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Unisys Corp. (UIS)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Unisys Corporation First Quarter 2023 Earnings Call. All participants will be in 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 Michaela Pewarski, Vice President of Investor Relations. Please go ahead.

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

Thank you, operator. Good morning, everyone. Thank you for joining us. Yesterday afternoon, Unisys released its first quarter 2023 financial results. I'm joined this morning to discuss those results by Peter Altabef, our Chair and CEO; Deb McCann, our CFO; and Mike Thomson, our COO who will participate in the Q&A session. 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 presentation slides that we'll be using this morning to guide our discussion, as well as other information relating to our first quarter performance on our Investor Relations 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 financial measures have been reconciled to the related GAAP measures, and we have provided reconciliations within the presentation. I would also like to remind you that all forward-looking statements made during this conference call, including any references to guidance or expected future financial performance are subject to various risks and uncertainties that could cause actual results to differ materially from our expectations. These factors are discussed more fully in the earnings release and the company's SEC filings. Copies of those SEC reports are available from the SEC along with other materials I mentioned earlier on Unisys Investor website.

Unisys does not assume any obligation to update the information presented on this call, except as Unisys deems necessary, and then only in a manner that complies with Regulation FD.

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

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Michaela. Good morning and thank you for joining us to discuss Unisys' 2023 first quarter results. We had a strong start to the year with a solid quarter of revenue growth and margin expansion, putting us on track to meet our full year financial guidance. Unisys is continuing to focus on our next generation solutions, and we are also seeing more interest from our clients in areas of growing importance to them, such as artificial intelligence, cybersecurity and data analytics. These conversations are leading to new growth opportunities, including land and expand opportunities within next generation solutions, which saw a sequential pipeline growth of more than 30%. We expect these higher margin opportunities to contribute to TCV in the back half of the year and set the stage for future growth and margin improvements in our solutions outside of License and Support, which we call ex-L&S solutions.

Macroeconomic uncertainty persisted during the quarter, with some clients being incrementally cautious of new investments and our financial services clients being cautious in general, although we are not seeing any impact for our L&S financial sector business. Overall, our revenue base is resilient as our solutions are largely supportive of our clients' mission critical systems. Our renewal rates remain strong, and our revenue is benefiting from strong signings in the back half of 2022. We also saw an increased volume of small and mid-sized new logo opportunities with faster sales cycles and ramps to revenue and healthy new scope signings with our existing clients. Similar to last quarter, I will focus on total company and ex-L&S performance, and provide an update on our next generation solutions and portfolio initiatives, after which, Deb will provide a more detailed discussion of our financial performance.

Looking more closely at our first quarter performance, total company revenue versus a year ago increased 19% on a constant currency basis and 16% on a reported basis. Our strong growth was driven in part by a near doubling of License and Support revenue due to the timing of license renewals concentrated during the first quarter as we expected. We also had a good quarter of growth in ex-L&S solutions. Ex-L&S revenue was $380 million during the quarter, increasing 5% in constant currency versus the prior year period. Growth was driven by strength in DWS and double-digit growth in SS&C, while CA&I faced some headwinds from a higher mix of financial services clients who were relatively cautious during the quarter. Our leading indicators remained healthy during the quarter. Ex-L&S, TCV increased 9% year-over-year, although ACV declined 5% year-over-year due to the specific mix in the quarter.

We experienced a modest slowing in new logo activity with incremental client caution driven by ongoing macroeconomic uncertainty and sector volatility in financial services. In new logo contracts, our ex-L&S TCV increased 26% year-over-year, driven by solid expansion and new scope activity with existing client. We believe there is a growing appreciation in the marketplace and with existing clients for Unisys as an innovative partner who can collaborate to solve a company's most critical challenges. We are continuing to penetrate our existing client base with our next-generation solutions of Modern Workplace within DWS, Digital Platforms & Applications within CA&I, Specialized Services & Next-Gen Compute within ECS, and certain Micro-Market Solutions within business process solutions. These next-generation solutions saw expansion and new scope TCV increases of 16% and ACV increases of more than 40% year-over-year.

There were exciting wins throughout the company in the first quarter, and many of those highlight how we are expanding into new scope of work with our existing clients through a combination of next-gen and more traditional offerings. In our DWS segment, Unisys signed numerous new scope engagements with an existing healthcare client. This healthcare client is a hospital system that provides critical care to underprivileged communities in more than 20 states. As part of these new scope engagements, Unisys will set up our largest service desk that will build a better technology experience for 195,000 end users with VIP service for physicians and nurses. We will also provide modern device management capabilities, including hardware and software asset management in partnership with ServiceNow. In our CA&I segment, we signed two new scope engagements with an existing technology services client who operate infrastructure on behalf of state and local governments. As part of these contracts, Unisys has expanded its footprint with Google Cloud, allowing us to provide more of these services to the state agencies.

Unisys is partnering with Dell Technologies to provide recovery services, including the Dell Cyber Vault solution, to help catalogue and securely store information. During the quarter, our SS&C team inside of ECS led a significant managed services expansion win with a leading global life services (sic) [sciences] company that will process millions of lab samples for patients around the world. This engagement strengthens our relationship with an important client who is entrusting Unisys to manage the systems and data infrastructure on which their most critical applications run. Notably, this has been a 40-year L&S client relationship, highlighting the tenure and depth of our company relationships. In addition to specialized managed services, our SS&C teams are leveraging decades of experience and data in the industries of the clients we serve to provide data analytics, application and monetization and industry solutions for financial services and travel and transportation clients, among others.

Within ECS, we invest heavily in innovation for License and Support clients and are already taking some of this IP and productizing it in areas where we see broader market demand. For example, our modular cargo offering, which is available in the market today, improves efficiency of air cargo operations with real-time tracking and control from initial booking through warehouse and flight management. As we engage with clients in collaborative discussions of their business challenges, our pipeline activity has increased. Ex-L&S pipeline increased 14% sequentially and is up 10% versus the prior year. On a sequential basis, our ex-L&S new logo pipeline increased 27% and is 60% higher on a year-ago basis. We're also seeing an uptick in larger opportunities in the pipeline, that, if converted, will benefit 2024 revenue. Our next-generation solutions are providing strong points of entry and are well positioned to play a prominent role in helping CIOs and CTOs implement solutions in cybersecurity, data analytics and artificial intelligence.

These capabilities have led to a number of land and expand project engagements that are improving our ability to contract on value rather than cost. In the aggregate, our pipeline for next-generation solutions is more than 15% larger than a year ago. Modern Workplace remains an area of high priority for our clients. At the end of the first quarter, the pipeline for these solutions has grown more than 100% sequentially. As we move past the pandemic, providing an employee experience that can sustain more permanent hybrid and remote work models is one of the highest priorities of many of our clients, especially as they look to find efficiencies through decreasing real-estate footprints, improving productivity and retaining talent. We're leaning into our Modern Workplace offerings and making investments in the next generation of power suite, our experienced management platform powered by artificial intelligence.

These investments will improve the speed and ease of implementation and decrease the time to value realization for our clients. Through native API integrations within our automation IP and artificial intelligence scripts, we will decrease the level of custom engineering work needed for our clients and ensure they get an immediate benefit from automation. Our Digital Platforms & Applications pipeline grew 15% sequentially, limited by lower activity with some financial services clients. In addition to our application development and modernization capabilities, our

DP&A teams are seeing an increase in client engagement in cybersecurity, data analytics and artificial intelligence applications, such as document digitization, financial fraud detection and content intelligence. This is allowing us to shift to higher growth areas of the market that are more aligned with cloud investment budgets.

While some of this work is long-term, many of these engagements are shorter cycle project work with the potential to lead to larger digital information and transformation contract. Efficiencies in our go-to-market operations are also driving pipeline growth. Opportunities are progressing through the pipeline at a faster pace. Another driver of our pipeline is the broader distribution of our solutions that we are beginning to achieve through our partner ecosystem, which is starting to support a variety of new selling motions and is allowing us to leverage relationships, technology and development resources of partners such as Dell Technologies, Okta, Lenovo, AWS, Microsoft and ServiceNow, among others. Moving to profitability, we delivered strong gross margins in our ex-L&S Solutions, which expanded by 310 basis points to 14%, primarily as a result of delivery efficiencies in CA&I and SS&C. We are continuing to see gains from automation throughout the organization as we optimize our talent distribution.

As we continue to strengthen our business units, we are becoming increasingly selective of the margin profile of the work we choose to take on. We continue to remain focused on rightsizing margin dilutive legacy contracts as they came up for renewal, and are optimistic we can continue to secure fair price increases while preserving our long-standing client relationships. We are also lowering our delivery cost through workforce optimization and evolving our talent acquisition approach to increase the speed and lowering the cost of fulfillment. We're deploying our internal talent marketplace that leverages machine learning and artificial intelligence, which will allow us to better utilize internal talent, reduce external hiring and ultimately lower the cost of delivery. We also continue to see a decline in voluntary attrition, which was 16.4% in the first quarter versus 18.6% a year ago.

Retaining talent is a key element of our strategy, and we remain committed to delivering an exceptional associate experience, as well as advancing our initiatives around diversity, equity and inclusion. Last month, we were honored to be included on Forbes list of Best Employers for Diversity for the first time. In addition, we are executing both our own ESG strategy, and we are going to market with an innovative business process solution to help our clients with their ESG efforts, particularly in the area of supply chain where government regulation is on the rise. The Unisys ESG Orchestration Manager enables organizations to manage the whole ESG supply chain process through an integrated modular platform. This is just one example of the types of innovation we will speak more of at our upcoming Investor Day on June 15th in New York. And I look forward to seeing you in person then.

With that, I'll turn it to Deb to discuss our financial results in more detail.

Debra McCann

Executive Vice President & Chief Financial Officer, Unisys Corp.

Thank you, Peter, and good morning, everyone. In my discussion today, I will refer to both GAAP and non-GAAP results. As a reminder, reconciliations of these metrics are available in our supplemental earnings materials posted on our investor relations site. I will also provide information, both including and excluding License and Support solutions to allow investors isolate the portion of ECS, which includes lumpy revenue recognition based on the timing of license renewals to evaluate the progress we are making in the business outside of this arena. My commentary will continue to discuss our segments Digital Workplace Solutions, Cloud, Applications & Infrastructure Solutions and Enterprise Computing Solutions.

As Peter mentioned, it was a solid start to the year driven by strong renewal rates and revenue growth from new business secured during 2022 and price increases secured within our ex-L&S solutions as we continue to strengthen the Unisys value proposition for our clients. While client sentiment is mixed largely due to macroeconomic uncertainty, we are seeing solid sentiment in DWS and increased engagement around certain solutions such as cyber integrations work within CA&I. Our pipeline remains healthy and we are seeing solid new scope TCV and ACV with existing clients which will convert to revenue as we move through the year. For the first quarter, company revenue totaled $516 million, an 18.9% increase on a constant currency basis and 15.6% as reported. The double-digit growth is largely driven by the timing of license renewals within L&S, which was expected to have a high concentration in the first quarter.

Excluding L&S revenue, constant currency revenue growth for the first quarter was 4.6% and 1.7% as reported, driven by high single-digit growth in DWS and the Specialized Services & Next-Gen Compute portion of ECS. Now for some segment detail, please note that as I speak about the segments, I will be discussing revenue in constant currency. Digital Workplace Solutions revenue in the first quarter grew 7.7%, as the benefit from recent strong new business wins and expansions with existing clients began to convert to revenue. Additional benefit was seen from improved pricing on several large renewals negotiated in the back half of 2022. We are past any material year-over-year impact from the 2021 exiting of non-strategic contracts in DWS, and the first quarter is more reflective of the underlying mid single-digits constant currency growth we have been achieving in the segment.

Revenue in our Cloud, Applications & Infrastructure Solutions segment declined 1.4% year-over-year, where we saw some caution around volumes and cloud investments, particularly with financial services clients, which account for more than 15% of the segment's revenue. During the quarter, we saw an uptick in shorter cycle sales in systems integration, software licensing and permitting, and cybersecurity advisory around attack-and-threat discovery. We had another solid quarter in terms of pipeline activity with CA&I pipeline increasing 17% sequentially, with nearly half of segment pipeline comprised of DP&A next-gen opportunity. Enterprise Computing Solutions revenue, which includes License and Support and SS&C, increased 60.1% year-over-year. Specialized Services & Next-Gen Compute which are our Next-Gen Solutions within ECS grew revenue 11.9% year-over-year, driven by application services.

We are continuing to make investments in our passenger and cargo transportation industry solutions, as well as our quantum logistics offerings to grow our recurring SaaS revenue streams from SS&C. These SaaS offerings already account for more than 10% of SS&C revenue and leverage the significant data and decades of experience our ECS teams have within financial services, travel and transportation. L&S revenue grew 90.9% year-over-year driven by ClearPath Forward license renewals that occurred in the first quarter. Our L&S client base has a large concentration of clients in the financial services who run mission-critical applications, and compute on our ClearPath Forward operating system. Within L&S, we are not seeing any material impact from volatility in the financial sector.

As we mentioned last quarter, we have a high level of visibility into L&S revenue on a multiyear basis, though the timing of license renewals are driven by our clients and can be difficult to predict with precision. However, we continue to expect L&S revenue of $350 million for the full year with second quarter L&S revenue expected to be approximately $75 million. Additionally, there has been no change to our outlook for low single-digit L&S revenue growth in 2024 and low double-digit growth in 2025, though the exact timing of license renewals is difficult to predict with precision and can shift between quarters or clients may choose to renew early based on budgeting processes or upon reaching consumption limits of existing pricing, among other reasons.

Moving to leading indicators, total contract value or TCV grew 2% year-over-year driven by strong renewal rates and expansion with existing clients offset by lower new logo TCV. ACV declined 18% year-over-year, driven by the mix of license renewal bookings in the quarter. Excluding the impact of License and Support, TCV was up 9% and ACV was down 5% on a year-over-year basis due to the mix of renewals that occurred in the quarter relative to the prior year. Our trailing 12-month book-to-bill ratio is 1 time for both total company and our ex-L&S solution. Our pipeline grew 15% sequentially and 6% year-over-year. Given our solid first quarter performance, strong renewal rates and expansion with existing clients, we are reiterating our full year guidance for total company revenue in the range of negative 3% to negative 7% year-over-year, which continues to assume ex-L&S revenue in the range of negative 1% to positive 4%.

License and Support revenue boosted our growth in the first quarter as we expected, but renewal levels are expected to be lower on a year-over-year basis for the remaining three quarters. And this renewal timing dynamic is the driver of our overall revenue decline despite the growth we are expecting in the remainder of the business. First quarter gross profit was $159 million, reflecting a 30.8% gross margin versus 19.6% in the prior year. The strong expansion was due to higher license renewals in L&S. Additionally, the prior year gross margin included impact from non-recurring expenses associated with charges on certain CA&I contracts. As a reminder, these charges were related to sub-contractor underperformance in delivery of solutions we no longer sub-contract. We are making progress on expanding margins in our ex-L&S solutions, where gross margin is 13.8% versus 10.7% in the prior year.

We achieved incremental delivery efficiencies in CA&I though margins were down on a sequential basis, primarily due to the non-recurring benefit from surplus IP address sales in the fourth quarter of last year. Across the organization, our teams are committed to bringing down the cost of delivery, more efficiently allocating talent, implementing cost of living adjustment clauses on existing contracts, and negotiating pricing that reflects the value of our solutions. We see an opportunity to deliver consistent long-term gross margin expansion through these processes, which are gradual by nature. Looking at margins by segment, DWS gross margin was 11.9%, contracting 90 basis points year-over-year due to advanced staffing to support work signed in the back half of 2022. We expect margins to improve in the segment sequentially through the year as that revenue continues to ramp and we realize delivery efficiencies.

First quarter CA&I gross margin was 13%, expanding 760 basis points year-over-year. Expansion was driven by the previously mentioned charges in the first quarter of 2022, as well as delivery efficiencies as we increased our use of automation and continued to increase our leverage of lower cost labor markets. ECS segment gross margin was 66.7% versus 52.1% in the prior year quarter due to higher license renewals, as well as revenue growth outpacing costs in the SS&C portion of ECS. Our non-GAAP operating margin was 11.6% versus negative 3.2% in the prior year. We are continuing to remain focused on diligently managing SG&A, which we held roughly flat year-over-year. Adjusted EBITDA increased significantly to $98.2 million versus $34.2 million in the first quarter of 2022, and our adjusted EBITDA margin expanded 1,130 basis points to 19%.

First quarter GAAP net loss was $175.4 million, which included a one-time non-cash settlement charge of $183.2 million, this charge was related to the purchase of annuity contracts totaling $265 million, which we executed in March. Because this purchase was made by the Pension Trust for our US qualified defined benefit plan, there was no impact on the company's cash position. This purchase was part of our continued strategy to transfer the company's pension liabilities to third-party insurers over time through annuity contract's purchase of plan assets. Excluding the impact of the annuity purchase as well as an additional approximately $10 million of pension expense and $17 million in cost reduction and other expenses net of tax, non-GAAP net income totaled $34.7 million in the quarter, compared to a loss of $27.3 million in the prior year.

Non-GAAP earnings per share was $0.51 versus a loss of $0.41 in the first quarter of 2022. We are reiterating our full-year profitability outlook for a non-GAAP operating margin of 2% to 4%, and adjusted EBITDA margin of 9.5% to 11.5%. While we significantly exceeded these levels in the first quarter, this is largely due to timing of L&S revenue in the first quarter, which is expected to be materially lower in the remaining quarters of the year.

However, we continue to expect more than 250 basis points of aggregate gross margin improvement across our DWS and CA&I segments, and margins should improve throughout the year as price increases are implemented on existing contracts and renewals and as we see increasing benefit from centralizing delivery technology infrastructure and backfilling roles where needed at a lower cost.

Capital expenditures totaled $20 million in the first quarter, relatively flat on a year-over-year basis and reflecting the ongoing execution of our CapEx-light strategy. We continue to expect full-year capital expenditures to hold relatively flat year-over-year between $80 million and $90 million. Free cash flow was negative $7.5 million in the quarter compared to negative $51.7 million in the prior-year quarter, largely due to higher technology collections in the quarter. Despite the full-year revenue decline we expect due to license renewal timing, we continue to expect full year free cash flow to be in line with 2022 at approximately negative $75 million. Adjusted free cash flow in the first quarter was $20.1 million, improving by $47 million year-over-year. On March 31, 2023, our cash position of $391.9 million was essentially unchanged from levels at year end. Our balance sheet and liquidity remain strong with the net leverage ratio, including all defined benefit pension plans of 1.7 times as of quarter end.

Looking ahead to the second quarter, due to the cadence of L&S revenue during the year caused by renewal timing, we expect overall company revenue to decline in the low double-digits year-over-year, with second quarter L&S revenue expected to be approximately $75 million and ex-L&S revenue expected to be roughly flat on a sequential basis relative to the first quarter. We expect a modest non-GAAP operating loss in the range of $5 million to $10 million, driven by the timing of L&S renewals. Our second quarter outlook puts us on track to achieve our full year guidance. Please remember that the timing of contract signings is difficult to predict with precision and the upfront revenue recognition of license revenue means timing of these contract signings within our ECS segments can have an outsized impact on our revenue and operating profit in a given quarter.

Briefly touching on our expected cash pension contributions to our US qualified defined benefit plans, while there is volatility in estimates of pension contributions due to financial market conditions, funding regulations and actuarial assumptions which are updated only once a year at year end, we estimate that the amount of our 10-year contribution forecast at first quarter end has modestly decreased to approximately $570 million to $590 million from the approximate $650 million forecast at 2022 year end. This is due to a combination of positive asset returns and the impact of the annuity purchase executed in the first quarter. Cash contributions, our US qualified defined benefit plans are still expected to begin in 2025 and continue through 2032.

With that, I will turn it over to Peter for some final remarks before we open the line for questions.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Deb. In closing, we are making progress on our key strategic portfolio, go-to-market and cost efficiency initiatives, and are successfully navigating the current market environment. We look forward to discussing our longer term strategy and the opportunities we see for the company to grow revenue and expand our margins at our upcoming Investor Day on June 15 in New York City.

Operator, will you please open the call for questions? Thank you.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Rod Bourgeois from DeepDive Equity Research. Please go ahead.

Rod Bourgeois
Analyst, DeepDive Equity Research, LLC

Q

Okay. Thank you. Hey, so congrats on the front loaded progress toward the full year targets. I want to start by asking about your license renewal pattern. You clearly had early license renewals in Q4, and you've now also reported a year-over-year surge in licenses in Q1. So is Unisys in an extended period of early renewals, or was the Q1 licensing activity somewhat more in line with what you had expected? So I'm just looking for any color on the latest licensing patterns, which would be really helpful. Thanks.

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

A

Rod, this is Peter. Thanks very much for the question. I guess the answer is yes and yes. So we had a slightly better quarter than we expected on the L&S renewals, but it was largely in line with what we did expect. So as we went through last quarter discussing about what the L&S progress was going to be over the year, we knew it was really lumpy. We knew the first quarter was in fact going to be our best quarter and it was our best quarter. It was a little better than we thought, but not marginally so. That's why Deb is being very careful to set expectations for the rest of the year. We do not think that the L&S revenue as a whole is going to be any larger than what we laid out at the end of the last quarter for all of 2023.

In terms of the rest of the business, and we really are working at a concerted way to kind of separate L&S from what we call ex-L&S, and the reason for that is just the lumpiness of L&S. As you could tell, we had a little better quarter than we expected this year. We had a little better year in 2022 on L&S than we expected. We simply don't have control over those two items. And so they are going to be lumpy from year-to-year. They're going to be lumpy from quarter-to-quarter. We have some view, we have a view that 2024 from L&S will be better than 2023, and we have a view that 2025 from L&S will be better than 2024. But it is still somewhat outside of our control. Ex-L&S is the rest of the business. And the driver in ex-L&S for us is what we call those Next-Gen Solutions.

We had a good quarter in Next-Gen Solutions but we actually expect better Next-Gen Solutions performance as the year gets stronger. So just to give you an example, when we think about pipeline, total pipeline growth for the company was up 6% year-on-year and 15% sequentially. That's very good for us. But next gen pipeline was not up 6% year-on-year, it was up 16% year-on-year. And next gen pipeline was then up 15% sequentially, it was up 34% sequentially. So we really do believe that, an important way to look at the company is through that ex-L&S. And we expect to make continuous progress on that year-over-year. Quarters can still be a little lumpy, but that is where we think we will make the steady advance with the company. And within ex-L&S, the growth effort is really within the next generation piece. So Rod, I hope that helps answering the question.

Rod Bourgeois
Analyst, DeepDive Equity Research, LLC

Q

Yeah. Definitely. And so my follow up is kind of a longer-term question, which probably is also a fitting topic for the Analyst Day. But I want to ask, given that your outlook is saying the next three quarters are expected to have soft license revenues just due to the timing and lumpiness there, will you during that time be making special efforts to kind of lay groundwork for fundamental improvements for Unisys after 2023? So just any color on what you're doing in terms of longer-term building up of the fundamentals?

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

A

Yeah. So that's a great question too. I'm going to turn that over to Mike, who is really working with all of our business teams to do exactly that.

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

A

Great. Thanks, Rod, for the question and good to speak with you again. As you know, I mean, this is something that we've been working on for a multitude of years and continue to work on. I think we really have the underpinning laid, and we are expecting to see continual improvement in margin, frankly, not only just over the remaining portion of 2023, but beyond 2023. Some of the major efforts there as we've talked about in previous quarters is the continual development of AI and ML and the efficiency of delivery. We continue to work on right-shoring and low-cost locations and support of the organization.

We continue to clean up and fix, I'll say, legacy contracts, and improve their margin profile. And we continue, as you know, to push to a higher mix shift from a revenue point of view, which has not got an impact on the margin side. Deb and I are partnering on SG&A reductions. So all of those things in my mind are core tenets to the continual improvement of the business fundamentals. And we, certainly, will have some more dialogue and give a little better and more detailed picture in Investor Day of how we plan to do that because it is a little bit different per business unit and the company overall. But that has been the plan, and continues to be the plan.

Rod Bourgeois
Analyst, DeepDive Equity Research, LLC

Q

Okay. Great. Hey, and just one final, hopefully, a quicker one. The 15% sequential pipeline growth, I'm just looking at that number also knowing that there's been some macro impacts in the last several months in the industry. What's driving that sequential pipeline growth over the last three months?

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

A

You know what, Rod, this sounds a great question. When I look at our performance and talk to both Deb and Mike and to our leaders, and you kind of get into that pipeline growth, the area of our pipeline growth that has been most accelerated is Modern Workplace, and interestingly, that is the area where we had the most revenue uptick in the ex-L&S business. So DWS, driven by Modern Workplace, clearly has the most pipeline growth for us. Now, you might say somewhat disappointingly, when you look at the profitability of DWS, the gross profit of DWS actually went down year-on-year, and while that is a bit of a disappointment, it is very understandable.

Revenue for that team increased over 7% year-on-year. Whenever you have revenue increasing, you always have a little bit of a short-term head to profit. But I think even more than the revenue, they're really gearing up for that very, very large increase in pipeline. So we're staffing up. We are a little bit getting out of in front of our headlights on that, because honestly, we think we need to do that to get to the revenue portfolio that we're showing. So I would say to you, that growth is in Next-Gen Solutions, and within Next-Gen Solutions, Modern Workplace looks very promising for us, and it is already showing that in the revenue growth in the first quarter.

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

A

And Rod, if I could add a couple of things to that, I guess the first word I would say is volume. We're not looking at situation where there is some anomalous thing where there is one big deal driving that pipeline. That is pretty consistent volume across all of our businesses. And we are starting to see some real penetration from a cross-sell perspective. We have talked historically about our cross-sell penetration being in about a third bucket. At this quarter we're actually closer to about 40%. So we are starting to see that penetration which is driving expansion and new scope, and in some cases as Peter just mentioned, highly focused on Modern Workplace. So it's been pretty good. And as you know, it's kind of on the tail end of a lot of the marketing efforts that we've done. We've launched our branding at the end of Q4, a lot of marketing campaigns going on. And the reality is, they take a little while to take root, and start to see the benefits of those enhanced efforts. So we're thinking we're aligned pretty nicely to our strategy and continue to press forward there.

Rod Bourgeois
Analyst, DeepDive Equity Research, LLC

Q

Very helpful. Thanks.

Operator: The next question comes from Joe Vafi from Canaccord Genuity. Please go ahead.

Q

Good morning. This is [indiscernible] (40:22) standing on for Joe. Thanks for taking our questions and thanks for all the color. It's really helpful. Maybe I can start on the macro. Clearly, macro remains tough, clients may not be doing full renewals or taking on piecemeal work. Have you noticed any shift in how your clients are thinking about investing in their business today versus, let's say, one or two quarters ago? Any sort of shift in their approach there?

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

A

Yeah. This is Peter again. I'm going to turn that over to Deb to work through the numbers on that a little bit with you. But let me give you my perspective. There are some changes, and I'm just trying to categorize. By industry as we look at the numbers and we think about how our clients are acting, I would say, we had what we think is a perceptible decrease in client volume, and actually in mine share in the first quarter in financial services outside of our L&S business. So L&S does a good amount of financial services work, and that's running financial services, back office to some extent, front office, and that did not change. But when we're talking about project work around financial services, it was later in the quarter, but it was pretty perceptive, that whole industry has been distracted by whether it was First Republic or SVB or others. And so I don't think it was a surprise to see our pipeline and level of activity somewhat distracted. We expect that to come back, and we expect that to come back quickly, but it was distracted.

When we look at our business as a whole, stepping out of that one piece of a sector, I would say, the big change over the past six months, and what you hear more of in our discussion in mine and in Deb's, is really a strengthening interest around data analytics and AI. And you see us talking about data analytics and AI, but it shouldn't surprise anybody. So every one of our Next-Gen Solutions has a good amount of data analytics and AI embedded in it. That's what makes them Next-Gen Solutions. So it's not as if we are new to that. But I would tell you that clients want to hear about that more. And so we are focusing on it, if you will, from a marketing standpoint, more you're going to see about more of that on our website. You're also going to see a somewhat more focused concentration on that as we go forward. But again, it's not as if we don't do it today and haven't done a lot of it. But I would say, that's probably the biggest change, is really kind of a more and more of an emphasis on data analytics and AI. But that's a change for, like, all of us as we read the paper every day. Deb?

Debra McCann

Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Yeah. No. I think Peter covered it. I mean, I think in my remarks what I had mentioned, the CA&I probably saw the biggest impact where we saw that decline 1.4%. And again, I think that was, as we said, largely driven by some caution in volumes and cloud investments. And particularly, as Peter mentioned, with financial services clients, which for CA&I are about 15% of that segment's revenues. So I think we are seeing that, but I think Peter summed it up.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. [indiscernible] (44:01), I think that was a really great question, and thank you for asking it.

Q

Thanks. Thanks for the color, Peter and Deb. And maybe I can follow up on the Next-Gen Solutions. It's clearly very good strong pipeline growth there. And if I heard it correctly, deals maybe moving through the pipeline at a faster pace. So what do you think is driving this faster sales cycle here?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. I'm going to let Mike take that. Just a couple of quick comments. I said that and it does appear that's the case. I will tell you, I think Mike has led a brilliant effort on our team to get this to happen, and the work he's done on the process back office of just how we push through deals, how we evaluate them sooner, how we make decisions on them sooner is really strengthening the company. And then, of course, to some extent, the deals, as you can see, are little smaller and that means they have to go faster. But Mike, over to you.

Michael M. Thomson

President & Chief Operating Officer, Unisys Corp.

A

Sure. Thanks, [indiscernible] (45:08), for the question. Very helpful. So yeah, I think from a perspective of velocity through, we've done quite a bit in the back office to establish kind of a rapid pricing. But if you think about it, it's really more about not having to have the level of variability in all of the clients. So a little bit more of a standardized offering now that our portfolio has kind of evolved a bit, we're able to leverage more of that, and obviously, that helps with our pricing. The other thing is, a lot of our penetration, especially as I mentioned, the increase in cross-sell and the dip into some of the new logos are smaller-based solutions, and they typically come to revenue sooner, and there are point of spear types of solutions.

So if we talk about penetration in cybersecurity as an example, that is something where we can price it very quickly. A lot of them are time and material-based. They go to revenue in a sooner cycle, and our goal is really about landing and expanding. So getting in, dealing with some apps modernization or migration as an example in the cloud space and then broadening that expansion into managed services and the rest of the infrastructure. So I think it's a little bit of what we've done in the back office. It's a little bit about our portfolios in general and our maturity. It's a little bit about the size of the deals and the types of things that we're actually pursuing in next-gen, just come to market quicker and the contract terms are a little shorter.

Q

Got it. Thanks. Thanks for all the color Mike and Peter, and good luck this quarter.

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

A

Thanks, [indiscernible] (46:53).

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

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Hi. Thank you for taking my question. So how far on that commentary around increase in the small to mid-sized opportunities? Is that something you deliberately are going after because they may have a faster decision cycle within their organizations? And did you also say that those contracts are normal as a shorter-term than larger deals?

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

A

Yeah. Anja, thanks for that question. It's a phenomenon that we have been remarking on for years and it just continues. And that is that, as we measure contracts, new contract signings, the average duration of the new contracts is shorter than the ones that had preceded it. Now, there's a lot to take away from that. So in part, that's an average number. And you're dealing with a lot of contracts. So averages can be a little deceiving. But what is underlying that, which I don't think is deceiving is that, our offerings have become more of the moment. Our offerings are more important to drive current revenue and current margin for our clients. And that means our clients need them more urgently. So it's not a question of putting in a deal and doing it for three or five years. Those are fine. But it's like, hey, I want this done within a year and I want to be able to see the results. And then if I like it, I'll renew it. And that's a challenge we're ready to live up to. So Mike, over to you on that.

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

A

Yeah. And look, I think it is intentional Anya for sure when we think about the types and size of the deals that we're looking at for penetration purposes. We've had a renewed focus in mid-market as an example, which are companies from our perspective are the $2 billion to $5 billion range. It's quicker decision-making. It's smaller type projects that get to revenue sooner. And those are areas where we can ultimately provide kind of full stack solutions to clients in that space. So I think it has been very intentional, and to a large degree, some of these services are SaaS based models, so they typically move into annual cycles as opposed to the historic models that were three to five years, as Peter alluded to in their signing. So some of it's a behavior of the client and some of it is intentional in our Next-Gen Solutions.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Okay. Thank you. I'm sorry if I missed this. Maybe you commented on it already. But the gross margin was helped by the L&S this quarter. So how should we think about the gross margin in the coming quarters?

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

Yeah. So hi, Anja, it's Deb. The coming quarters, because you're right, L&S, because it was a strong L&S renewal quarter, that drove a lot of the strength. So the guidance we gave for Q2 is non-GAAP operating loss negative $5 million to negative $10 million for Q2. And then in total, we talked about that the ex-L&S, the margin, the gross margin we're expecting to grow 250 basis points. So there will be improvement kind of in that ex-L&S over time. But the L&S, you're right, will be driving some of the lumpiness in that profit over the next three quarters.

Anja Soderstrom
Analyst, Sidoti & Co. LLC
Q

Okay. Thank you.

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

And that's we've done – Yeah. You're welcome, Anja. And that's why we've done, such a focused work, really starting last year at giving you data that is both L&S and ex-L&S as well as total company, because we want everybody to see how the pieces are put together. But we also want everybody to see that L&S number increases and decreases almost in unexpected ways, although we have a general view as to how it will play out. But most of our focus on growth and focus on margin expansion is in the ex-L&S space.

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

Yeah. [indiscernible] (51:12) clarify the 250-basis-point improvement is CA&I and DWS because there's that SS&C part that already has higher margins.

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

That's right.

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

So just to clarify.

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

We just want more of it.

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

We want more, right. Exactly.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Okay. Thanks for that clarification.

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

A

Yes.

Operator: The next question comes from Matthew Galinko from Maxim Group. Please go ahead.

Matthew Galinko
Analyst, Maxim Group LLC

Q

Hey. Good morning. Thanks for taking my questions. Can you talk about any expectation for attrition from legacy lower margin contracts that are coming up in 2023? I know we had some material impact a couple of years ago. But particularly in the environment we're in today, is there potential for more of those to just be sunset and create a material headwind for Unisys revenue, or is that something that you're not concerned with this year?

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

A

Hey, Matt. It's Mike. Good to speak with you again. Look, I'll sum it up quickly and I'll give you a little bit of color. It is something that we are not overly concerned about for this year, or frankly, in future years. A, for this year because we really don't have any contracts that are up this year of the magnitude that would be a concern. But more importantly what we've actually seen over the course of the fourth quarter and the first quarter is our ability to get price increases on the contracts that we were concerned about.

And I think a lot of that has to do with the quality of service that we've been providing for these clients for decades. So it's a heck of a lot easier of a negotiation from a price increase point of view when you're delivering gold glove service for multiple decades. So we've not had problem from a pricing perspective and increasing those. We don't have any imminent ones that are coming due that we're concerned about, and that's actually an area of land and expand for us, and we've seen that in a couple of instances already. So I think we're in pretty good shape, unlike what we went through in 2021 with the carryover of those exits in 2020.

Matthew Galinko
Analyst, Maxim Group LLC

Q

Perfect. Thanks. And my follow up is, on the marketing investments and campaign, I guess what should we be looking for, as a gauge or indicator that those are having its desired impact? And I guess, what timeframe should we be looking at to be able to gauge some sort of impact, whether this year or next year?

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

A

Yeah. So Matt, that's a great question. I think there's really almost two different ways to look at it. From our perspective, in terms of operationally, we're looking at how many people are coming to the site and how often they're saying. When you look at it, just kind of operationally, it's doing really well. I think people are staying, I think, the data is almost four times as long, and we're getting twice as many people who are either, we think, clients or prospects. So operationally, we're really making progress there. When you think about how should you look at it, it's pretty clear, is it helping us get the revenue, Is it helping us get the margin, is it helping us develop pipeline and getting to win rates. So I think, the proof is in the pudding as far as our shareholders are concerned. And those have to get to revenue and profit. But from our standpoint, we're seeing some success. Mike, any thoughts of that?

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

A

Yeah. No, Matt, it's great question. And look, the easiest answer is the front-load of that is the pipeline which we're already seen some expansion on. That has to turn into TCV and ACV based on higher win rate. So we're seeing not only the length of time people are spending on the site, but actually who is spending time on that site. We put in a new lead generation program on the back of that, which helps us further qualify some of those leads. We have some third-party, what you would almost consider, inside sales as a back end of that to qualify those leads even further. From our point of view, it's really the conversion of those leads. The second piece of your question was time.

The other thing there is, we have to be a little bit have some patience here. That is not the type of thing where you put some new information on your website and that turns into a lead in a week or a month or a quarter. So it takes a little bit of time for that to happen. But I will tell you, I speak to clients all the time, prospective and current. The view on the brand, the view on our ability to generate breakthroughs and experience breakthroughs, the dialogue around the market awareness of our solutions, the number of people participating on our sites, the increase in pipeline, those are all attributes from our point of view that says it's moving in the right direction.

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

A

Yeah. And just, I found some of the data there. Just again, March was the single highest month of web traffic we've ever had. We've had in the first quarter, four times more clients and prospects visit our website than a year ago. And those clients and prospects are staying longer. So again, I think from Deb and Mike, in my perspective, that's a lot of progress. From your perspective, it has to show up in new sales and new revenue and increasing win rates.

Matthew Galinko
Analyst, Maxim Group LLC

Q

Perfect. Thank you.

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.

I want to thank everybody for joining us. Again, between now and the next quarter, we will have our Investor Day, June 15, in New York City. We are sending out invitations to people. But if you don't get an invitation, that is an oversight. So please reach out to Michaela Pewarski, and she will get you invited. So we're looking forward to seeing you all on June 15 in New York. And thanks very much.

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