that's going on there in terms of more and more of these ATM shipments being enabled with recycling, which will become a bigger piece of the installed base. The 80 Series continues to gain traction. We think there's upside there with CFIs and in Europe. And then when you just look at the average fleet age, which runs about 6 years for NCR, we have certain regions, Europe, Middle East, Africa, CLA that are all over 7 years. So those are the things that are not factored in. I think when I look back at the guidance, a flat number for ATMs is a good number to start the year and hopefully, we build from there.

**Daniel Louis Kurnos** - *The Benchmark Company, LLC, Research Division - MD*

And on the Diebold, any thoughts on taking share from Diebold?

**Mark D. Benjamin** - *NCR Corporation - President & CEO*

Yes. So Dan, this is Mark. So we continue to really enjoy our market share gains. Our products are market-leading. I will take this question as a chance to really -- because you cited the last quarter, so just keeping a little bit of score in the history. A year ago this quarter, we spoke about really a new organizational model here at the company where essentially, we aligned the internal NCR operations to meet with a line of business and reporting the external model, which is the way we reported it, so Hardware, Software and Services. And when we did that last year at this time, it was a large organizational shift internally, which, in hindsight, did have a bit of distraction, and it did cause some internal changes with where people were sitting, what they were doing. This year, as I look back, we're obviously well established in that model. We have a new global head of sales running our field sales force of over 1,200 associates. Our customers just came out, as I referenced earlier, a great year-end season with NCR Solutions, with NCR Services. So if you take all of that into account, Dan, and really our ability to execute in the market, we like our position.

**Daniel Louis Kurnos** - *The Benchmark Company, LLC, Research Division - MD*

All right, fair enough. A couple of quick ones then. Just on the new or the accelerated transformation. I know we've talked about end-of-life-ing in the past. Can you just kind of give us a road map as to how we should think about the impact for both the top and the bottom line? I know you gave us some numbers around the incremental investment, but just sort of the pace of that investment and any impact, if you do have to end-of-life certain products as you bring new products onboard and the subsequent impact longer term, if there are any revenue benefits in addition to the cost savings you expect to see there.

**Paul Langenbahn** - *NCR Corporation - EVP of Global Software*

Sure. This is Paul. I'll take that. I think that's directed primarily at the Software portfolio. So first of all, we have a lot of new offers. We referenced some of them earlier that we're incredibly excited about around both retail transformation, whether that is a front-end checkout experience, frictionless mobile shopping, outdoor transformation of the petroleum and convenience retailing area, where we're transforming the consumer



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experience out of the dispenser. All of those new offers, we expect to generate traction for us. Where the product life cycle management focus or the products that we are putting into end-of-sale or end-of-life, really, part of the focus there is just pruning the portfolio so that we can invest more in the things that will drive growth for NCR. So to give you some perspective on that, in 2017, we put -- we made end-of-life decisions on about 30 of our software products, which is about 15% of the portfolio, and we'll continue to work on that through 2018. That will allow us to continue to invest more in growth. The last thing I'll say is that everything we'll invest in, for the most part going forward, will support the platform strategy. And so even products that may have a licensed component will also drive the cloud component of our P&L through that ODSP platform strategy that Mark talked about earlier. So for us, everything starts to hang together centered around the ODSP and driving those strategic offers that Mark talked about there. That's where a lot of the cloud acceleration will come from.

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**Daniel Louis Kurnos** - *The Benchmark Company, LLC, Research Division - MD*

Got it, that's helpful. And then just last one for Bob, just sort of the housekeeping. Does the guide include the buybacks or not?

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**Robert P. Fishman** - *NCR Corporation - Executive VP, CFO & CAO*

I think the guide includes the \$125 million that we've done to date, but does not include the remainder of the \$300 million. Again, you could think of that as potentially 1 million share of upside associated with the \$175 million, depending on how quickly we buy and at what price.

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**Operator**

We'll go next to Dan Perlin with RBC Capital Markets.

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**Daniel Rock Perlin** - *RBC Capital Markets, LLC, Research Division - Analyst*

Bob, I'm just trying to reconcile a little bit what -- kind of what you call out with last quarter orders and backlog and ATM really flowing into the back half or the fourth quarter so far. So you had said you thought that would translate to about \$150 million in revenue shortfall. And then you had said the backlog conversion rates kind of expectation for another \$50 million. So that was like \$200 million that I think we thought, or at least I thought, maybe would flow into '18, which wouldn't be anywhere near kind of a flat number. So I heard all the reasons that you guys said. You're maybe being conservative. I'm just trying to make sure we kind of reconcile those comments into what just transpired in the fourth quarter as well as what you're guiding to. So can you help me bridge those?

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**Robert P. Fishman** - *NCR Corporation - Executive VP, CFO & CAO*

Yes. In terms of the numbers that you talked about, those were the reasons that we had pressure in the fourth quarter. The view was that those orders would come to us throughout 2018. So not necessarily in Q4 or right away in Q1. So in the ATM business, we need to build the backlog, win those orders to drive the growth in Q3 and Q4. And again, to the point Mark raised, the comparisons in Q3 and Q4 are much easier. So the goal is to drive the orders early in the year to support the backlog that didn't drive the ATM growth in the back half.

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**Daniel Rock Perlin** - *RBC Capital Markets, LLC, Research Division - Analyst*

So are you saying we're starting the first half of the year still in a hole of \$200 million and you're going to somehow reconcile that in the back half? Is that kind of the messaging?



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**Robert P. Fishman** - NCR Corporation - Executive VP, CFO & CAO

The ATM growth in the first half of the year would be slightly down, is the way I would describe it, and then grow in the back half. But I would not start with \$200 million of pressure. I would say slightly down based on the backlog position, but then improving in Q3 and Q4.

**Mark D. Benjamin** - NCR Corporation - President & CEO

Yes. And Dan, this is Mark. So I think also to add, the conversion rates really are what impacted us versus the backlog ATMs last year. So I think we were very thoughtful this year about looking at the trends and the history and how that backlog actually converts. So I don't want to oversell the conservatism point because I know you mentioned that in your question. But again, the compares will get easier, we are starting to see again in Q4. And as we enter this year, we are starting to see some of the North American movement on orders start to show themselves a bit, so meaning positively. So I think Bob's got it covered right. But this is -- again, we want to meet our commitments and we want to be responsible.

**Daniel Rock Perlin** - RBC Capital Markets, LLC, Research Division - Analyst

Understood. The incremental investments, I just want to make sure I also have this right. You said -- previously, you're going to have to invest \$60 million. Now you're saying it's an incremental of \$30 million to \$80 million. You're talking \$90 million to \$140 million or something to that effect. That's to just achieve the \$150 million to \$200 million cost savings that you expect on a run rate basis by 2020. So it wasn't clear to me how you're layering in that \$90 million to \$140 million. Is that heavy in '18 and less in '19 and -- or how are you thinking about that?

**Robert P. Fishman** - NCR Corporation - Executive VP, CFO & CAO

Yes. The best way to think about it is our free cash flow without the accelerated transformation would have driven \$100 million of savings, but would have had a \$60 million negative impact on free cash flow. So \$60 million cost in free cash flow in 2018 and 2019. So in terms of -- if we were running with the transformation we talked about at our last Analyst Day, it would've been \$120 million of cost. What we're saying now is that we're going to spend \$150 million to \$200 million. So think of it as an incremental \$30 million to \$80 million over the next 2 years. So for example, in 2018, I have \$100 million in my free cash flow, call it \$40 million more than I would have had if I had not accelerated this transformation. That accelerated transformation gets me \$50 million more savings by 2020 and obviously, that'll ramp into 2019. That's why we think it's a pretty good payback. It allows us to do things like continue to drive Services margins but as importantly, address our Hardware margin challenge. But that's why we want to do it now.

**Daniel Rock Perlin** - RBC Capital Markets, LLC, Research Division - Analyst

Okay. And then just one last one, real quick. As you guys went through this kind of strategic review process for the costs and all the things inside of that, I'm wondering if you didn't kind of unearth other assets that you might consider jettisoning throughout the year and just what that process might have looked like. I mean, you can't go through all these cost structures without finding some stuff maybe you may want to get rid of down the road. So any thoughts around that would be helpful.

**Mark D. Benjamin** - NCR Corporation - President & CEO

Yes. No, it's a good question. And we run a annual strategic plan cycle here at NCR. Certainly, this -- with the success we've had, Dan, in the Services transformation, which is also part of this restructuring and you saw that show through in really the great margin improvements in '17 that will also continue in '18 and beyond, it really gives us a lot of confidence, a, to go at these opportunities with restructuring and execute as aggressively as we can. The return is well worth the investment. As far as other opportunities to streamline the business and potentially jettison some products, I think we're -- we have a very, I think, well-identified product life management or PLM program we're running within our Software business. We have several dozens of products that will approach an end-of-life rather quickly for us. Some may include us giving -- selling those products or



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giving those products to other vendors. I think there's really significant opportunities as we go through the portfolio. And as we've gained confidence like we have in Services, I think this team is highly motivated to go execute against the drivers.

### Operator

We'll go next to Ian Zaffino with Oppenheimer.

### Ian Alton Zaffino - Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst

Two questions. I'm going to throw them out here at once. First of all, the -- I know you talked about the [strategy] at JPMorgan. What are you seeing on the regional guys and what are you hearing from them? Is it similar or are they maybe going the other way? And then the other question would be, on the buyback, it looks like you obviously bought some stock and -- versus last year where, I guess, that was really done, I guess, together with Blackstone maybe exiting some of their position. Was there a discussion about that maybe happening again? Is that still a possibility? And how do you think about buybacks now that you spent the \$125 million and there hasn't been maybe a similar deal that you had last year with Blackstone?

### Mark D. Benjamin - NCR Corporation - President & CEO

Yes. Ian, thanks for the questions. And maybe Bob and I will tag team on this one. So just the first part of your question around the regionals and the community institutions, I think they're on the same path of the Branch Transformation where digital and physical really are coming together. The community space, we've seen examples where they're well ahead of the larger regionals or top-tier institutions with their transformation using products like the interactive ATM that we speak about, early adopters of the recycling opportunity. So -- and by the way, also, a large buyer of our digital banking services that drives a lot of our cloud growth. So I think it's mixed, but we do see a little more nimbleness within that community and lower end of the regional side. And Bob, do you want to cover the second part? Maybe I'll...

### Robert P. Fishman - NCR Corporation - Executive VP, CFO & CAO

Yes. On the Blackstone, I mean, we can't speak for Blackstone. They're a large investor of ours. They'll make their own decisions. From a share repurchase perspective, we have \$175 million left to spend, and we expect to spend it opportunistically throughout the year in terms of buying back shares.

### Operator

And we'll go next to Kartik Mehta with Northcoast Research.

### Kartik Mehta - Northcoast Research Partners, LLC - Executive MD, Director of Research, Principal & Equity Research Analyst

Mark, in your comments about the Hardware business and maybe the [reformation] of the business, I'm wondering if you are considering being in the manufacturing business, maybe outsourcing the ATM or any other part of the manufacturing process you might have right now?

### Mark D. Benjamin - NCR Corporation - President & CEO

Sure. Yes, I mean, it's -- we're being a little cautious here on the call because we're -- we haven't really done anything internally. And obviously, these moves would have some impacts across the organization. But Kartik, I think you're on the right track with your question. Part of our hardware modernization efforts and transformation will be the use of third party and contract manufacturing for some aspects of our Hardware business. I can't tell you down to the specific percentage of ATM scope, [POS], what that would be and where that would be. It is a multiyear plan, so it does have a 2-year ramp to ultimately achieve what we want to achieve. And as we see success, we'll accelerate. But it is certainly part, Kartik, of our



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strategy around the use of outsourcing to make us, in many ways, more competitive, closer to the customer. There could be obviously significant improvements to working capital needs. So there's really just a number of benefits that we intend to get out of a program like this. It is a significant departure for NCR, but I think the teams running the Hardware business and driving the program are quite excited.

### Operator

At this time, I would like to turn it back to Mark Benjamin for closing comments.

### Mark D. Benjamin - NCR Corporation - President & CEO

Okay. Well, we realize it's probably a good end of the day after a day in the markets, but we appreciate your time tonight, and we look forward to talking to you soon. Thank you.

### Operator

That does conclude today's conference. We thank you for your participation.

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