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Unisys Corp. (UIS)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Unisys Corporation Third quarter 2021 Earnings Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to Courtney Holben, Vice President of Investor Relations. Please go ahead.

Courtney Holben

Vice President-Investor Relations, Unisys Corp.

Thank you, operator. Good morning, everyone. This is Courtney Holben, Vice President of Investor Relations. Thank you for joining us. Yesterday afternoon, Unisys released its third quarter 2021 financial results. I'm joined this morning to discuss those results by Peter Altabef, our Chair and CEO; and Mike Thomson, our CFO.

Before we begin, I'd like to cover a few details. First, today's conference call and the Q&A session are being webcast via the Unisys investor website. Second, you can find the earnings press release and the presentation slides that we will be using this morning to guide our discussion, as well as other information relating to our third quarter performance on our investor website which we encourage you to visit.

Third, today's presentation, which is complementary to the earnings press release, includes some non-GAAP financial measures. The non-GAAP measures have been reconciled to the related GAAP measures, and we've provided reconciliations within the presentation. Although appropriate under generally accepted accounting principles, the company's results reflect charges that the company believes are not indicative of its ongoing operations and that can make its profitability and liquidity results difficult compared to prior periods, anticipated

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future periods or to its competitors' results. These items consist of post-retirement, debt exchange and extinguishment, and cost reduction and other expense. Management believes each of these items can destroy the visibility of trends associated with the company's ongoing performance. Management also believes that the evaluation of the company's financial performance can be enhanced by use of supplemental presentation of its results that exclude the impact of these items in order to enhance consistency and comparativeness with prior or future period results.

The following measures are often provided and utilized by the company's management, analysts, and investors to enhance comparability of year-over-year results, as well as to compare results to other companies in our industry: non-GAAP operating profit, non-GAAP diluted earnings per share, free cash flow and adjusted free cash flow. EBITDA and adjusted EBITDA, and constant currency. For more information regarding these metrics and related adjustments, please see our earnings release and our Form 10-Q.

From time to time, Unisys may provide specific guidance or color regarding its expected future financial performance. Such information is effective only on the date given. Unisys generally will not update, reaffirm, or otherwise comment on any such information except as Unisys deems necessary, and then only in a manner that complies with Regulation FD.

And finally, I'd like to remind you that all forward-looking statements made during this conference call are subject to various risks and uncertainties that could cause the actual results to differ materially from our expectations. These factors are discussed more fully in the earnings release and in the company's SEC filings. Copies of those SEC reports are available from the SEC and along with the other materials I mentioned earlier on the Unisys investor website.

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

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Good morning, everyone, and thank you for joining us to discuss our third guarter results. During the third guarter, we made continued progress executing on our strategy for sustained revenue growth and margin improvement by expanding our solution portfolio and enhancing our go-to-market efforts, while managing our workforce to successfully attract and retain talent in a competitive labor market. We also increased gross profit and free cash flow year-over-year. Mike will provide detail on our financial performance and accomplishments. But, first, I will give some insight into the business.

Starting with Digital Workplace Solutions, or DWS, our goal has been to transform to a higher growth and higher margin business by enhancing and expanding our solution portfolio with a focus on proactive experience, leveraging our recognized leadership position in the market and our InteliServe and PowerSuite platforms. In the third quarter, we made progress toward these strategic goals, while exiting some contracts that weren't core to how we plan to grow this business.

With respect to the build portion of our build/partner/buy strategy, we have developed our Experience Model Office solution, or XMO. This offering analyzes data from multiple sources, including device experience tools such as our PowerSuite solution, our cloud contact center platform and other satisfaction and sentiment tools to identify and remediate pain points and improve user experience. This will help clients achieve business goals such as maximizing productivity and improving employee engagement, and will also streamline our support model by reducing reactive service needs.

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Additionally, we defined and began incorporating our second-generation Experience Level Agreement, or XLA, framework into contracts, providing a more advanced persona-based way for clients to assess the impact our solutions are having on user experience. We believe we are leading the market in advancing to second generation XLAs and our clients are responding positively.

We also filled several key leadership and architect roles during the quarter. With respect to partnerships in DWS, we have broadened our relationships with some leading device experience management partners to become channel partners in addition to solution partners. And our integration of Unify Square is progressing as we continue to actively assess additional opportunities to enhance our solution portfolio through acquisitions.

In the quarter, we signed a DWS contract with a global commercial real estate services firm to implement a case management system which will help the client move to a centralized global model for this process and technology. Also in the guarter, Unify Square signed contracts with nearly 20 new logo clients, including consulting contracts and PowerSuite software subscriptions, focused on migrating to or managing Zoom and Microsoft Teams UCaaS environments.

Moving to Cloud & Infrastructure Solutions, or C&I, we continued to execute on our strategy of growing cloud in our targeted markets by leveraging our established credentials. CloudForte and embedded security solutions to help clients transform their traditional ITO environments to effective hybrid and multi-cloud solutions. Revenue growth continued during the third quarter in C&I with cloud revenues specifically growing 26% year-over-year. As we noted on our last call, in July, we completed a new release of our CloudForte program. And since July, we have continued to enhance the artificial intelligence embedded in CloudForte with a specific focus on cloud spend optimization.

We're also utilizing predictive analytics to help clients avoid incidents and automated root cause analysis to remediate and prevent future issues. Additionally, increased migration automation in our solution allows us to move significantly more workloads to the cloud more quickly at increased levels of reliability. We are on schedule for a new release of the CloudForte platform with additional functionality in the fourth quarter.

We're also expanding our partnering with CloudForte including enhanced integration with Google Cloud, increasing our ability to deliver outcome-based end-to-end cloud services to clients using Google Cloud and to help them optimize their workforce environment. We have broadened our work with AWS and Microsoft Azure, increasing automation to enable a more seamless experience for clients with improved functionality while also enhancing cost efficiency.

We are assessing potential C&I acquisition candidates with a focus on enhancing specific capabilities and increasing geographic coverage. And during the quarter, we signed a contract with a leading Mexican insurance company to design a hybrid environment integrating public and private clouds and to perform related migration work.

Turning to Enterprise Computing Solutions, or ECS, our goal is to grow revenue through expanding the ECS ecosystem, while maintaining license revenue stability. We are enhancing our existing services and platforms and developing new solutions to help clients manage their ClearPath Forward environment. We are incorporating advanced AI and automation into our Application Lifecycle Management platforms and workflow-oriented design into our Application Development Solutions. We're also expanding the interoperability of our ClearPath Forward systems which are already able to be deployed in the public cloud via ClearPath Forward for Azure to enable use in a hybrid and multi-cloud environment.

Our IP-led industry focus solutions such as AirCore and Elevate represent an additional opportunity for growth in ECS. We're partnering with software and platform developers to modernize our application development and to enhance our lifecycle management of these solutions, and we're working with channel partners to embed these industry applications into their solutions to increase our client reach.

We're also evaluating opportunities to acquire smaller companies that support ClearPath Forward. We recently signed a contract with New Zealand's Waka Kotahi NZ Transport Agency to extend our engagement to manage IT infrastructure on the ClearPath Forward platform to support systems processing approximately 25 million drivers license and 60 million motor vehicle transactions per year.

Turning to our broader go-to market efforts, our total company TCV was up 13% year-over-year in the third quarter and total ACV was up 30% year-over-year. As we price contracts, we're aiming to offset our anticipated cost increases, leading to the competitive market for later. Total company pipeline was also up 5% sequentially supported by growth in our proactive experience DWS solutions and cloud solutions pipelines, which increased sequentially both on a dollar basis and as a percent of total pipeline.

We're increasing awareness in our new DWS and cloud capabilities meeting frequently with industry analysts such as Gartner, IDC, Everest, ISG and HfS, and we have been recognized for our leadership in a number of areas. We were recently named a leader in advisory firm ISG's Provider Lens study on the future of work in both managed employee experience services and managed digital workplace services in the US, the UK, and in Brazil, in addition to other regional leadership recognition. We were also named a leader in the Next-Gen Private and Hybrid Cloud Managed Services by ISG in the US, the UK, and in Brazil, and we're recognized by IDC as a major player in worldwide managed multi-cloud services.

We have evolved significantly as a company, and we're launching a global advertising campaign to help ensure that the market knows who Unisys is today. We're undertaking a similar initiative aimed at attracting talent in key recruiting geographies. We're also expanding the depth and breadth of content on our website and implementing a cross-selling initiative to highlight our full portfolio of solutions across segments to clients. The mark for talent remains highly competitive and our workforce management efforts, including compensation retention adjustments and increased associate initiatives such as talent development, internal mobility and focus on workplace flexibility have helped us to continue to attract and retain key resources needed to execute on our strategy.

Our last 12 months voluntary attrition was 15.3%, which is significantly below the pre-pandemic level of 17% for the third quarter of 2019. Demand for open roles filled internally as a percent of total increased 6 points for the year-to-date versus 2020 to 36%, reflecting the effectiveness of our internal development, mobility programs and up-skilling, and referrals represent over 20% of total hiring on a year-to-year basis.

Our commitment to DEI is a bedrock of our people strategy. Unisys was named a Champion of Board Diversity for the seventh consecutive year by The Forum of Executive Women and women representation as a percent of the leadership of the company has increased by 3 points from 32% as of 2020 to 35% on a year-to-date basis.

In conclusion, I'd like to thank our associates for their ongoing effort in supporting our strategy and progressing toward achieving the goals we set out at the beginning of the year.

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

Michael M. Thomson

Executive Vice President & Chief Financial Officer, Unisys Corp.



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Thank you, Peter, and good morning, everyone. In my discussion today, I'll refer to both GAAP and non-GAAP results. As a reminder, reconciliations of these metrics are available in our earnings material. As Peter highlighted, during the third quarter, we continue executing on our strategy for sustained revenue growth and margin improvement by expanding our solution portfolio and enhancing our go-to-market efforts while proactively managing the workforce and increasing gross profit and free cash flow year-over-year. Overall, our year-to-date performance is in line with our internal expectations and we are reaffirming all full year 2021 guidance metrics as a result.

During the third guarter, we grew revenue in two of our three segments with continued year-over-year revenue growth in both C&I and ECS. Our ongoing enhancements to our cloud capabilities and efforts to increase awareness with industry analysts and clients continue to yield results with C&I revenue growth of 1.7% year-overyear to \$118.9 million in the third quarter. This was supported by cloud revenue growth within the segment of 26% year-over-year.

One item to keep in mind going into the fourth guarter is that we expect our C&I revenue to be down year-overyear due to a timing issue associated with revenue recognition from a public sector client that benefited us in the fourth quarter of 2020, as well as some run-off traditional infrastructure work that's not part of how we're planning to grow this business. We still expect C&I to be the fastest growing segment overall for the full year 2021.

The enhanced functionality associated with our ECS solutions including ClearPath Forward for Azure and our focus on growing ECS services continues to provide benefits to the ECS segment. ECS revenue grew 1.8% yearover-year. This growth was helped by a higher license revenue than expected in part due to a contract being renewed for a longer duration than initially anticipated. I think the fact that clients are signing eight-year agreements for ClearPath Forward operating system is a testament to the strength of the solution and the modernization road map that supports this offering. ECS services revenue grew 1% year-over-year.

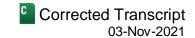
As we previously noted, we had expected the third quarter to be the lightest of year in terms of license revenue, which we still expect to be split approximately 55% and 45% between the first and second half of the year. This software renewal cadence is as expected and actually de-risks the fourth quarter as ECS license revenue is more evenly distributed throughout the year with a lot less reliance on fourth quarter signings. As a reminder, the prior year first half, second half split was 40%, 60%, with 40% of the full year segment revenue coming in the fourth quarter. We expect overall 2021 ECS revenue to be roughly flat year-over-year.

With respect to DWS, we're moving into the next phase of our transformation of this segment with a heavy emphasis on our go-to-market implementation, enabling us to bring our enhanced experience solutions to new and existing clients. We have transitioned away from some heritage contracts that were not core to how we're planning to grow this business. We also saw some impacts related to supply chain shortages, and both of these items impacted revenue, which was down 4.7% year-over-year to \$141.3 million. As a result of all of this, the total company revenue was down 1.5% year-over-year in the third quarter to \$488 million.

As I noted, though, this does not change our expectations for revenue for the full year as this quarterly cadence was anticipated and was embedded in our guidance, as was our expectation for year-over-year decline in the fourth quarter revenue due to the timing issues I mentioned, which is why we're reaffirming that guidance at zero to 2% year-over-year revenue growth.

The company backlog was impacted by the continued shift of our mix of business towards higher growth and higher margin solutions and the exiting of some non-strategic contracts. Additionally, during 2021, we have seen the duration of contracts in backlog shortening as it did in 2020 and 2019. As a result, total company backlog was

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\$3 billion as of the end of the third quarter, relative to \$3.3 billion as of the end of the prior quarter. Type of solutions that we are shifting our mix towards are less capital-intensive and have a shorter implementation timeframe, which we expect will leave this backlog to convert to revenue more quickly than it has in the past. This is supported by year-over-year increase in ACV that Peter noted. Of the \$3 billion in backlog, we expect approximately \$380 million will convert into revenue in the fourth quarter.

Moving to profitability, third quarter total company gross profit was up year-over-year and gross profit margin was up year-over-year as well. These results were supported by year-over-year improvements in C&I and ECS gross margins. C&I gross profit increased 116.3% year-over-year to \$9.3 million and gross margin improved 410 basis points to 7.8%, driven by the improvements to margin in both cloud and traditional infrastructure work. ECS gross profit increased 28.8% year-over-year to \$97 million and gross margin improved 1,360 basis points to 65%, helped by the higher revenue I mentioned earlier. DWS gross profit was \$16.8 million relative to \$21.6 million in the prior year period, largely driven by the flow-through impact of lower revenue. DWS gross margin was 11.9% relative to 14.6% in the prior year period.

As with revenue, our year-to-date non-GAAP operating profit margin results are roughly in line with internal expectations. And accordingly, we are reaffirming our full year 2021 guidance for this metric at 9% to 10%. SG&A expense increased year-over-year in the quarter largely due to increased investments in our go-to market efforts, primarily related to direct sales support and increases in non-cash-based compensation.

As a result, total company non-GAAP operating profit margin was 5.7% relative to 8.6% in the prior-year period. We anticipated additional investments in our go-to market efforts over the next few quarters to support our growth strategy, increased awareness of our enhanced solution portfolio and, within the context of a highly competitive labor market across the IT services industry, increased compensation to retain and attract top talent, we need to maximize our growth strategy. Based on this, we expect to be towards the lower end of the non-GAAP operating profit margin guidance I've just mentioned.

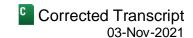
Consistent with our discussions over the last couple of quarters, I'm pleased to report that we've concluded our cost optimization program, and it is now fully underpinned. The annualized savings associated with this program are at the high end of the targeted range we provided which was \$130 million to \$160 million. As I mentioned already, the reinvestment of a portion of these savings has begun and will continue through the first half of 2022.

Our net loss from continuing operations was \$18.7 million or \$0.28 per diluted share versus \$13.3 million or \$0.21 per diluted share in the prior-year period. Non-GAAP net income was \$6.9 million versus \$36.8 million in the prioryear period, and non-GAAP diluted EPS was \$0.10 versus \$0.51 in the prior-year period. These GAAP and non-GAAP net income and EPS results are reflective of lower operating profit that I mentioned, as well as higher taxes this year due to the geographies in which the income was earned.

As with revenue and non-GAAP operating profit margin, our year-to-date adjusted EBITDA results are generally in line with our expectations. And so, we're reaffirming full year 2021 guidance for this metric at 17.25% to 18.25%.

Adjusted EBITDA in the guarter was \$74.6 million relative to \$82.3 million in the prior year period, and adjusted EBITDA margin in the quarter was 15.3% versus 16.6% in the prior year period based on similar drivers as non-GAAP operating profit and margin. Likewise, as with operating profit, we expect to be towards the lower end of the guidance range in light of these investments in our team to support growth in a competitive labor market.

We continue our capital-light strategy and our focus on integrating best-in-class offerings to enhance our solutions and optimize our development costs. Our capital expenditures declined year-over-year again in the third quarter,



down 18.4% to \$26.1 million. We now expect CapEx to be between \$100 million and \$110 million for the full year 2021, which is lower than our previous expectations.

Free cash flow and adjusted free cash flow also continued to improve with free cash flow up 14.9% year-over-year to \$39.4 million and adjusted free cash flow up 36.3% to \$69.9 million. These cash flow metrics were also up significantly on a sequential basis and we continue to expect to be free cash flow positive for the full year 2021.

In continuing our efforts to further de-risk our balance sheet, we completed a transfer of additional gross pension liabilities in October through a \$235 million annuity contract. We expect a one-time, non-cash, pre-tax settlement charge in the fourth quarter associated with this liability transfer of approximately \$130 million or \$1.94 per share.

Another positive balance sheet item to note is last week, Moody's has resolved the positive outlook associated with our debt by providing an upgrade of our Corporate Family Rating to B1 with a stable outlook, and our senior secured notes were upgraded to B1 as well.

To wrap up, our third quarter was consistent with our expectations and represents continued progress on our refresh strategy and the achievement of both our short and long-term financial goals, and we look forward to continuing this progress in the fourth quarter.

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

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Mike. Before opening the call for questions, I would like to highlight some upcoming leadership changes that we noted in our earnings press release. Mike will be taking on the role of President and Chief Operating Officer effective upon the hiring of a new CFO. As you know, Mike has played a central role in the significant financial transformation of the company since becoming CFO in 2019, including the substantial strengthening of the company's balance sheet. Mike has also played an important operational role in the company and he currently overseas our corporate development efforts and our strategy function.

I would also like to thank Eric Hutto, our current President and Chief Operating Officer, who is leaving the company after 6.5 years of service to pursue other interests. Eric has been instrumental in improving the financial performance of the company over the last few years and in the implementation of our new strategy and operating model, as well as other elements of the company's business during his tenure. Eric will be leaving his current role on November 30.

We have begun a search for a new CFO and Mike will continue to fill that role until we have appointed a new CFO. At that point, he will transition to President and Chief Operating Officer. I will assume Eric's responsibilities on an interim basis until the CFO transition is complete. As a reminder, I also served as President from January of 2015 until March of 2020. We wish Eric success in his future endeavors and look forward to Mike's contributions in his new role.

With that, operator, can we please open the call for questions?

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now begin the question-and-answer session. [Operator Instructions] Our first question comes from Rod Bourgeois from DeepDive Equity Research. Please go ahead.

Rod Bourgeois

Analyst, DeepDive Equity Research, LLC

Hey, guys. Hey, good morning. And hey, so first question about top line trends, particularly with bookings. So, the backlog, I guess I'm wondering is there additional intentional backlog churn that should occur as you continue to shift your mix to these more attractive segments. I guess I'm just wondering, there seems like there's a lot of mix shift happening and impacting the backlog. You exited some contracts this quarter. Is there more of that activity to come or is the bulk of that completed at this point?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Yeah, Rod, this is Peter. Thanks for the question. There is a little more of that to come. So when there are a couple of things happening on the backlog number and Mike pointed out several of them, the first is, there is just – there is some additional, if you will, field services revenue that is low margin, that we are continuing to work with clients on. And we're looking for a path to get to higher margin contracts with them, really moving them into next generation. If we do, that's great. If it continues to be basically from us not a successful endeavor, then we expect there'll be some more of that attrition of the lower margin work. Not a material amount, but some.

The second thing that's happening around the backlog number, as Mike also pointed out, is really a mix change in what we're signing as well as a mix change in our pipeline. So, from a backlog standpoint, when we look at the types of work we're signing, a bigger percentage of that is higher margin, a bigger percentage of that is the next generation work in our DWS business and the cloud work in our Cloud & Infrastructure business. That's what we want. That is the strategy of the company.

But those types of business tend to be shorter duration contracts, at least initially. And so, you see our ACV or annual contract value, which is what we measure as the revenue in the first 12 months of signing a contract, ACV is going up 30%, while TCV, the total contract value, is going up 13%. Both good numbers. We like 13% up. We like 30% up. But you could see the balance is different and that's because the contracts at least to-date are shorter term as we move into that new world. So that's why you have a little more effect on backlog. I hope that's helpful.

Rod Bourgeois

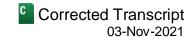
Analyst, DeepDive Equity Research, LLC

Yeah. That's very helpful and clear. And I assume – should we assume that contract duration will continue to come down given that the lower duration is not only – is continuing in your existing pipeline?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

I think to a modest degree. I mean, as I'm looking at the average contract size that we have now, I think that it's very close to where it will essentially stabilize. So I think there's a little bit of that, Rod, but I don't think there's much left. I think we're close to the average contract duration we expect to get.



Rod Bourgeois

Analyst, DeepDive Equity Research, LLC

Okay. Great. And then just on the operating margin outlook, it seems that, as you called out in your commentary, you've increased your go-to market investments. And it was interesting to me, a lot of the other IT services firms are just seeing a general increase in talent cost...

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Yes.

Rod Bourgeois

Analyst, DeepDive Equity Research, LLC

...of wage inflation, attrition, and so on. And it seems like that effect within Unisys is less pronounced, perhaps, than what's happening at other firms. Is that an accurate assessment where your margin challenge this year is more to do with go-to market investments rather than a general increase in talent across the board? Is that the right way to look at your margin challenge this year?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

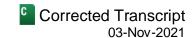
So, it's a really good question and it's one that we've actually done a lot of work on. Katie Ebrahimi, who leads our HR team, Mike and others, as well as myself have really kind of wanting to understand – first of all, we're on track. So, we're very specific about the guidance we give. We're reaffirming guidance. That's on a revenue standpoint, that's on an earnings standpoint, as well as an EBITDA standpoint. And so, we're on track with our numbers and we're on track with the process we expected this year. So, there are a couple of things going on for us beyond what I would consider the two surprises. And the two surprises are increased labor rates and supply chain hindrance, if you want to talk about that.

So, let me get back to the two surprises after I kind of set out the framework. So, we always knew this year was going to have really two parts, first half and the second half which is the way you should have a year. So, we always have two parts, but specifically in the first half of the year that was bringing in and enhancing our leadership team now that we have changed our organizational model as of January 6 of this year. And in the first six months, we brought in six significant executives, and they have brought in members of their teams as well. So, leadership team started. And the second thing that happened in the first half of the year was really building out the functionality and the capability of what we expected to sell in next generation DWS and the next generation cloud.

The second half of the year, it was really devoted to building out our go-to-market efforts and those are underway. And so, you're seeing us spend more money around sales resources, you're seeing us spend more money as we put together a new branding and advertising which for Unisys is very important. That's part of what we have to do as we move into the next stage. So, we're on track, but it has been a year full of change which we expected.

Now, with respect to margins, again we're on track on our margins, but we have had two surprises. And the cost of labor is higher than we expected and that's true really on a global basis. One of the things that has happened in a COVID and post-COVID world is the availability of people is actually higher, because you can now hire people to work remotely pretty much anywhere, so that's a good thing and the bad thing is that means they can work for anybody.

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So the demand on resources is higher. So we are seeing an increase in labor costs. We think we're handling that pretty well. Our turnover – last 12 months turnover is lower than it was in 2019, which we think is the right compare. And we think that the increase in our turnover has been modest compared to some other firms in our industry. But it's still getting – getting to that point, it still required, if you will, a surprise upside to our cost structure and we're not – and although we are making changes in pricing and we do believe that we have the ability to increase prices, that's our new work on renewals as well as through cost of living adjustments in our existing price contracts, it's not immediate and it's not necessarily a complete one for one in a quarter or even in two quarters. But we think that we have pricing power, we have a handle on that.

The other change that has been a surprise is supply chain. So we are having issues getting all of the third-party equipment and parts necessary to kind of fill our expected funnel. And so, that means some less revenue for us in the quarter in terms of getting third-party products through our system, but more than the third-party product revenue, it means our people are not as busy. We think that's temporary. And so, we are, if you will, staffing to a slightly higher rate of supply chain than we currently have to deliver. And that's because we do believe the supply chain issues are temporary. So, in the meantime, that has increased our cost somewhat. Long-winded answer, but I hope that helps, Rod.

Rod Bourgeois

Analyst, DeepDive Equity Research, LLC

That's super helpful and congratulations on the attrition accomplishment there. So, I'll hand it over. Thank you.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Okay.

Operator: [Operator Instructions] Our next question comes from Joseph Vafi from Canaccord. Please go ahead.

Joseph Vafi

Analyst, Canaccord Genuity LLC

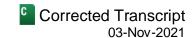
Hey, guys. Good morning. And, Mike, congrats on the upcoming promotion, well-deserved. It's maybe a little early, but here we are, we're in November and I know you're not providing guidance yet, but how do you look in the next year when you look out there around the demand environment relative to this year, the product set maturing? And just a few thoughts there on the set up, I guess, looking into 2022. And then I have a quick follow-up.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Well, Joe, thanks. Let me take the first part of that and then really let Mike take the second. One of the functions at the company that has reported to Mike is, if you will, our strategy and planning function. So, we just completed what we call a long-term plan, which is our, if you will, our strategy both from an operation standpoint, as well as from a financial standpoint for the next three years. So, Mike will give you a little more color on that. And as I said, he's been in charge of that now for a couple of years at the company.

With respect to the first part of the question about how do we think about demand, in part, we feel that the demand in general in the marketplace is good, and we think that the positioning that we are doing is better. So, as I mentioned to Rod's question, when we look at our – not only at our sales and we see what we're selling, when we look forward at our pipeline, we find a 5% increase in our pipeline and even more significantly when we look at



the position of that pipeline, we find mix shifting in that pipeline. So our higher margin, next generation end user experience piece of the DWS pie, if you will, is expanding as a percentage and in absolute dollars inside the pipeline.

The cloud versus cloud and infrastructure piece is expanding in percentage and in absolute dollars in the pipeline. And so that's really what our strategy is about in terms of growth and in terms of getting to higher margins. So we think the demand based off our pipeline and what we're seeing in the market is there. We think our opportunity – again, the second half of the year has been about building out our go-to-market function. We think the opportunity for us to take advantage of that is there.

And then in ECS, we're seeing increases in our services revenue which has been a piece of ECS that we think is readily assessable. And so we're pleased with that, although we think that could increase more quickly as we move on for that.

So, Mike, over to you for the rest.

Michael M. Thomson

Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Sure. Thanks, Joe, and thanks for the complement in the intro here. Really appreciate your continued support. Look, I think it's certainly not by mistake that I made a comment around both our short and long-term results. You're right, it's a little early and we will obviously give our guidance when we conclude the year and do next quarter. But from our perspective, we're feeling really good about where we're at, right? We're entering this next phase in the construct of our go-to market strategy. We're really doubling down on our efforts there as far as the communication of that strategy, the awareness of that strategy, the feedback that we've gotten from industry analysts and clients and what the pipeline looks like, it gives us some real uplift in where we think we're going. So, we feel pretty good about what we told you in January.

Yes, there are some general economic headwinds in the construct of the things that Peter mentioned, workforce and supply chain, et cetera, but the same things that everyone is dealing with in the industry. I think for the things that we can control, we feel really good about what we're seeing. We feel really good about the solutions, the continued expansion of those solutions and their acceptance in the marketplace.

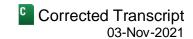
So, I don't think, Joe, that you'll see from us any wavering on the commitments that we had discussed in January of this year. And again, we feel pretty good about where we're going here and we feel like we got it right. And so, we'll continue to get through the remainder of this year, continue to ramp up in the early half of next year with all of those go-to market efforts and, again, just really stay on track for the commitments that we've made.

Joseph Vafi

Analyst, Canaccord Genuity LLC



That's great. Thanks, Mike. And then just one quick follow-up, I just kind of noticed, rewinding the clock here the last couple of years, a lot of the larger new wins that you mentioned, historically, were – there was a pretty big mix in, say, state and local deals. I know this quarter you're mentioning more on the enterprise side. And it sounds like also the go-to market being broader like that is really more geared to enterprise versus perhaps that state and local market. I was wondering if you're seeing a potential expansion to your TAM as a result of this or how do you think about the new go-to market versus previous and your targeted verticals? Thanks a lot.



Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Yeah. Joe, that's a great question, and you're right. So – and I think part of that change is due to the branding approach that we're taking, and part of it is due to the enhanced go-to market efforts. So, there's no question that one of the things that Unisys has is a very solid reputation in governments around the world including in the US in state and local. We're not currently in the US in federal due to the sale of that team to SAIC, but we're not taking that for granted. But we're expanding what we call our commercial sales efforts, so efforts outside working for governments.

And as you can see from our numbers for the quarter, the commercial sector for us as a percentage of revenue actually grew significantly. So, as we are – we're starting from strength, if you will, with the government sector, in that government reputation. But as we move out into the newer solutions, we're finding a lot of interest and support in the commercial sector. So that's an accurate observation, Joe. And the answer to that is we're embracing it. We think that's terrific.

Michael M. Thomson

Executive Vice President & Chief Financial Officer, Unisys Corp.

And Joe, maybe one quick follow-up for me on that as well. So we did have Wisconsin that came on recently, which was a state and we are seeing expansion in the state and local areas that we currently support. And there's lots of work to be done there. Clearly, I think there's been some, I won't call it delay, but with all of the budget discussions and where things are going from that perspective, we do expect that we'll see continued growth in that area. And reminder too that we always think about that public sector is highly regulated, complex environment. So not limited to state and local, but we do feel like we've got some really strong support in that particular arena and have always viewed that as a little bit of a tailwind for that C&I business.

Joseph Vafi

Analyst, Canaccord Genuity LLC

That's great. Thanks, guys.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Joe.

Operator: [Operator Instructions] Our next question comes from Matthew Galinko from Maxim Group. Please go ahead.

Matthew Galinko

Analyst, Maxim Group LLC

Hey, good morning. Thanks for taking my question. I think going back to the supply chain challenges, Peter, you mentioned, you're sort of still putting dollars behind. It sounds like you've confidence that those are temporary and that maybe you see an end in sight, not to put words in your mouth, but what gives you the confidence? What are you seeing or hearing in the market that makes you think we'll see some resolution in that some of those delays are going to abate?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

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Yeah. So that's a great question. Again, I think there's two elements for us in particular. One is that – and Mike referenced both of them in his comments. So, one reference – one was with respect to, if you will, the winding down of some of the least profitable field services contracts, there are some stranded costs that you have there that is not a light switch. And so, what you saw this quarter, particularly in the DWS profitability, was the result not only of the revenue going away, but a bigger percentage of profit/loss, if you will, because of the wind-down costs of some of those contracts. That's really independent of the supply chain issues. So, that's there as well.

Then on the supply chain, we worked very closely with our suppliers. And, I think it's fair to say there's a scramble to make sure that those supply chain lines are solid. We work, we believe, with the absolute best suppliers and partners in the industry. We've got very close relationships with those suppliers. And so we do think that's a temporary issue. Now, how long that takes, whether it goes through the end of the first quarter of next year, I think that's probably accurate. So, I think you can expect the fourth quarter and the first quarter to continue to have some supply chain constraints. But at least for us, we think that by the end of the first quarter, we should not see any significant supply chain constraints. We'll see. I mean, it's a work in progress. But that's kind of the way we're modeling it and we are making sure that our labor team is responsive to that environment, but we also think it's a little bit short term.

Matthew Galinko

Analyst, Maxim Group LLC

Got it. All right. That's helpful. And then maybe on the M&A front, I can't remember and maybe I missed it, but you did talk about possibly making acquisition in the ECS service provider space.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Yeah.

Matthew Galinko

Analyst, Maxim Group LLC

I don't remember commentary around that in the past, but is that always part of the plan that you – sort of the three-year plan or long-term strategy that you set out recently, or is that evolution of how you're seeing the market?

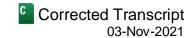
Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

It's always part of the plan. Matt, you're exactly right. I don't think we've mentioned it before. It's not a significant part of the plan. So I think we put it in the comments really for -to be holistic. When we think about our inorganic activities, the vast majority of those inorganic activities are earmarked at DWS and at cloud. We've only made one acquisition this year, that's Unify Square, that acquisition is progressing. But when I look at the pipeline of acquisitions that we might complete, let's say, in the next 12 months, they continue to be focused on DWS and cloud.

One of the things we have looked at and it was originally part of the plan was whether there are smaller shops that are servicing our CloudForte – our ClearPath Forward clients and whether it makes sense at some point to roll up some of those smaller shops because those shops are focused holistically on services for not only ClearPath Forward, but the ClearPath Forward family of applications and the applications that clients have that sit on top of ClearPath Forward.

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So, that's always been part of the plan. It's never been a significant part of the plan because it is smaller rollups. We haven't closed any of those. But for completeness, we wanted to mention that just so everybody knew that that could happen, but we don't expect that to be material at all.

Matthew Galinko

Analyst, Maxim Group LLC

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Got it. That's helpful. Thank you.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

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You're welcome, Matt.

Operator: Our next question comes from Jon Tanwanteng from CJS Securities. Please go ahead.

Jonathan E Tanwanteng

Analyst, CJS Securities, Inc.

Hey. Good morning, everyone. Thanks for taking my questions and congrats, Mike, again on the promotion. Just a quick question again on the supply chain stuff. I was wondering if you'd quantify how much revenue you missed in the quarter I guess due to the shortages or delays in availability, and do you expect to catch up to those – to that pushed-out backlog by year end or so.

Peter A. Altabef



Chair & Chief Executive Officer, Unisys Corp.

Yeah, Jon, thanks for the question. I'll take the beginning of that and let Mike take the second part of that which is the catch-up and when we expect to have that catch-up. The first part of the question is actually not so easy. It's clear about the third-party supply chain issues from – we can quantify what we were not able to take delivery of, what we were not able to install, what we were not able to process. But the bigger issue for us is not that – is not that revenue per se, but the services revenue of our team and kind of the lost opportunity to not do that.

So I can tell you that I do think it's a significant part of the relatively minor revenue shortfall this quarter compared to what consensus provided. So I think it's a significant part of that. It's just difficult to quantify because some of that is lost services opportunities, not just adding up the hardware and the software. And so, there you go. Mike, on catch-up?

Michael M. Thomson



Executive Vice President & Chief Financial Officer, Unisys Corp.

Yeah, sure. And Jon, I think Peter touched on it, but I do believe that the catch-up aspect of the direct component of the supply chain, i.e., our field services technicians getting the parts they need to fix an issue of our clients, right? So, that piece of it will come back. And again, it's really just the longevity of how long it takes to get those particular parts in.

Peter did mention, I think, as well, we have a pretty strong relationship with most of the part providers and equipment providers that we use. In fact, in a lot of cases, we're kind of going to market together. So, I think we're pretty high on that list on getting that equipment and/or parts in place, so that we can continue to service. So, that's the shorter piece on the comeback. And I would expect that to be maybe a quarter or two in regards to the recovery there.

The other piece, and I think Peter is right as well, is the catch-up on the indirect piece is actually the one that's harder to quantify, right? We don't know what decisions are being deferred from our clients because they can't get certain equipment in order to transform their infrastructure, et cetera. Although I do think it will spark some additional reasons to continue with cloud transformations and cloud migrations, right, because when you look at the on-prem kind of infrastructure component, it's certainly much more difficult to run. So, I think it plays in well to our longer-term strategy, but I definitely think that you'll see at least a quarter or two of slowness in regards to the recovery of both the direct and indirect components of the supply chain.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Yeah. And just picking up from what Mike said, I 100% agree and I think you made a really good point. While we tend to think of the most direct impact of this be field services in our DWS business, there's also a direct impact in our cloud and infrastructure services business and that is supply chains constrictions, particularly on the infrastructure side. And I do agree with Mike as well that, that constriction is likely to put more pressure on enhancing our cloud business which is a good thing for us and the cloud business [ph] and demand (00:55:46) in general. And that assumes that the cloud providers can spool up to meet existing demand.

Jonathan E Tanwanteng

Analyst, CJS Securities, Inc.

Okay. Great. Thanks, guys. I appreciate that color. And then, the second question is, I was just wondering, you mentioned that the technology and the licensing was better than you expected because you extended the contract length more than, I guess, you had initially thought you would. What was the magnitude of that increase and kind of – just to clarify, you don't expect to change in your Q4 renewals as a result, right?

Michael M. Thomson

Executive Vice President & Chief Financial Officer, Unisys Corp.

Yeah. I'll take that, if you don't mind, Peter. So, Jon, I'll talk about it in the construct of term, right? So the initial expectation for that particular client was a five-year contract renewal. And they ultimately re-upped for eight years. So, again, I think, as I mentioned in the comments, it's from our perspective a really good indication of the longevity of the ClearPath Forward operating system and the confidence that the clients that use that operating system have in it and a testament I think to the roadmap for that particular solution. As you know, we've done quite a bit to it over the course of the last three to five years in modernizing it, having it ready to run on Microsoft Azure, x86 machines, third-party open software sourcing, et cetera. So, really strengthens that product. It is not a pull-forward, right? It's not like we're stealing from Q4 to increase Q3 in that regard. That was an individual contract that we expected to sign in Q3, and it just signed for a longer duration than anticipated.

Jonathan E Tanwanteng

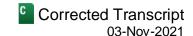
Analyst, CJS Securities, Inc.

Okay, great. Thanks for that color. And then my final one on – Peter, you mentioned you're due diligencing some opportunities in the C&I segment in terms of acquisition. Can you just give us a little more color as to what capabilities you're looking for and I guess what actually is available and is the multiple there – that are out there?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Yeah. So, I'd be happy to. We continue to look at both the DWS and the C&I space. Again, it is more a capabilities play for us than a specific revenue play at this point. We really like what we're seeing in Unify Square



in terms of filling out those capabilities on DWS. We think that was an excellent acquisition. We are looking at a couple of more capability plays in DWS.

And then with respect to cloud, it's an interesting view there. We are looking at specific capability plays. We believe that going forward for IT services companies like us, there'll continue to be expansion on the infrastructure side of cloud, if you will, the managing migrations, the managing the data, the moving data from one cloud to the other, optimizing the cost for our companies on the cloud.

We also see really an expanded opportunity around application, not only application modernization, but new application development for cloud optimized applications. And so, as you think about our acquisition framework, one of the things that I think you can expect us to see is really filling out and enhancing that application modernization and application development capability. We have some of that in-house, plus we think about the future, we think about where the demand in cloud will be not just now, but over the next two to three years. I think you can see us focus on building out that application side of the cloud pretty significantly.

Michael M. Thomson

Executive Vice President & Chief Financial Officer, Unisys Corp.

And Jon, maybe I'll just add one thing there as well. Peter covered the capability side, but there's also some geography play in regards to that as well, strengthening certain presence in a certain region and then getting some scale through doing that as well from a resource perspective, whether that's advisory or to Peter's point, the skill sets around apps development, modernization, migration, et cetera.

So, again, lots of good targets out there. You asked a little bit about the multiples. Clearly we are looking at all different sizes and shapes and looking for specific skills and/or capabilities. So, I think from a perspective of due diligence, we know exactly what we want and where we want it. And I think that's helping narrow the search and certainly putting us in a position to cost them effectively.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

And I hope – following up on Mike's comment there, I hope the people on this call appreciate, while we do think the inorganic efforts we have underway are significant, they're mostly significant in compared to the industry just because we haven't done them. The Unify Square was the first acquisition this company had done in a long time. And it's the only one that we have done this year. So, again, our strengthened balance sheet is not burning a hole in our pocket. We're being very careful and very diligent. When we find good opportunities, we'll act on them, but we're not acting just for the sake of acting. And I think I hope we've made that clear to everybody on this call and I think our actions are pretty clear.

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

Anja Soderstrom

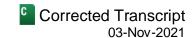
Analyst, Sidoti & Co. LLC

Hi, and thank you for taking my question. Actually, a lot of good questions asked already, but I'm just curious for the – you were talking about the [ph] TCV (01:01:49) was a little bit lower, but the average contract value was higher. And you alluded to shorter contracts there. How sticky are those contracts for you?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

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That's a great question. I guess, in part, that – we'll see how sticky those contracts are. Looking at the deals we have signed and that – it is to be expected because again, when you're dealing with next-generation cloud work and you're dealing with next-generation EUX work, you're also doing things for clients that haven't been done before. So this isn't just a new source of increased margin and revenue for us, it's new value to the client. We do expect over time that those will result in longer term, more TCV-focused contracts because we think that the value of those contracts is going to be obvious. So we actually feel very good over time about expanding, if you will, the relative ratio of TCV to ACV in that business itself. But it's going to take a little while to do that. Mike, thoughts on that?

Michael M. Thomson

Executive Vice President & Chief Financial Officer, Unisys Corp.

Yeah. No, I think that's right, Peter. Clearly, Anja, some of these contracts have auctioneers on the back-end. We typically don't count them in the construct of what we're discussing here. And a lot of these are moving more and more into SaaS-based contracting models so hence the shortening of the duration, the quicker implementation based on the solutions that we're actually offering, bringing that to revenue sooner in the life cycle, less CapEx to bring it on. All of those, I think, are favorable things, but I think Peter hit the most important thing here.

The whole solution is geared towards profitability of our clients. And if we're making them more successful and more profitable, we expect that's going to be a very sticky scenario in regards to just extending the life of those contracts. And from our perspective, hopefully, opening the door for us to have multiple contracts and expand the relationship even further.

Anja Soderstrom

Analyst, Sidoti & Co. LLC

Okay. Thank you. That was all for me.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Oh, thanks very much.

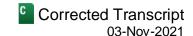
Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Peter Altabef for any closing remarks.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thanks very much. I know we have gone a little long on this call, so I won't belabor closing remarks other than to thank everybody for the really, really strong questions. To remind everyone that we have more information than ever on our Investor Relations website and that we remain available to you for follow-up questions. So with that, thank you very much.

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



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