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PBI - Q2 2013 Pitney Bowes Inc. Earnings Conference Call

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OVERVIEW:

PBI reported 2Q13 revenues of $1.2b and adjusted EPS from continuing operations of $0.52. Expects 2013 revenues for continuing operations (excluding currency impact) to be in the range of 1% decline to 2% growth and adjusted diluted EPS from continuing operations to be $1.62-1.77.

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PRESENTATION

Operator

Good morning and welcome to the Pitney Bowes second quarter 2013 results conference call. Your lines have been placed in a listen-only mode during the conference call until the question-and-answer segment. Today's call is also being recorded. If you have any objections please disconnect your lines at this time. I'd now like to introduce your speakers for today's conference call, Mr. Marc Lautenbach, President and Chief Executive Officer; Mr. Michael Monahan, Executive Vice President and Chief Financial Officer and Mr. Charles McBride, Vice President, Investor Relations. Mr. McBride will now begin the call with the Safe Harbor review.

Charles McBride - *Pitney Bowes Inc - VP of IR*

Thank you. Good morning. Included in this presentation are forward-looking statements about our expected future business and financial performance. Forward-looking statements involve risks and uncertainties that could cause actual results to be materially different from our projections. More information about these risks and uncertainties can be found in our 2012 Form 10-K Annual Report and other reports filed with the SEC that are located on our website at www.pb.com and by clicking on Investor Relations. Please keep in mind that we do not undertake any obligation to update any forward-looking statements as a result of new information or developments. Also, for non-GAAP measures used in the press release or discussed in this presentation you can find reconciliations to the appropriate GAAP measures in the table attached to our press release and also on our Investor Relations website. Additionally, we have provided slides that summarize most of the points we will discuss during the call. These slides can also be found on our Investor Relations website.

Now our President and Chief Executive Officer Marc Lautenbach will start with a few opening remarks. Marc?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Thanks, Charlie, and thank you for joining us this morning. In addition to disclosing our second quarter earnings results, we also announced this morning that Apollo Global Management has acquired our Management Services business for approximately $400 million. Before I discuss our agreement with Apollo, let me briefly talk about our second quarter results and where we are in terms of our strategic objectives. Following my comments, Mike will provide more color on our results and then we will open up the lines and Mike and I will take your questions.

Overall, I'm very pleased with our results and how our teams performed throughout the second quarter. I feel good about our position in the marketplace and where we are headed into the second half of the year. As you may recall at Analyst Day back in May, we outlined our strategy for delivering more sustainable value to our shareholders by unlocking the inherent value in Pitney Bowes. We told you that we would focus our efforts in three critical areas -- First, stabilizing mail. Second, driving operational excellence. Finally, growing our business, especially through participation in digital commerce. Importantly, there are activities in all these initiatives today, but as we discussed at Analyst Day, the benefits will accrue over some period of time.

During the second quarter we made solid progress in each of these areas. In terms of stabilizing our Mailing business, we continue to see lower rates of decline and recurring revenue streams in North America Mailing. In fact, this was the sixth consecutive quarter that the decline slowed and importantly, very importantly, there were improving trends in equipment sales. This is significant and we believe we will continue to make progress. Revenue in Production Mail increased 18% and we finished the quarter with a higher backlog of orders than the previous year. Further, we saw increased revenue in presort mail. In aggregate, we believe all of these speak to the stabilization of the mailing business that we discussed earlier this year.

Turning to operational excellence, there were a number of actions throughout our business to enhance operational excellence in reduced costs, support EBIT margin improvement in many of our businesses. Specifically we saw margin improvement in North America Mailing, Production Mail, Software, and Management Services. The balance sheet is perhaps the most important indicator of operational excellence and we made substantial progress. Specifically, we retired $375 million of debt, we substantially improved our inventory position over the last 12 months, and improved our DSO by a full day. The other pillar of operational excellence that's very important to me is client service, and again we are making substantial progress. Specifically, we concluded a pilot in our North American SMB organization, which will provide better client service, improved market coverage, all at a lower expense. We will roll this coverage model out in North America in the second half of this year.

Likewise, we are focusing our businesses in places where we can innovate and provide distinctive value. Beyond PBMS North America we reached definitive agreement to sell the European operation of Management Services. In addition, we've begun important work to focus our product and geographic footprint. All this work is enabling us to create a simplified and focused operating model based on standardized processes, which creates the basis to drive a much more efficient structure going forward. All that said, our strategy will be incomplete if we don't ultimately grow our business. We are focusing in markets that in aggregate represent over $45 billion of opportunity.

Two very important reminders from Analyst Day. First, we're not yet in our ultimate segment configuration. We continue to do that work to ensure that we can represent ourselves in a very transparent way. Said another way, digital commerce is more than just today's Software segment. Second, this initiative will take some amount of time. Though our Software segment, as reported, declined, and again not all of our digital commerce assets are currently in the Software segment, we did see quarter-to-quarter revenue improvement and significantly improved profitability. Likewise, we continued to make investments in our ecommerce solutions and we are seeing increased transaction for our cross-border solutions business.

Finally, our Volly solution has met the targeted levels for Australia Post. The digital mailbox has been in public beta since May and Australia Post is increasing the number of available provider and on-boarding many of Australia's largest mailers. Our focus with Volly is now created on the right business model and capabilities in the U.S. in the second half of the year. In the next several quarters, we will work to create a more specialized sales force for our digital commerce business and I'm confident that we have the right ingredients for a strong and growing business that is differentiated from others in the marketplace.

Before I hand over the call to Mike, let me briefly talk about our decision to sell our Management Services business to Apollo. First, and this is important, Pitney Bowes Management Services is a strong business with a highly skilled team, a remarkable client base, and a solid reputation in the market. Second, following a thorough evaluation of our strategy, we concluded the PBMS business would be best served operating as a stand-alone company with greater opportunity to add value for its clients and employees. Third, we believe employees of our Pitney Bowes and PBMS will benefit from being part of a stronger and more focused companies that are committed to providing the greatest value for our clients and our shareholders. Importantly, this move is a critical step in executing our strategy as we streamline our operations and rationalize our portfolio. It will give us the flexibility we need to focus on developing and delivering the highest value technology, innovative software and differentiated services in growth areas where we see the greatest opportunity to lead.

We expect the deal with Apollo Management to close later this year. The proceeds from the sale will be principally used to pay down debt. As I said earlier, I'm very pleased with our results so far but there is much more to do. We'll take time to firmly put into place the tools, processes, disciplines and execution focus to drive this Company forward. This is an ongoing and continuous process and by no means a straight line to the top. I'm convinced that our strategy is sound, we're on the right track and that we are focused on exactly the right areas to continue to unlock the value of Pitney Bowes.

Let me now turn it over to Mike for a more detailed discussion of our second quarter results. Mike?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Thank you, Marc, and good morning. As Marc indicated, we've taken significant actions over the last several months to improve the business profile, lower costs and actively manage our debt. These actions are the first steps, and very important steps, to lay the ground work for our transformative journey. In line with our strategy, today we announced that we had reached a definitive agreement to sell the North American operation of Management Services to funds affiliated with Apollo Global Management for $400 million. We expect this deal to close later this year and will treat this business as a discontinued operation in the third quarter. Consistent with the capital allocation strategy we laid out at Analyst Day, we expect to use the net proceeds from the sale of this business to principally reduce debt.

As a result of lower than expected first half operating performance for the North American operations in Management Services, including pricing pressure on contract renewals and a longer than anticipated sales life cycle for some of the new growth areas, future and near term cash flows are now estimated to be lower than originally projected. Accordingly, the Company performed a goodwill impairment review as of June 30, 2013. As a result, a pre-tax, non-cash, goodwill impairment charge of $98 million was recorded. Additionally, and as we previously announced, we entered into agreements to sell the European portions of our management services business. We closed one transaction and we expect to close on the other in the coming days. The operating results and loss on sale related to these businesses are now recorded in discontinued operations.

From a financial performance perspective, during the second quarter we had double-digit revenue growth in two of our business segments and flat revenue in a third segment on a constant-currency basis. We also experienced improving trends in elements of our revenue stream, including equipment sales, financing, supplies, and business services. I'll discuss those trends in more detail as I take you through the results for each of the business segments. SG&A also continues to decline and we were able to realize non-recurring tax benefits from the resolution of certain tax matters in several countries. During the quarter we also retired $375 million of maturing debt using cash on the balance sheet. The results for the second quarter further support that we are positioning the Company to achieve its long-term strategy.

Now let me take you through our results. Once again, please note that the operating results and loss on sale related to the European businesses and management services are now recorded in discontinued operations.

For the second quarter, revenue totaled $1.2 billion, which was nearly flat when compared to the prior year on a constant-currency basis and a decline of less than 1% on a reported basis. Revenue benefited from growth in our Production Mail and Mail Services businesses. Revenue in International Mailing was flat on a constant-currency basis. These gains were offset principally by low and mid-single-digit declines in our North American Mailing, Software and Management Services segment. Adjusted earnings per share from continuing operations for the quarter were $0.52 per share compared with $0.51 per share in the second quarter of 2012. Adjusted EPS excludes a restructuring charge of $0.07 per share, a goodwill impairment charge of $0.40 per share related to the North American Management Services business, and discontinued operations of $0.10 per share. Adjusted EPS includes $0.05 related to one-time tax benefits recorded in the quarter.

GAAP earnings per diluted share for the quarter were a loss of $0.05 per share compared with income of $0.50 per share in the second quarter of 2012. The loss in GAAP earnings per share this quarter is primarily related to our goodwill impairment charge and the loss in discontinued operations.

Turning to the income statement, adjusted earnings before interest and taxes, or adjusted EBIT, was $198 million this quarter and the adjusted EBIT margin was 17.1%. Adjusted EBIT this quarter included net incremental investments of about $3 million versus last year for growth initiatives, particular our eCommerce and Volly solutions. Last year's EBIT margin benefited from a $4 million insurance reimbursement related to the Dallas facility fire. Adding back depreciation and amortization, adjusted EBITDA for the quarter was $255 million or $1.26 per share.

SG&A for the quarter was $377 million, a decline of $4 million or 1% versus the prior year. As a percentage of revenue, SG&A was 32.5%, which was an improvement of 10 basis points over the prior year. The improvement in our SG&A, despite incremental investment in growth initiatives, highlights the early success of restructuring efforts. Consistent with our goal to enhance our operational excellence, improve our client experience, and variablize our cost structure across the business, we continue to identify additional opportunities to reduce costs and streamline the business. This is further reflected in the restructuring charge recorded in the quarter for actions that should benefit future periods.

Net interest expense, which includes financing interest, was $50 million, which was slightly higher than the prior year. The average interest rate this quarter was 5.1%, which was 22 basis points higher than the prior year. Average outstanding borrowings during the quarter were $167 million lower than the prior year. The effective tax rate on adjusted earnings for the quarter was 25.5% versus 33.3% last year. During the quarter we realized non-recurring tax benefits of $0.05 per share due to the favorable resolution of certain outstanding tax issues in several countries. Additionally, the sale of the European operations and Management Services resulted in 0.5% reduction in the effective tax rate, since this business was operating at a net loss.

On the balance sheet and cash flow, free cash flow during the quarter was $124 million and on a GAAP basis we generated $147 million in cash from operations for the quarter. Year-to-date we generated $232 million in free cash flow and $279 million in cash from operations. During the quarter, we returned $47 million of cash to our common shareholders in the form of dividends and had $11 million of restructuring payments. Cash flow was lower this quarter than the prior year for several reasons. Last year's taxes were a source of cash because of deductions we got for pension contributions and for bonus depreciation. Those deductions were not repeated this year and taxes were a use of cash this quarter. Also, we had less of a cash benefit from the declines in our financing portfolio as a result of higher quarter and revolving receivable balances related to our payments business. Finally, because of the timing of accounts payable and bank reserve account deposits we had less of a cash flow benefit this quarter than the prior year.

We continue to actively manage our working capital requirements and expect working capital to have a more positive impact on cash flow in the second half of the year as a result of initiatives in place to reduce day sales outstanding in accounts receivable and increased inventory turns.

We had $3.65 billion of debt on the balance sheet at the end of the quarter, which was about $27 million less than the second quarter last year. As I stated earlier, we retired $375 million of debt that matured in June using cash on the balance sheet.

Now, I'd like to discuss the second quarter results for each of our business segments. This information can also be found in our earnings' press release and the slides that we posted to the www.pb.com website under the Investor Relations section.

North American Mailing revenue for the quarter was $433 million and EBIT was $166 million. North American Mailing revenue declined 4% on a constant-currency basis and less than 5% on a reported basis versus the prior year. Revenue was impacted by lower recurring revenue streams, however we continue to see a moderation in the decline for these revenue streams when compared to the prior year and the rate of decline this quarter was the lowest in six quarters. We expect this trend to continue as I noted at Analyst Day in May. Equipment sales for the quarter declined less than 5% versus the prior year, which is an improvement from the first quarter. EBIT margin was 38.4%, an improvement of 140 basis points versus the prior year, due to ongoing cost reduction initiatives that reduced costs, including the costs of supplies, rentals and support services, as well as SG&A expenses.

The International Mailing revenue for the quarter was $165 million and EBIT was $19 million. Year-over-year revenue was flat on a constant-currency basis and down less than 1% on a reported basis. Revenue benefited from increased sales of our Connect+ mailing systems in Europe. Increased equipment sales and higher supplies revenue in Asia Pacific also contributed to revenue. EBIT margin was 11.7%, which was a decline from the prior year, due to a higher portion of non-core mailing equipment sales, such as printers and supplies, which have relatively lower margins. Also during the quarter, there was increased expenses as a result of a move to a new facility in the UK.

Turning to the enterprise business solutions group, Production Mail revenue for the quarter was $145 million and EBIT was $14 million. Production Mail revenue increased by 18% year-over-year and benefited from the installation of several large production print and inserting equipment orders in North America. The business finished the quarter with higher backlog of orders than the prior year due to demand for our new inserting equipment and printers, particularly as major mailers upgrade their color production capability. Supplies revenue also improved as a result of a growing base of production print installations. EBIT margin of 9.4% was an improvement versus the prior year due to the growth in revenue and ongoing productivity initiatives. The Company continues to invest in Volly at a similar rate to last year. This year though, we recorded $2 million in licensing and services revenue in the quarter related to our support of the digital mailbox platform for Australia Post.

Software revenue for the quarter was $92 million and EBIT was $16 million. Revenue declined 7% on a constant-currency basis and 8% on a reported basis as a result of fewer large dollar licensing deals in North America. There are also continued to be weakness in our international markets, especially in Asia because of some of the ongoing economic uncertainty in these regions and the austerity measures in the public sector of many countries. EBIT margin of 17.1% was a significant improvement when compared to the prior year, due to continued cost reduction initiatives that result in a more variable cost structure. Compared to first quarter results we have seen an improvement in both revenue and EBIT in this business. With the appointment of new leadership in the first quarter in the Software business, coupled with realignment of our sales force, we are better focused on building the revenue pipeline and improving our effectiveness in closing deals.

Management Services revenue was $175 million and EBIT was $15 million. Revenue for the quarter declined due to continued pricing pressure on contract renewals. EBIT margin of 8.4% was an improvement when compared to the prior year due to lower operating costs.

Mail Services revenue was $119 million and EBIT was $15 million. Revenue for the quarter grew 10% driven primarily by growth in our eCommerce business. We expect to expand cross-border shipping destinations as we move towards global deployment. Pre-sort operations also contributed to revenue growth in the quarter due to increased mail volumes processed. EBIT margin of 13%, a decline versus the prior year, was primarily due to the ongoing investments in infrastructure costs to build capacity for our ecommerce offerings. EBIT comparisons were also negatively impacted by the $4 million of insurance proceeds we received in the second quarter 2012 related to the Presort facility fire in Dallas. Additionally, EBIT margin was impacted by the recent postal rate case, which changed some of the Presort discount categories.

Marketing Services revenue was $30 million and EBIT was $4 million. Revenue in EBIT declined due to lower fees related to certain marketing contract renewals for the MoverSource program late in 2012.

That concludes my comments on our business performance this quarter. Now I'd like to update you on our 2013 guidance.

The Company's updating its 2013 guidance for continuing operations to reflect results-to-date and Management Services as a discontinued operation in the second half of the year. The Company now expects annual revenue, excluding the impacts of currency, to be in the range of a 1% decline to 2% growth when compared to 2012 pro forma revenue of $3.98 billion, which excludes the revenue of Pitney Bowes Management Services. Adjusted earnings per diluted share from continuing operations are expected to be in the range of $1.62 to $1.77, which now excludes the expected earnings of Management Services for the year. The Company now expects GAAP earnings per diluted share from continuing operations to be in the range of $1.07 to $1.22. This guidance includes the goodwill impairment charge recorded this quarter of $0.40 and restructuring charges recorded to date of $0.07 per share and excludes any additional actions that may occur as the Company implements plans to streamline its operations and further reduce costs. It also includes $0.08 per share for costs associated with the debt tender in the first quarter.

Free cash flow is expected to be in the range of $575 million to $675 million. This reflects the cash flow impacts of exiting the Management Services business later this year.

Finally, as a result of signing the definitive agreement for the sale of the North American Management Services business in the third quarter, the Company anticipates recording an after-tax charge in discontinued operations in the range of $0.40 per share to $0.50 per share, primarily related to the difference between the company's book and tax basis in the business.

That concludes my remarks. Operator, you may now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Kartik Mehta, Northcoast Research.

Kartik Mehta - *Northcoast Research - Analyst*

Marc, I wanted to ask you a little bit about the North American Mailing business. The decline in that business, obviously a little bit better than it was in the first quarter, and I'm wondering as you see improvement in the business, as you look at business condition, do you anticipate that this business can get to at least flat by next year? What are your expectations for this business over the next 12 months?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I'm going to resist the temptation of giving a specific number here. What we've said at Analyst Day, and I think is the right way to think of it, is that we think this business will stabilize. As a benchmark, you can look at mail volumes from the USPS of minus 1% or minus 2%, meter mail is slightly more than that, so I think I'll stick with the words that we used earlier. We would like to continue to see us improve, and that's what Mike said. We think we're getting close to flat.

Kartik Mehta - *Northcoast Research - Analyst*

You talked a little bit about the digital sales force. I'm wondering will this be new salespeople you hire from the outside or is the thought that you transfer some of the people from some other segments into this new area for the Company?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

The answer is yes and yes. I think we've got a great sales force as I indicated in the software business already, we need to help them build their skills specific to what we think are very unique and differentiated products. I suspect the preponderance of our sales force will be what we have and we'll make target hires in term with the leader. As Mark has gotten into the business, he's refreshing that into his leadership team as well. I think it's going to be a combination of both, Kartik.

Kartik Mehta - *Northcoast Research - Analyst*

Just the last question on guidance, Mike, just a clarification. Is any of the proceeds that you're going to use from a PBMS to pay down debt included in the guidance? Of the lower guidance, is all of it because of PBMS or is there a little portion because maybe business conditions are a little bit softer than you thought?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

It's specifically related to Management Services.

Kartik Mehta - *Northcoast Research - Analyst*

Is any of the debt, Mike, included? The pay down of the debt?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

It's not. It would be, obviously, if it's late in the year when we close, it would not be a material impact.

Kartik Mehta - *Northcoast Research - Analyst*

Thank you very much. Appreciate it.

Operator

Ananda Baruah, Brean Capital.

Ananda Baruah - *Brean Murray, Carret & Co. - Analyst*

The first one for me is could you comment a little bit more on the Production Mail backlog that you mentioned going into the second half of the year? I think you said it was up year over year and that there were mailers that were actually doing install base refreshes right now, so I'd love to get some more detail around that? Typically, how long could we expect these refresh cycles to play out in Production Mail? Sounds like there's a lot of temp demand and there's obviously impact this quarter as well, and I have a follow-up as well, thanks.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Sure. In terms of the production mail business obviously 18% growth is quite good. That related to a couple of particularly large deals that got installed in the quarter. I would not say that we think the production mail business is an 18% grower over the long-term. I think the important thing is that we're continuing to see strong backlog and that backlog obviously gives us some visibility to the latter half of the year. We think this business is on a good path. As the economy continues to improve, that generally frees up the capital investments by our customers. We think it will continue to perform solidly, and obviously in the second quarter we had a particularly good result with a couple big deals.

Ananda Baruah - *Brean Murray, Carret & Co. - Analyst*

Thanks, Mike. Marc and Mike, I guess the financing income was almost flat sequentially and that's very atypical -- well, it's been very atypical in recent years for a June quarter. Is that purely the result of the stabilization that we're seeing in the metering business or are there other dynamics there play? Finally, given that it was essentially flat in the June quarter, are we to the point now where we might start to be able to see some sustained sequential uptick in the financing revenue? I know we talked about, for a couple years now we've talked about, we are not there to where we could see growth yet, but I just want to get the proper context for that since we saw pretty solid quarter there?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Sure. I would frame this very much in the context of what Marc described. I think with respect to recurring revenue streams, we're seeing sustained improvement in all elements including financing income. We actually saw finance receivables come down very modestly in the quarter, so I think we're on the right trajectory. I think we're still a little ways from it being flat, but as we describe we're looking for quarter-to-quarter improvement in that rate of decline.

Ananda Baruah - *Brean Murray, Carret & Co. - Analyst*

Got it. Last one for me guys right now, can you give us some sense of what the incremental, as you guys define them, cost savings were through the business model, June quarter versus March quarter? Just want to get some sense of what kind of cadence you guys might be putting yourself on track for?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I think it's hard quarter to quarter to project that specifically, but the way we would look at it is we had a $4 million decline. We had about $7 million of, I would say, combination of incremental spend on growth initiatives and a one-time insurance proceed last year and that would say net-net we had about $11 million decline in the underlying SG&A. I would say that's consistent with what our plans are, but again it will vary quarter to quarter based on the actions we take.

Ananda Baruah - *Brean Murray, Carret & Co. - Analyst*

Got it. That's very helpful. Thanks a lot.

Operator

George Tong, Piper Jaffrey.

George Tong - *Piper Jaffray - Analyst*

This is my first PBI earnings call and I'm excited to be on Board. Can you talk a bit about your meter based trends in Europe and Canada? What your views are and the sustainability of growth there and how much that growth can offset the declines you're seeing in North America?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

On a relative scale obviously the North American or US meter base is the largest. We continue to see good performance in both Canada and Europe in terms of sustaining and even marginally growing that base. The U.S. base is more of a rental business than in Europe, so you see that in the aggregate of our SMB revenue. You saw that our international revenue was essentially flat year over year. That's been in that pattern for the last few quarters. That's a combination of the impacts of the meter placements offset by some other recurring revenue challenges. We think we've shown the international business can be stabilized and now we continue to look for improved performance in the North American business.

George Tong - *Piper Jaffray - Analyst*

That's helpful. You mentioned earlier that your guidance update reflects primarily the sale of your management services businesses, but I notice that also you revised your revenue growth guidance to down 1% to 2% growth, which reflects your continuing operations expectations. Can you comment on what drove that revision and what you're seeing in your core business?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Sure. Actually similarly, there's an impact of the management services business. As we talked about, we have seen print outsourcing as a growth driver in the second half of the year. As we looked at moving that business to discontinued operations, we reflected that in our overall guidance, and obviously we looked at overall performance year to date and net-net that was the change in guidance.

George Tong - *Piper Jaffray - Analyst*

Great and last question for me. Digital commerce solutions are obviously an important part of your long-term growth story. You've talked a bit about scaling eCommerce and a bit of a Volly. Can you tell us about other initiatives you had going on in the second quarter? How those projects are tracking, and how quickly you expect revenue streams from these various projects to ramp?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

In terms of the couple of key initiatives, eCommerce is an important piece of that and we continue to see that ramp in the second quarter as we made investments in building out the infrastructure to support that and moving into additional countries. As you noted and as we noted here, Volly, we continue to invest in that. Obviously, as Marc noted, other investments come in the form of our go-to-market strategies, both for our core mailing business as well as our software business. We're making investments across the business. They just vary based on the business profile and trajectory.

George Tong - *Piper Jaffray - Analyst*

Okay, thank you.

Operator

Scott Wipperman, Goldman Sachs.

Scott Wipperman - *Goldman Sachs - Analyst*

Mike, I was just wondering if you could elaborate on the comments on debt pay down. Should we be thinking about that as pre-funding the 2014 maturity, or do you think you guys could look out the curve to reduce some other towers you might have? Then, I have a few follow ups.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes, we're evaluating that. I think both are options for us, and obviously we'll look at the implications particularly as we see what the markets look like once we get to a closing period. Those are obviously the two options we're considering.

Scott Wipperman - *Goldman Sachs - Analyst*

Got it, okay. Then, just on the international mailing, I know there have been some prior benefit from the launch of Connect+, does that turn into a comfort comps in the second half of '13? How should we think about the trajectory there?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Actually, Connect+ continued to be a positive contributor this quarter. If you recall, we launched Connect+ a little bit later in both France, and Germany and so we continue to have some runway in those markets. They usually take longest to get product approval. France is the second biggest mailing market after the U.S., so we see some opportunity to continue to grow on around Connect+

Scott Wipperman - *Goldman Sachs - Analyst*

Okay, great. The last one, the outlook for restructuring in the second half of the year, if you could just remind us -- I recall that the charges that you discussed at the Analyst Day, but how should we think about those rolling through in the second half of the year?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

What we described was charges in the neighborhood of $100 million to $125 million to drive cost savings through 2014. We took the first installment of that in the second quarter of $20 million. We will continue to identify initiatives as we go forward. Incorporated now in that, obviously, will be the impacts of separating the management services business and that will play into greater simplification of our overall infrastructure. We would expect those costs to continue to roll in over the next several quarters.

Scott Wipperman - *Goldman Sachs - Analyst*

So it's going to be through 2014?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes.

Scott Wipperman - *Goldman Sachs - Analyst*

On the restructuring charges you're saying?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Correct.

Scott Wipperman - *Goldman Sachs - Analyst*

Got it. Okay thanks for all of the questions.

Operator

Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

I just had a couple of questions. The first question I have is basically can you talk a little bit about the changes, Marc, you discussed in your coverage model in the U.S.. Can you give us a few more details on how you're shifting things, and how we should think about it from a cost perspective, like cost benefit perspective I guess?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

The focus is to improve our coverage and become more efficient, so the specific tactics underneath that is we are adding inside sales and web capabilities to the go-to-market mix so that we can reach our clients more cost effectively. As you contemplate the sales force going forward, there will be a higher mix of inside sales over time, a higher mix of web capabilities and proportionally less face-to-face sales resources. We think the net benefit of that is when you use these leverage techniques of web and inside sales you reach more customers more effectively. The results of the pilot have been that we've seen increased client satisfaction. In terms of the benefits that we believe, I think I would go back to, Shannon, the numbers that we offered at Analyst Day of -- as we exit '14, $100 million to $125 million of going rate SG&A. That's buried in there. I would say the other important aspect of this that we haven't spoke as much about is all the stuff that we're doing to make the back room more efficient. So, when we talk about simplifying the operating model and focusing on a fewer number of businesses, a fewer number of products and a more consolidated geographic model that will help us simplify the business model and make the back room a lot more efficient.

We're continuing that journey. This is something that Mike and the team have done very credibly before and took $400 million out. It's a journey we know, but there's still plenty of opportunity in the business.

Shannon Cross - *Cross Research - Analyst*

Great, thank you. Can you talk a little bit about the sales process for the PBMS business? I mean I think it was back in 2008 you guys had put it -- obviously, well before your time, but it had been put on the market and then right into the recession there was obviously no interest because it was the recession and cash was tight. I'm curious as to how this came about? Was it a bidding process or did Apollo come to you, just any color you can give us?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Listen, the first part of the process was a fairly thorough evaluation of the overall business and it was my conclusion and the Board of Directors conclusion that while this was a very good business, strong client lists, very well run, great leadership team, that ultimately there could be more value outside of the Pitney Bowes family, if you will. Based on that decision we then began a fairly robust process with the market looking at Pro-Financial as well as strategic buyers that ran over the last several months. We ultimately culminated in a signature over the last 24 hours. I've seen a lot of divestitures and acquisitions and I will tell you this process was as robust as any as I've seen in terms of soliciting input and feedback from the market.

Shannon Cross - *Cross Research - Analyst*

Great. I think it's probably the right move given the strategy you've laid out. My final question is just could you talk a bit more about linearity in the quarter? I know, Mike, I think you'd mentioned some weakness in Asia. You also mentioned some strength in production as you got to the end of the quarter. I'm curious on a geographic basis if could you talk about what you hearing from your customers in terms of the health of enterprise?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I would think we see North America very much as you hear generally in the marketplace, that it's a bit up and down but generally the longer-term trend is positive. Europe for us has been relatively stable in a relatively unfavorable economic environment, so we don't see a lot of change there.

When I speak about that, I mean particularly our Mailing business. Software, we have seen more of an impact from Europe and Asia because we have a fair amount of business with government agencies, so there is a sector element to that underlying the individual economies. I think that's basically what we see. Then, obviously very small business where it's particularly important to us in North America continues to be, I would say, cautious.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I think that's a fair characterization and we're certainly not immune to the broad sector of trends that are going on in the economies. That said, I do like our geographic footprint, right now. If you look at where we're strongest, it's the United States. Relatively speaking, that's the strongest economy that we see around the world. In terms of Europe, we're deeply penetrated in northern Europe relatively speaking. That's stronger in Europe and if you look at where we are in Asia, our biggest footprint is Australia and Japan and again I like those economies. Rather fortuitously, I like our geographic footprint. All that said, we aren't immune from secular trends, but I like how we are positioned.

Shannon Cross - *Cross Research - Analyst*

Great, thank you very much.

Operator

Blaine Marder, Loeb Capital Management.

Blaine Marder - *Loeb Capital Management - Analyst*

Congratulations on strong results particularly in North American Mail and Production Mail.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Thank you.

Blaine Marder - *Loeb Capital Management - Analyst*

My question resolves around, Marc, you said in your commentary that you believe that the segment reconfiguration is not yet complete. Just seeing the dilutive impacts of the sale, how are you weighing on one hand getting low multiples for higher margin businesses and the dilution effects of selling, when maybe looking at buying some higher multiple businesses and so you're shifting the mix, but paying high multiples for acquisitions potentially and selling businesses that could potentially be dilutive? How are you weighing that in the entire strategy? Thank you.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

That's a rather involved question. Let me take it up a notch. Let me say definitively, we have not completed our segment work to reconfigure ourselves. Again, what we're trying to do is put our growth businesses with our growth businesses and our businesses that we're running for cash together, so we expect that will happen over the coming couple of quarters. That's not a belief, that would be just a fact. In terms of the overall portfolio, the way that we're thinking about it is what's the most value that we can create? As it relates to PBMS in particular, my conclusion and the Board's conclusion, Mike's conclusion was that more value can be created outside of Pitney Bowes family than in. That has no level of prejudice on the rest of the portfolio or what we do forward. That was a micro decision. In terms of the dilution that's caused by the divestiture, as Mike indicated and we talked about again, we're working on the cost and expense structure that will speak to the dilution, to a portion of the dilution, that is created and we'll look at ongoing options going forward. That said, we are moving the business to places where we can drive more value. One would expect you would see that in improved margins of our business.

In terms of going forward, and you jumped a little bit ahead of me in terms of acquisitions. Again, what we said about acquisitions is we'll be very disciplined and focused and do those in a way that we, again, think we can drive disproportion in value. Likely, to the extent that we do them, we would do them in digital commerce space and in software and you're right. You would pay a higher multiple for that, but we would only do that if we think it's accretive to the overall business. What we said was, it would have to be accretive in a fairly short, 18 months amount of time. I like the way that we're thinking about this equation. I think it's predicated on how we drive value. By the way, I'd say not just value for Pitney Bowes, but I believe in the case of PBMS divestiture in particular, I think Apollo's going to create a lot of value. I'm hopeful that the employees see that value as well, so this is, from my perspective, a win all the way across the board.

Blaine Marder - *Loeb Capital Management - Analyst*

Thank you, Marc, that's helpful.

Operator

Chris Whitmore, Deutsche Bank.

Chris Whitmore - *Deutsche Bank - Analyst*

I actually wanted to follow up along that line of questioning and ask about balance sheet targets, leverage targets and the like, and whether you think that this asset sale gives you enough fire power or capital to move into that next phase of the strategy? Can you give us some thoughts around balance sheet capacity and willingness to put on debt? Or, do you think you have enough capital to execute that acquisition portion of the strategy? Thank you.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Chris, thanks for the question. In terms of the balance sheet, obviously if we pay down debt with this, we think we'll maintain our ratio in the neighborhood of where they are today, credit ratios. Obviously, as we look ahead and would look at acquisitions we would look at that in the context of its contribution to EBITDA. If we were to add debt, we would look for growth in the business that would support that. As Marc said, we continue to look at the overall portfolio. We continue to look at, obviously, growing earnings in the business to drive the opportunity for leverage. We're not committed on a particular path at this point, but we believe this disposition of this business will continue to strengthen our balance sheet overall.

Chris Whitmore - *Deutsche Bank - Analyst*

Are there other significant assets for consideration for monetization here?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I would say we continue to look at our whole portfolio, but this is obviously, of the things we've done in the business thus far, the most significant.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Chris, I'd go back to the comments that we said in May, we're obviously not going to comment prospectively on anything that we might do in the future. We did set out pretty specific criteria for the business that needed to be strategically coherent, you needed to return an acceptable cost of capital, and you needed to be a leader in the market place. That was and is the criteria that we look to stay in the portfolio. All that's predicated on the basic sense of, how does it create value? While there were positive impacts to the sale of PBMS in terms of the balance sheet, that was not the primary motivation. The primary motivation was about value. I liked the balance sheet last week and I like it this week. I think we've got a strong balance sheet and as you and others have remarked, we've got a lot of opportunity to generate fairly substantial cash flow organically going forward.

Chris Whitmore - *Deutsche Bank - Analyst*

So Marc, you talked about classifying the businesses as growth businesses and cash flow businesses and I look at -- I know software is a key component of the growth strategy, however that asset isn't growing. Can you give us some color as to the timeline and key milestones around getting that business to turn towards positive growth? Related to that, I'm a little surprised to see the significant margin expansion in that business despite the softer top line, so can you help us understand the level of investment in that business and how that may be changing going forward? Thanks a lot.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Sure, it's a great question. Again, when we talk about digital commerce, that is not equal to just the software businesses going forward. That's one of the reasons that I feel so strongly that I want to reconfigure how we report segments is to be transparent to you in terms of how we're thinking about the business and then over time how we run the business. That's the first caveat. What we said at Analyst Day was that we believe it will take a couple of years to get that business growing at market rates. That is our objective. Again, it's $45 billion of opportunity and those markets are growing double digit, so that's the time frame. The important milestones along the way, beyond getting ourselves configured from a segment perspective, is what we do to the sales force. As you'll recall, my primary insight in terms of what was required to get that business to grow was a specialized and dedicated sales force. We're starting that journey, but it will take some number of quarters to build those skills in a way that we would like. Once we get ourselves configured, I think some of this becomes a little bit more clearly.

The other key milestone along the way is what happens with some of our key offerings and products, so Mike talked about eCommerce and our volumes there. We talked about Volly, we talked about some others that will be important as well, and we'll add color to those as we go forward. In terms of the margins, the margins did improve sequentially. I would tell you that they're more akin to the kinds of margins I expect to see in a software business. I compare them and do consider the first quarter somewhat of an anomaly in terms of what we saw for margins. The overall investments that we're making in this business today and going forward are consistent with how you'd run a software business, both from an SG&A perspective as well as an R&D perspective. Now, within the software and digital commerce business, you've got businesses that are more mature that require a little bit less sales and a little bit less R&D and then you've got businesses that are growing like what we're doing with the eCommerce and those require more investments. That's what happens when you have the mosaic of businesses, you've got different ones that are different life cycles. That's how we're thinking about going forward and what you would expect to see and what we try to do today, not just in digital commerce and that conversation, but if you begin to layout the markers for what you expect to see around digital commerce, operational excellence and the stabilization of mail.

Chris Whitmore - *Deutsche Bank - Analyst*

Thanks very much, Marc, I appreciate the color.

Operator

Herb Hart, Monness.

Herb Hardt - *Monness, Crespi, Hardt - Analyst*

I have two questions, one is the marketing efforts. Are there other major changes you need to make or is this just evolutionary, grind it forward?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Listen, as you evolve a business, you'll always make changes. Some of those will be more substantial than others, but that is just a truism of business that you need to continue to move the business to values. That will mean, principally, we make organic investments. We'll continue to look at the portfolio, both acquisitions and divestitures, consistent with what we've laid out, but we're certainly not going to stand still. This is a great business, but there's a lot that we need to do to unlock the value and what you're seeing -- I mean, if you step back and look at what's happened over the last 90 to 180 days, it's fairly remarkable in terms of the level of change and how the business is being repositioned. While not everything will be as dramatic as what we've announced in the last 24 hours, or to a degree the last 90 days, we aren't standing still. We're going to move forward, and we're going to move forward aggressively because we want to lead.

Herb Hardt - *Monness, Crespi, Hardt - Analyst*

The other question is the balance sheet. Is there a goal debt, because it seems to me with interest rates where they are you'd want to keep as much debt as we can because three, four, five years from now it's probably not going to be this cheap?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes, what we've said is we're focused on investment grade credit ratios and we believe that we've got a very solid balance sheet around that today. We think with the divestiture we'll continue to be in that position, so we're comfortable with where the debt portfolio is today and we'll continue to manage that as we go forward.

Herb Hardt - *Monness, Crespi, Hardt - Analyst*

Thank you.

Operator

Glenn Mattson, Sidoti & Company.

Glenn Mattson - *Sidoti & Company - Analyst*

Just looking at the equipment line, I'm sure some of that surge in that business was due to some kick out from the March quarter, but even when you add those two together and do a year-over-year comp of the first half, there was still pretty solid growth. Can you say, possibly, this is the first sign that we're seeing maybe cyclical upturn in that business?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

In terms of the equipment sales line obviously that's benefiting from the performance in the Production Mail business, so that's a very positive contributor to that. We've seen progression on a quarter-to-quarter basis in the North American mailing business and solid sales performance in the European business. It's a combination of those things that I think are very consistent with what we laid out of continuous progress leading with equipment sales and driving recurring revenue streams.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

To add a point, when we talk about stabilization of the mailing business we're talking more than just the SMB business. We're talking about the total portfolio of assets that we have around the mailing business, so we can get back to going whether this is the first time we've seen equipment sales increase in while or not, but I think it's a pretty important data point in our journey forward.

Glenn Mattson - *Sidoti & Company - Analyst*

Yes, I would agree. Then just a little more on the eBay relationship. I'm not sure of you guys break out specifically what you did in that business for revenue, but if you don't, can you talk about it as progressing at the pace you'd expect? Also, the countries that you've been exporting to for a couple quarters now, are you seeing further penetration within those existing countries?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

We are. We saw good sequential growth and we're about $9 million higher than last year in that business. That has come not just from eBay, but obviously with the broader eCommerce business. We continued to see penetration by offering it in more markets around the world, but we are seeing improved penetration in some of the key markets, which not surprisingly would be markets like Canada, the UK, and Australia.

Glenn Mattson - *Sidoti & Company - Analyst*

Okay, great. That's it for me, thanks guys.

Operator

Ananda Baruah, Brean Capital.

Ananda Baruah - *Brean Murray, Carret & Co. - Analyst*

I'll try to be quick. I was -- just with regards to the EPS guidance, I wanted to ask why seemingly the second half isn't a little bit firmer than it appears that maybe it could be? I guess the way I'm looking at it is this, if I adjust out the $0.10, which you're backing out from the sale of management services, if I'm assuming I'm doing that correctly, it would suggest that EPS for this quarter, operationally, was $0.42 and if that's the case, then it would suggest you're guiding at your mid point in your guidance of $0.37 for the September/December quarter. If I don't do it that way it suggests that the guidance is $0.42 for the September/December quarter. Given that regardless of how I do it, seasonality in the second half of the year, particularly in the December quarter is a little bit stronger, which is typical, so I would think this run rate of $0.42 operationally, almost linear through the year, would be a bit conservative for the second half of the year. I just wanted to ask the question as to why would we see linear operational EPS through the year? Is there something going on that you're just being a little cautious about, or is there something that we should be aware of? Thanks.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Ananda, I would suggest that our guidance has not changed except for the exclusion of Management Services. There's a number of puts and takes here, so it gets a little complicated. Essentially, if you take the range of $1.85 to $2 and you subtract the $0.23 that's assumed here for Management Services, that yields the $1.62 to $1.77 adjusted EPS. That is consistent with our guidance prior with the exception of management services, so we're not projecting any change in our outlook for the second half of the year.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Building on that, if you look at what's implied in the revenue in the second half of the year, it means the revenue is going to continue to sequentially improve. As Mike said, there's nothing mysterious about the guidance. It is simply air lifting PBMS out for the divestiture.

Ananda Baruah - *Brean Murray, Carret & Co. - Analyst*

I appreciate that. Very helpful and congrats on the progress guys.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Thank you.

Operator

Andrew Feinman, Iridian.

Andrew Feinman - *Iridian - Analyst*

It's great to see the turnaround starting to take shape at Pitney Bowes. If you combine the proceeds from the North America divestiture and the European management services divestiture and you take out the taxes and other fees, can you say what the total net proceeds are for those two combined?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes, obviously, we have to finalize the transaction and the taxes in the third quarter or fourth quarter, but we expect it to be north of $300 million in terms of net proceeds. Obviously, as we suggested, the bulk of that would be used to reduce debt.

Andrew Feinman - *Iridian - Analyst*

Is that both deals, North America and Europe, or are you just talking about the North America part?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

In total. So, the net cash on the European business is rather modest.

Andrew Feinman - *Iridian - Analyst*

Okay, so you're saying that your free cash flow this year would be $575 million to $675 million, let's take $625 million just use a mid point. You have had $230 million of free cash flow in the first half, based on what you've said the first quarter was $107 million, the second quarter was $124 million, so you still have operating free cash flow coming in this year of $395 million and so call it $400 million and then $300 million of net proceeds. So, you have $700 million of cash coming in this year, but you ended the quarter with $600 million of cash, so that's $1.1 billion of cash on the balance sheet at the end of the year, which is something above between $5 and $6 a share. What I'd like to know is, you have $450 million of debt due in 2014 and $400 million of debt due in 2015, can we assume that you will pay that off from cash on hand?

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Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

We have about $300 million remaining due in '14. Obviously, as part of closing the transaction, we're looking at our options around managing the debt portfolio. You obviously totaled it all up to a pretty big number. There's dividends and other things against that as well, but we'll continue to provide insight into what we're doing as we go forward.

Andrew Feinman - *Iridian - Analyst*

Okay, well I'll just say that, from my perspective anyway and forgive me for telling you it, but as we wait for the turnaround, which I'm confident will be successful given your plans and history, it's nice to have our investment de-risked by some of the cash going to pay down debt during the time that we wait and also pay the dividend during the time that we wait. I'm thrilled with the quarter and you guys are doing a great job. Keep up the good work.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

We appreciate the input.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

And the compliment.

Operator

(Operator Instructions)

No further questions at this time.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Great, thank you.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Alright team, listen, to summarize we made good progress. I'm very pleased with where we are so far, if you look at the progress that has been made over the last couple of quarters. That said, this is a journey, so we will continue to try to be as transparent with you as we can going forward and lay out our markers for progress. Thanks for your interest in the Company. We really do appreciate it. I thought the questions were terrific and we'll look forward to talking to you soon, thank you.

Operator

Ladies and gentlemen, this conference will be made available for replay after 10 o'clock today and run through Friday, August 30 at midnight. You can access the AT&T executive playback service at any time by dialing 1-320-365-3844 and entering the access code 296300. That number again, 1-320-365-3844, with the access code 296300. That does conclude our conference for today. Thanks for your participation and for using AT&T executive teleconference service. You may now disconnect.

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