Pitney Bowes – Deutsche Bank Leveraged Finance Conference

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Ned Zachar: Morning, everybody. My name is Ned Zachar and I manage the Investor Relations program for Pitney Bowes. I'm very glad to be joined by my friend and colleague, Gregg Zegras, who is President of our Global Ecommerce segment. It's very nice to see a lot of my buy-side friends this week, and we very much appreciate the invitation from Deutsche Bank. Specifically Alex Barth and Anthony Klarman to get us in to participate.

I want to make sure that you all know we sent a press release out this morning with links to the slide deck and to today's webcast in view of the updated business outlook that Gregg is going to walk through in just a little bit. I'm going to -- to start the presentation, I'm going to spend a little bit of time on SendTech and Presort and then turn the dais over to Gregg, so he can walk through that in-depth discussion of GEC. And I'll finish with some remarks on the second quarter and then leave ample time for Q&A.

The firm is organized in three segments. And all the activities are centered on reducing the complexity of sending mail and parcels. So we're providing technology, logistics, equipment, software, supplies. We're providing what you need as a client to take out that complexity of mailing and shipping. That is the common theme among all three of our segments. And we wrap it with the financial services business, largely in SendTech, but increasingly throughout the firm as well.

The SendTech business, $1.4 billion of revenues, roughly $450 million of EBITDA; Presort, $573 million of revenues and $100 million plus in EBITDA; and then the Global Ecommerce segment is generating $1.7 billion of revenues and basically breakeven EBITDA, and Gregg is going to talk a little bit more about that in a moment.

I'm going to spend a little bit of time on SendTech. It is the firm's, what I describe as its raison d'être. For decades, we have been providing mail creation, finishing and metering technology to customers of all sizes, usually wrapped in a lease arrangement, which gives the team very good visibility as far as revenues and cash flow. Our technology, which you can see at the top left part of the slide, can create mail, place postage on thousands of pieces of mail an hour; banks, insurance companies, state and local governments, higher ed, they're all among the key sectors that are using our technology and services.

There's 700,000 customers in the U.S. From the U.S. government to the 5 person law office, and we operate internationally in a handful of countries as well. And from a customer standpoint, everything in between as far as size is concerned. The average client relationship is 8 years, and over the half of the client base is now using our shipping technology, which makes up 12% of the $1.4 billion segment revenues. I'll say that again, 12% of the $1.4 billion is coming from the growing shipping revenue base. Shipping revenues grew roughly 25% in this year's first half on a year-over-year basis and the plan is for shipping revenues to overcome the natural secular headwinds on the mailing side so we could eventually see top line improvement for the SendTech business.

If you look back over the last couple of years, most people did not think that that was actually going to be possible. Again, $1.4 billion, $450 million of EBITDA.

Low to mid-single-digit revenue decline has been the historical trend, though it's been a bit better than that in the first half of 2022, mostly due to the shipping revenue highlights I mentioned before as well as strong equipment sales.

When you think about the Presort business, I think the easiest way to understand it is -- that if you place a stamp on a piece of mail, it's $0.58. $0.54 if you use our metering technology in SendTech and then with our workshare discounts and our sortation technology in Presort, you can expand that discount. So we end up saving customers about $0.10 per piece of mail that they send.

In 2021, we processed over 17 billion pieces of mail. We're effectively the second largest mail handler in the world. And the customer base is anybody who is sending a lot of mail; banks, insurance companies, BPOs, colleges and universities, credit card companies, all of those sectors make up a significant chunk of our customer base. Mechanically, we transport the mail to one of our 35 sortation centers, sort the mail in our machines, sometimes more than once, to a 5-digit ZIP code and then transport that mail to the relevant regional USPS office.

One thing I want to make sure I mention, we have a field trip set for Los Angeles on September 28 to visit our Global Ecommerce facility in Ontario and then our Presort facility, which is closer to John Wayne Airport. We did this in Atlanta about 3 months ago. It was a chance for people to see the buildings come to life, meet our people inside the building and see how your capital is actually being allocated. So if you're interested, please find me afterwards, and I'll make sure you get that information.

What's important about Presort is that we're finding ways to grow despite the declines that are natural as far as first-class mail. We're gaining market share. We're adding to our marketing mail capabilities and taking on in-sourced volumes and making tuck-in acquisitions. If you combine that with the generally increasing workshare discounts, all of these items are contributing to the growth in that business and offsetting the mid-single-digit declines as far as first class mail is concerned. Again, $575 million of revenue and $100 million plus in EBITDA.

And with that, I'm going to turn it over to Gregg, and he can talk a little bit about Global Ecommerce.

Gregg Zegras: Thank you, Ned. Everyone hear me okay? So a little bit about global commerce. It's good to be here as well. This business unit, just for some context, was created in 2015. So we're not quite 10 years old inside of a 100-plus-year-old U.S. company. And we have been exploring different opportunities in Ecommerce, which is -- we define it as it's a B2C capability. So we are purpose-built to help retailers, marketplaces and other merchants deliver on their value proposition when their consumer is shopping online.

We are very capital efficient in the way that we have deployed our capabilities over the last few years. I've used this visual to kind of describe where we participate in the supply chain versus what others do. So in the gray areas on the left of the slide are typically our clients, right? They're responsible for the manufacturing, [that is, the creation of the parcel]. And then, depending on where they are in the world, either taking stuff by planes, by boats if they're overseas or on trucks in the U.S. to get those goods into our network.

Inside of the blue box, we operate both physical and digital capabilities. I will spend most of the time today talking about our domestic parcel network, which is a physical capability. We will take that [client] inventory into our warehouse, ensure that it has an appropriate label and sort it through our technology and out the other side of the warehouse onto a truck, hand it off to the United States Postal Service for final mile. That is the business model. Our goal is to move that package through our network as quickly as we can and inside of a day physically and then get it into the transportation and into the post office who does the final mile.

We also operate and have been doing for a very long time, something very similar for cross-border. We actually started this business on the back of cross-border services, so actually tackling the hardest part of ecommerce by doing this to 200 different countries. But it's the same model. We don't touch the goods at the manufacturing side or in the first mile or lift. We help process that package and then hand it off to a very diverse network of final model providers across the globe.

Underpinning all of this is some world-class leading technology that we've been investing in, a lot of which Pitney Bowes had historically inside of our SendTech business that we have been adapting for Ecommerce, compliance and capabilities, labeling technology and all of the tracking that is required in order to provide the consumer with a good experience. Simply stated, when you place an order on somebody's website, you like to know when it's going to be delivered. That is all the technology that sits underneath our Global Ecommerce business both for the U.S. and for the cross-border side.

We love this market. I'll tell you, I loved this market prior to the pandemic. We saw a big opportunity to be a provider of these services before the world changed. We've participated. We've been growing at an 18.5% CAGR over the last 3 to 4 years. What we have found in the last couple of years as a result of the pandemic is a step change in the amount of usage of ecommerce by the consumer -- which is never going back. So you've got a twofold increase in the amount of volume that's available in the market.

And as I said, I loved this market before the pandemic, I love it even more going forward. Our network of 16 U.S.-based domestic hubs processed about 175 million packages last year. Similar trajectory for this year. Again, we ship cross-border to 200 different countries, real important value proposition. Most of our customers cannot afford nor have the capability to deal with that at scale. And so we provide a nice solution for them to be able to add incremental sales to their domestic business by having a cross-border capability.

We're closing in on 500 customers around the globe. Most of those are in the U.S. And we have seen and have an opportunity to really start to find some meaningful margin expansion in this business going forward. And so we love this market, and we certainly love it going forward, and we're positioned very, very well to take advantage of it. It's the reasons that -- for those reasons that I'm optimistic about what it is we've been doing in global Ecommerce and where we kind of see this going forward.

We have two core platforms. I just described them in domestic parcel and cross-border that are running now with some of the best capabilities in data science and software underneath them. And they are both operating with predictable cost and service levels for the first time since the pandemic, which is important. The last couple of years were challenging for anybody who is in this space, including some of the largest carriers in the world. And so we are coming out of this pandemic in a much better position with scaled platforms that are running really well.

The build-out in this network is largely behind us as well. So during the last couple of years, we continue to invest in the network, bringing on new facilities, investing in automation, investing in robotics, really modernizing the way that we run the operation, improved our labor strategy, our transportation capability, all of which was capital that we've invested over the last three or four years and is largely done. So the major capital investments in this business are behind us. It will allow us to shift gears towards bringing new services to market and continue to optimize the network on behalf of our customers.

We have some good leading edge indicators, again why I'm optimistic about our business going forward. The service levels which I described, the client satisfaction which we measure dipped pretty significantly during COVID. Has improved by 46 [NPS score] points in just the last year. That's a good leading indicator for retaining customers, having less churn of customers, which is important for the model going forward.

We win in the marketplace. We have permission to be in this marketplace, and we win in this marketplace. We are a much different logistics provider from some of the large guys. We tend to be more consultative. We tend to go after the mid-market of retail. So those are customers that are doing up to $100 million in online sales. The reason our value proposition works is they tend to have less access to the larger carriers other than a rate card, don't tend to get support or the kind of service and we also bundle our capabilities. So we can go to a mid-market retailer and offer them domestic solutions and cross-border solutions through one technical integration to our API and get a much more personalized experience that is resonating in the market and is also part of why we win.

And as I said, with stability now around these two platforms, we're really starting to focus on our innovation agenda, which we had to leave for a bit during COVID. So making investments in Canada. We have a good service going from the U.S. to Canada. We've now made that bidirectional as well as doing intra-Canada delivery. The national network that we've built out in the ecommerce space has now also got the potential to do both regional and local deliveries on behalf of customers, and we can add things like guaranteed services to this going forward, all of which would command premium price going forward on the backs of a network that now is at a predictable cost.

One thing I wanted to highlight, I was talking about some of the improvements that we've made. This is a little bit of a look at kind of where our service levels have been historically in the domestic parcel business. When we had a world where there was more demand, there was capacity. Operating in the 70s and 80s was getting us by, but it was not on the right foundation. We have made a step change [improvement] in our service levels over the last six months. We are now operating consistently in the low to mid-90s and even as recently as this month at 95%, which is now market competitive. And that is really important that provides that stability to the customer. It's why we have better client retention and less churn.

Underneath that as well, when you have good service that's predictable, also our economics are improving. We've seen a $0.35 improvement in our gross margin in this unit. And as part of the service in just the last year, I talked a little bit about the NPS scores, lower churn, and we continue to win in the market, which are all things that are contributing to what we see as the new long-term plan that we published this morning through the web portal.

So on a path forward, what we're -- what we've been announcing is not formal guidance, but certainly from a global ecommerce perspective, a couple of the key points. We expect to end 2022 with an exit rate of 195 million to 200 million parcels in the network. That's an important moment for us, particularly as we start to look at what the value of new business that's in our pipeline that it's launching ahead of this peak. What that will translate into in terms of volume in the network. We also expect to have a continued improvement in our gross margin, I just shared with you the $0.35. Expect that to be 400 basis points in 2023.

So again, when we've got the model where it is today, and we've got a network that's operating at scale, as you add incremental volume to it, you get margin expansion. And that is the point and the inflection point that we are at in this business. We also understand that there will continue to be headwinds because of the strong U.S. dollar in our cross-border business. Our plan takes that into account. We are working on ways to mitigate those currency impacts by opening up other lanes. I mentioned Canada. We have a very, very strong business from the U.K. and the EU into the U.S., which is helping offset some of that.

And longer term, we expect to be in an EBIT positive position of 6% to 8% by 2026. And with CapEx levels that are approximately 20% of EBITDA in the long-term trajectory. And so I would say in kind of summing up this portion of it, confidence in what we're doing in ecommerce. We have a permission to be in this space. We have good clients. We continue to win in this market. We have a very core set of capabilities that are operating, operating at scale, operating at predictable costs and we continue to win in the market, all of which are good indicators for the financial plan that we expect to deliver not just in 2023, but going forward. My expectation in 2023 as we start to contribute meaningful cash flow to the corporation, and that will continue to be a trend going forward.

So with that, I'll turn it back to you.

Ned Zachar: Thank you very much. Let me spend just a couple of minutes on the second quarter results. We reported on July 28 for the June quarter, revenues were minus 2% on a constant currency basis which is $871 million. EBIT was $39 million versus $56 million a year ago. Key points, SendTech and Presort in the aggregate grew top line, though they did get beat up on transportation and labor costs, which were headwinds for sure in the quarter. Hopefully, that can begin to calm down later this year.

Gregg pretty well covered the challenges he is seeing on the cross-border side. So I'm not going to rehash that, except to say that the improved performance in GEC from a service standpoint is expected to drive volumes and financial performance as we exit the year.

One point I want to make sure that it's clear. We don't provide quarterly guidance, but our CFO, Ana Chadwick, noted that third quarter will look roughly the same as the second quarter from a financial standpoint. So some of the things we're seeing that Gregg is talking about are sort of happening real time and should begin to impact the numbers [positively] as we look into the fourth quarter and into 2023.

Guidance for the year, just to make sure we've got on the table, we're looking for revenues to range between a low single-digit revenue decline to a low single-digit increase and EBIT guidance is high single-digit decline to a mid-single-digit increase. We also expect to generate solid levels of free cash flow.

In terms of the capital structure, we paid down a ton of debt over the last several years, $1.6 billion to be specific, with the combination of free cash flow and proceeds from asset sales. Total debt at the moment is $2.2 billion. Leverage net of cash of $582 million is running at about 4.4x. That does not include the $100 million of proceeds that we got from the sale of Borderfree at the beginning of the second quarter.

I'd also point out that last year's debt refinancing, which I think occurred in March of 2021 was an important transaction. We substantially extended our debt maturities and now roughly 1/3 of the debt stack is secured bank loans and the balance will be unsecured public bonds. And I'd also make the point, Presort and SendTech can support the debt stack all by itself. And then the improvement that Gregg talked about in the last few minutes will augment that cash flow capability, if you will. The $500 million revolver does remain undrawn.

Last point here, at the risk, I think, of preempting a question. The preferred approach for the 2024 maturity would be a capital markets solution. But if the capital markets remain unsettled, a combination of cash, free cash flow over the next several quarters and existing bank facilities are more than adequate to handle that maturity.

We very much appreciate everybody's attention today. And I conclude by saying I think that there are compelling investment opportunities throughout our capital structure, both at equity and debt paper. As I outlined, SendTech and Presort have leading market positions and are finding new ways to grow and are much more durable businesses than commonly thought just a couple of years ago. Gregg walked us through the vision for the financial path in GEC, which should build on the very solid free cash flow that we are already generating.

So with that, I'd like to thank everybody again, and we'll take -- have some time for questions if anybody has any. Thank you.

Ned Zachar: I'm just going to repeat the question, Gregg. So the question is about FedEx and the announcement they made a week or so ago in terms of what they're experiencing operationally in their network.

Gregg Zegras: Yes. So for the Global Ecommerce segment, we -- when we compete with FedEx, we tend to compete with them in one of their niche verticals. It used to be called SmartPost. They now express that as FedEx Ground. So I don't have a good way to answer for the entire global announcement that they made about their business. I will tell you inside of the Ecommerce space, I'm optimistic because there's significantly more volume opportunity available to all of the players.

So even if there are short-term headwinds, which we're certainly experiencing, there are -- that's clear. I mean we're expecting -- as I look at the market for 2023, our expectation is you're going to have low single-digit growth rates in ecommerce. And I think those -- and then we project those will return to mid- to high single digits in 2024.

I think the important point is there's still a large available market to us because there was a step change in the amount of usage from 2020 to 2022. And so I would describe it that way, and we like to think about what we can control. We can control, making sure we have good value props in the market, good services priced correctly and that we'll win while there's other challenges going on more broadly.

Thank you for the question. In the back.

Unidentified Audience Member: (Inaudible - microphone inaccessible)

Ned Zachar: So if I get the question right, how do we think about how tied together the three businesses are? So my conversation with investors over the past -- since I've been at the firm in the last year, I have gotten a lot of questions about do the three businesses together belong in the same place, in the same umbrella. And I'd go back to the point that I made at the beginning of the presentation, is that everything we're doing now is reducing the complexity for our clients as they do their mail and shipping activities.

So once upon a time, we used to have a software business. Once upon a time, we used to have an equipment business. We also had outsourced Mail Solutions business and the portfolio has been honed, if you will, to a level, to a group of businesses that I do, in fact, think they do make sense together at this moment in time, and that is the underlying common theme that reducing the complexity of mailing and shipping. There is some customer overlap, especially between SendTech and Presort. And, financial services is a wrapper around all three.

Gregg Zegras: There's a little bit of overlap in some segments of the small, medium-sized business Ecommerce shipper where we can use Pitney Bowes technology in order for them to have the capability of the ship or we can go through a partner-play.

I think another way to think about the three segments, too, is with Ned's definition in the go-to-market, you've got different groups addressing different aspects of the go-to-market, right? And so SendTech going more after the SMB space, presort going more after large mailers. We're looking for those operational efficiencies and then GEC focused on kind of the mid-market of retail and with a dash of enterprise retail, and you think of it from a segmentation standpoint and then bringing capabilities to the market through those three segments. 55% of the SendTech customer base is now using -- has access to our shipping capabilities or shipping software. So there is an overlap in that regard for sure.

Ned Zachar: Thank you for the question.

Unidentified Audience Member: (Inaudible - microphone inaccessible)

Gregg Zegras: So the question is about our exposure internationally as far as SendTech is concerned. SendTech, 15% of the business would be international, 85% would be domestic. We're operating in a handful of European countries as well as a couple of countries in Asia, including Japan and Australia. So that is the -- there's some exposure, but it's not super significant as far as that is concerned. Plus their revenues and expenses would be fairly well matched as far as movements in currency which would not create a lot of volatility as far as their income statement is concerned, if that answers your question.

Unidentified Audience Member: (Inaudible - microphone inaccessible)

Ned Zachar: Was that the higher, what?

Unidentified Audience Member: (Inaudible - microphone inaccessible)

Gregg Zegras: Higher postal rates for the Presort business? Okay. So in the Presort business, the most relevant measure would be the workshare discounts that are available to companies that basically are doing work on behalf of the clients, of course, but also that the post office would otherwise have to do. So the basic drift is you focus on that part of the equation in terms of what those workshare discounts are, for example, in our case, sorting the mail down to a 5-digit sortation level.

And so the actual -- the absolute level of the rates aren't as important as what those workshare discounts are and how they are moving. In general, they've been moving up which is a net benefit to the firm. We did get a work share discount on the first -- sorry, around the 7th of August, which will provide a little bit of benefit for us in the second half of the year. But that's the relevant place to be looking for what the Post Office is doing in terms of how it affects Presort. Really appreciate your attention. Thank you all very much for coming out to see us.

Gregg Zegras: Thank you, guys.