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EDITED TRANSCRIPT

PBI - Q4 2016 Pitney Bowes Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 01, 2017 / 1:00PM GMT

OVERVIEW:

Co. reported 4Q16 revenues of $887m and GAAP EPS loss of $0.44. Expects 2017 revenue (excluding currency impact) to be in the range of 2% decline to 1% growth from 2016 levels and EPS to be $1.70-1.85.

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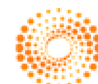

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CORPORATE PARTICIPANTS

Adam David *Pitney Bowes Inc. - VP of IR*

Marc Lautenbach *Pitney Bowes Inc. - President and CEO*

Michael Monahan *Pitney Bowes Inc. - EVP and COO*

CONFERENCE CALL PARTICIPANTS

Kartik Mehta *Northcoast Research - Analyst*

George Tong *Piper Jaffray & Co. - Analyst*

Shannon Cross *Cross Research - Analyst*

Allen Klee *Sidoti & Company - Analyst*

Glenn Mattson *Ladenburg Thalmann & Company Inc. - Analyst*

Hunter Martin *BNP Paribas - Analyst*

PRESENTATION

Operator

Good morning, and welcome to the Pitney Bowes' fourth-quarter full-year 2016 results conference call.

(Operator Instructions)

Today's call is also being recorded. If you have any objections, please disconnect your lines at this time.

I would now like to introduce your speakers for today's conference. Mr. Marc Lautenbach, President and Chief Executive Officer; Mr. Michael Monahan, Executive Vice President, Chief Operating Officer; and Mr. Adam David, Vice President, Investor Relations. Mr. David will now begin the call with a Safe Harbor overview.

Adam David - *Pitney Bowes Inc. - VP of IR*

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 2015 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 tables attached to our press release, and also on our Investor Relations website. Additionally, we have provided slides that summarize many 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?

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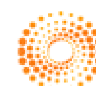

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Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Thank you, Adam, and good morning. Let me start by saying that the fourth quarter was not the quarter we wanted or expected. As always, there were puts and takes in the business. However, the primary story is in software.

In the third-quarter earnings call, I referenced several large software deals that our expectations were built on. We were encouraged not only by the size of these deals, which were substantial for any large software Company, and especially for a Company of our size, but also because these opportunities were with clients with whom we have a strong, long-term relationship, and have successfully closed business in the past.

There was every indication that we would close these deals by the end of the fourth quarter. Unfortunately, these deals slipped into 2017. While I'm confident we will close many of these deals this year, the failure to close these deals in 2016 caused a different quarterly performance than we were expecting.

While I continue to be confident in the future of our software business, there is no question we need to up our game going forward. This was not the first quarter we have had a poor close rate on large deals. Consequently, we have made a series of changes in our Software Executive Sales Management Team. Going forward, Bob Guidotti will personally direct the software sales organization.

Moments like these require you to step back and to take stock of the lessons learned. I would summarize my learnings as follows:

First, this reaffirms our initiative to build an indirect channel for our software business. Systems integrators bring reach, technical skills, brand credibility, and more executive relationships to our business. All of this will be helpful to Pitney Bowes.

Second, we need to up our own game, selling to executives in our software business, and in general continue to improve the skills of our software direct sales force. Third, we need to continue to sharpen our analytical capabilities to provide us a clearer view of our pipeline. Our new business platform will help us a lot in this respect.

Finally, based on how 2016 ended, especially in software, we are adding conservatism to our 2017 guidance. While we are not happy with our tactical performance in the quarter, or for that matter the year, we did continue to make progress creating the strategic foundation for our business.

In terms of reinventing our mail business in 2016, we have shipped more than 50,000 SmartLink devices, 22,000 SendPro applications, and 10,000 SendKits. Moreover, our shipping APIs, delivered through PB Commerce Cloud, are positioned to make a real difference for us in 2017.

Two weeks ago, we announced SendPro online shipping and mailing solution. This latest solution is the only online application in the market that provides both USPS postage for mailing, and multiple shipping options. We have learned much from our new meter products, and will incorporate those insights into our complete meter refresh, which will roll out later this year. The entirety of these efforts will move our meter business from 20th Century technology to a new contemporary form factor, supported by an open platform, and SaaS.

Turning to our Enterprise business, the new postal rate case in the United States, and our production opportunity pipeline has positioned us well for 2017. The new rate case, which was effective on January 22, creates a greater incentive for high-volume mailers to leverage our solutions. And our new insert solutions continue to outperform our expectations.

In terms of operational excellence, we are through much of the stabilization work of our Enterprise business platform, and continue to be very encouraged by the opportunities this platform not only creates to deliver productivity, but also a totally different client experience and enables many of our new offerings. Our Global e-Commerce business performed well, especially in the context of a difficult currency environment. The solid results are a clear demonstration of the resilience and the robustness of this market opportunity.

We continue to be confident in both the short- and long-term prospects of this business. And while our software business performed poorly in the quarter, we continued to make good progress building our indirect channel. We increased the number of absolute partners, enabled more of the professionals, and the pipeline continued to build.

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More work to do for sure. However, this new channel is making a difference now, with improved quarter to quarter, as well as year-to-year performance. We clearly took a lot on in 2016, and our annual performance may have suffered because of it, but the changes we made were necessary, and have positioned the business to create long-term value for our shareholders. With that, let me turn the call over to Mike.

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

Thank you, Marc, and good morning. As Marc discussed, and as most of you have had a chance to see by now, we had a weaker-than-expected finish to the fourth quarter for both revenue and earnings per share. Let me spend some time going through the three specific factors affecting the quarter: I'll then get into the financial details of the full year and the fourth quarter, before providing more color around our 2017 expectations.

First, as Marc noted, software revenue fell short of our expectation, mostly on lower license sales in the last few weeks of the quarter. Given the high-margin nature of this revenue, the shortfall significantly impacted earnings.

Entering the quarter we had a healthy pipeline of deals. However, typical with this business, we expected a significant portion of business to close in the last two to three weeks of the quarter. Unfortunately, there were three large deals worth $17 million, along with a few smaller deals that the did not get finalized in those last few weeks, as we expected.

We have consequently made changes in our Software Executive Sales Management Team, as Marc stated. Bob Guidotti's experience and leadership, coupled with our aggressive effort to build and train our partner network sales teams, are expected to produce better results relative to our performance over the course of 2016.

Second, while year-to-year comparisons for North American SMB in the quarter reflect modest revenue improvement from the last two quarters, we expected a stronger sales finish. As Marc noted, we have launched a number of new solutions in SMB, some of which are equipment-sales based, and others that will create streams over time. The product mix in the quarter resulted in lower-than-expected equipment sales.

Third, the US dollar further strengthened relative to key currencies in December, just as consumer spending began to ramp up for the holiday season. While the marketplace and retail business still you grew an impressive 18% in the quarter from prior year on a constant currency basis, growth slowed from the pace earlier in the quarter. Despite currency fluctuations, the business continues to turn out a strong performance, again growing revenue double digits, and improving its EBIT margin.

We continue to add new clients to the platform, which will continue to contribute to revenue growth and margin improvement as the business scales. The total Global e-Commerce business, including office shipping, grew 10% from prior year, when excluding currency changes.

Let me now turn to the financials. First, I'll take you through a high level review of our annual results, and then I'll discuss the quarter in more detail. Please note that a reconciliation of GAAP to non-GAAP results can be found in the financial schedules in our earnings press release, and posted on our Investor Relations website.

Turning to our full-year results, annual revenue was $3.4 billion, a 3% decline from prior year, excluding both the impact of currency and market exits, a 4% decline excluding the impact of currency, and a 5% decline on a reported basis. When compared to prior year, on a constant currency basis and excluding the impacts of market exits, Digital Commerce Solutions revenue grew 6%, Enterprise revenue was flat, and SMB revenue declined 6%. On a reported basis, Digital Commerce Solutions revenue grew 4%, Enterprise revenue declined 2%, and SMB revenue declined 7%.

Adjusted earnings per diluted share from continuing operations was $1.68. GAAP earnings per share were $0.50. GAAP earnings per share included $0.22 of restructuring and asset impairment charges, $0.03 in charges related to the redemption of the Company's PBIH preferred stock, $0.02 from loss on disposition from our market exits, and $0.01 for discontinued operations.

In addition, the Company recorded a non-cash estimate of $0.88 per share goodwill impairment charge related to the Software Solutions business, principally as a result of recent operating experience. The Company expects to finalize the valuation assessment and resulting goodwill impairment charge at the time the 10-K is filed, and does not anticipate any material adjustment.

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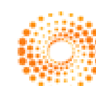

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Free cash flow was $430 million, and on a GAAP basis, we generated $491 million in cash from operations. Overall, free cash flow was in line with our annual guidance range. During the year, we used a substantial portion of our cash flow to return capital to our common shareholders, in the form of a common dividend and share repurchases.

For the year, the Company paid $141 million of cash dividends, bought back more than 10 million shares of common stock for $197 million, and made $65 million in restructuring payments. From a debt management perspective, earlier in the year, the Company obtained $300 million in new bank term loans, which were used to partially refinance $371 million of notes that matured in January of 2016.

In September, we issued $600 million of 3 3/8% five-year fixed-rate notes. The issuance was a debt-neutral transaction, as the Company paid down commercial paper outstanding and redeemed all $300 million of outstanding shares of our PBIH preferred stock on November 1, 2016.

At year end, we had $3.4 billion of debt on the balance sheet, which was about $118 million more than prior year, including the refinancing of the PBIH preferred stock with debt. The Company ended the year with $771 million of cash on hand, and no commercial paper outstanding.

Looking at the full-year income statement, as a reminder, a reconciliation of GAAP to non-GAAP measures can be found on our financial statements attached to our press release, and posted on our Investor Relations website. Adjusted earnings before interest and taxes, or adjusted EBIT, was $631 million, which was $85 million lower than the prior year.

Adjusted EBIT margin was 18.5%, which was a decline of 150 basis points from prior year, and largely the result of the decline in SMB and software revenue. Adding back depreciation and amortization, adjusted EBITDA for the year was $810 million.

SG&A for the year was $1.2 billion, which was $80 million or 6% lower than the prior year. As a percent of revenue, SG&A was 35.2%, which was an improvement of 60 basis points from the prior year. SG&A declined largely from operational excellence actions taken to improve the Company's efficiency, and also on lower variable compensation costs, which were adjusted to align with the Company's performance.

Partially offsetting these reductions were investments in advertising in support of our brand, and expenses to support our US Enterprise business platform implementation and stabilization. Since 2012, we have reduced absolute SG&A by $290 million, while investing in our new Enterprise business platform, expanding our digital capabilities through the Commerce Cloud, investing in our Global e-Commerce platform, and also launching new products, as well as a new advertising and brand campaign.

R&D costs for the full year were $121 million, which was an $11 million or 10% increase from prior year. The higher R&D was in support of the Company's investments in Global e-Commerce and digital products in SMB.

For the full year, we recorded pretax restructuring and asset impairment charges totaling $63 million, primarily related to actions associated with our previously announced plans to reduce costs. This resulted in a 4% decline in full-time equivalent headcount during the year. Additionally, the Company recorded a pretax non-cash goodwill impairment estimated charge of $169 million, related to the Company's Software Solutions business.

Net interest expense, which includes financing interest, was $144 million, which was a decline of $15 million when compared to the prior year. This is primarily the result of lower average interest rate on debt, and actions we have taken to manage our debt over the last year. The effective tax rate on adjusted earnings for the year was 31.6%, compared with 33.5% last year.

Now, let me turn to the quarter's results. Revenue for the fourth quarter totaled $887 million. Compared to the prior year, revenue declined 4% on a constant currency basis, and 5% on a reported basis. Adjusted earnings per share from continuing operations were $0.53 for the quarter, which represents a $0.05 per share or 11% growth over prior year.

GAAP earnings per share was a loss of $0.44 this quarter. GAAP earnings per share included a non-cash estimate of $0.89 goodwill impairment charge, $0.05 restructuring and asset impairment charges, $0.01 related to the redemption of the Company's PBIH preferred stock, and about $0.01 for disposition expense related to our market exits.

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Free cash flow during the quarter was $164 million, and on a GAAP basis, we generated $200 million in cash from operations. During the quarter, we used $35 million of cash to return capital to our common shareholders in the form of dividends, and we made $14 million in restructuring payments.

Turning to the income statement, adjusted EBIT was $187 million this quarter, which was $1.8 million higher than the prior year. Adjusted EBIT margin was 21.1%, which was an increase of 130 basis points over the prior year. Adding back depreciation and amortization, adjusted EBITDA for the quarter was $225 million.

SG&A for the quarter was $284 million, which was $57 million or 17% lower than the prior year. As a percent of revenue, SG&A was 32%, which was about 440 basis points lower than prior year. The decline in SG&A is due to operational excellence initiatives taken to reduce our cost structure, along with adjusting variable compensation costs to align with the Company's performance.

R&D costs for the quarter were $32 million, which was a $5 million or 19% increase from prior year. This was in support of Global e-Commerce, and the launch of new SMB products.

During the quarter we recorded a pretax restructuring and asset impairment charge of $14 million, primarily related to actions associated with our previously announced plans to reduce costs. Additionally, as noted, the Company recorded a pretax non-cash goodwill impairment estimated charge of $169 million during the quarter, related to the software business. Net interest expense, which includes financing interest was $40 million, which was relatively flat to the prior year. The effective tax rate on adjusted earnings for the quarter was 31.9%, which was about 20 basis points lower than the prior year.

I'd now like to discuss the fourth-quarter results for each of our business segments. This information can also be found in our earnings press release, and the slides that we post to the PB.com website, under the Investor Relations section. North American mailing revenue was $341 million, and EBIT was $138 million. Overall, the revenue decline reflects lower recurring stream revenue.

Included in reported results, equipment sales were down 7%, while support services increased 4%. This result reflects a reclass of service revenue out of equipment sales of approximately $2.6 million. There was no impact to total revenue in the quarter.

Excluding this reclass, equipment sales were down low-single digits, while support services were essentially flat in the quarter. Total recurring revenue streams, which includes supplies, rentals, financing and services, declined from prior year, largely driven by lower financing and supplies revenue.

EBIT margin was 40.6%, which was about 470 basis points lower than prior year. EBIT and EBIT margin for this segment were largely impacted by the decline in the high-margin revenue streams, equipment sales mix, and higher R&D costs related to the launch of our new products. In addition, we increased our bad debt provision in line with our policy, as a result of some delay in payments from our clients associated with our business Enterprise platform cutover.

In international mailing, revenue was $101 million, and EBIT was $12 million. Excluding the effects from currency and market exits, revenue declined at a mid-single-digit rate.

Overall equipment sales declined from prior year, as strong equipment sales growth in France was more than offset by weakness in the UK and Italy. Italy's year-to-year weakness was a result of a large government transaction in the prior year.

The decline in recurring revenue streams was consistent with the prior quarter. EBIT margin was 12.1% which was a decline from prior year of about 60 basis points, largely due to the decline in higher margin revenue streams, partially offset by lower expenses.

Turning to Enterprise Business Solutions, in production mail, revenue was $115 million and EBIT was $19 million. Equipment sales grew 1% over prior year on higher inserter equipment placements.

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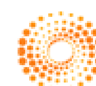

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Support services revenue declined as a result of the shift from in-house mail production to third-party service bureaus who tend to self serve, as well as reduced service revenue associated with market exits. EBIT margin was 16.2%, which was an improvement of about 250 basis points from prior year, due to higher equipment sales margin and lower expenses.

In presort services, revenue was $118 million, and EBIT was $26 million. The revenue decline was driven by lower first class volumes, along with lower average revenue per piece of mail processed, largely as a result of the earlier USPS rate change. This was somewhat offset by an increase in standard class mail volumes processed. EBIT margin was 21.9%, which was a decline of about 80 basis points versus prior year, primarily due to the revenue decline.

For the Digital Commerce Solutions Group, in Software Solutions, revenue was $91 million, and EBIT was $12 million. As noted earlier, the revenue decline was driven by several anticipated large deals that did not get completed in the last few weeks of the quarter. Customer engagement and location intelligence license revenues declined, but were partially offset by growth in customer information management licenses.

The Company continues to invest in expanding the indirect channel and training partner sales in technical resources, to build future partner-led pipeline and revenue. We added three new regional systems integrators during the quarter. As I mentioned earlier, we have made changes to the sales organization structure to improve the direct sales force effectiveness. EBIT margin was 13.5%, which was an improvement of about 30 basis points versus prior year, mostly due to lower expenses.

In Global e-Commerce, revenue was $121 million and EBIT was $10 million. Excluding the impact of currency, e-Commerce marketplace and retail revenue grew 18% from prior year. This was driven by strong growth in UK outbound marketplace and retail volumes. Results reflect the impact of both a stronger US dollar and a weaker British pound sterling.

Office shipping revenue declined from prior year, due to lower licensing and professional services revenue, which impacted the overall revenue growth rate for the Global e-Commerce segment this quarter. EBIT margin was 8.6%, which was an improvement of about 30 basis points versus prior year, due to cross-border synergy savings and revenue growth. This was partially offset by a decline in higher margin office shipping and higher R&D costs to support e-Commerce expansion.

The Global e-Commerce segment had a 15% EBITDA margin this quarter. This reflects the continuing profit and cash improvements post the Borderfree acquisition. That concludes my comments on our financial performance for the quarter and year.

Now, I'd like to discuss our 2017 guidance. Based on our 2016 results, including the final fourth-quarter outcome, the Company is updating its 2017 annual guidance, principally to reflect a more conservative outlook for the software business. We still expect 2017 revenue, excluding the impact of currency, to be in the range of a 2% decline to 1% growth from 2016 levels.

The Company now expects 2017 earnings per share to be in the range of $1.70 to $1.85. Accordingly, we now expect 2017 free cash flow to be in the range of $400 million to $460 million. The lower free cash flow range reflects the adjustment to earnings guidance, as we expect free cash flow to be predominantly earnings-driven.

There are several key factors to take into consideration within our business that will impact our 2017 results. The Company expects 2017 to benefit from improving trends throughout the year from: SMB's new products and digital capabilities; software's expansion of its indirect channel and improvement in the direct channel; Global e-Commerce to continue to add new clients and volume through the retail and marketplace networks, which will contribute to revenue growth and benefit earnings as the business continues to scale; presort services network expansion, as well as the January 2017 USPS rate change; and ongoing improvement in cost savings initiatives driven by the expected benefits from the Company's operational excellence initiatives.

Additionally, the Company expects 2017 earnings to be impacted by incremental marketing expense related to enhancing the Company's digital capabilities, and a normalization of variable compensation to align with the Company's performance. We also expect the annual tax rate on adjusted earnings to be in the range of 31% to 35%, which similar to 2016 and 2015, is expected to be highest in the first quarter.

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From a capital-allocation perspective, maintaining investment grade ratios remains a priority. We plan to continue to provide a competitive dividend yield, and also continue investing organically in order to grow the business.

Operator, that concludes my remarks. Please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

The first question comes from the line of Kartik Mehta with Northcoast Research. Please proceed with your question.

Kartik Mehta - *Northcoast Research - Analyst*

Marc, I wanted to ask you a little bit about the software business. I know you've thought that business was going to turn around for a number of quarters, and it has struggled, and you talked about a sales reorganization. Is this a -- where are you in terms of sales reorganization, is this a second or third try at how you're aligning the sales force, or is this really the first time that you're truly realigning the sales force to get to where you want to?

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Thanks for the question. To be clear, what we did is we removed a layer of executives, as well as flattened our Asia organization. It does not affect and therefore should not be disruptive to our sales efforts, people working with clients, but it will allow Bob in particular to have his hands directly on the sales force.

We think both removing the layer, as well as having Bob directly over the sales organization, will help. But it will not, in that sense, create the disruptions that we've had with our software sales reorganizations in the past.

Kartik Mehta - *Northcoast Research - Analyst*

And Marc, just had your Analyst Day. You seemed pretty confident in how the business was trending. Is this change to guidance for 2017 strictly related to the software business, or are you seeing any other businesses having some issues that you weren't anticipating?

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

From my perspective, the change in guidance is principally around software. As we got together December 6 for Analyst Day, the transactions that Mike referenced, we thought were in reasonable shape. Over the next couple of weeks that changed. So based on where we finished, which was principally because of software, as well as lower close rates in our software business, we thought the prudent move was to adjust our guidance, but it is really around our software performance.

Kartik Mehta - *Northcoast Research - Analyst*

And just one last question, Marc. I apologize for continuing on the software subject, but on the software side, do you think it's a product issue at all? I know you've struggled with this for a number of quarters. Could it be a product issue that maybe the products that you have aren't competing?

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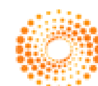

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Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

You look at the transactions that were deferred, and we've obviously looked at them in some level of depth, none of those were because of competitive losses. They were all simply deferrals. That's one fact that I think is important, and informs my point of view.

The second is, if you look at the transactions that we were working on that we didn't get, they were large transactions with sophisticated clients. And as I said in my remarks, these are transactions that we think we have good line of sight out for this year. I'm continuing to take confidence in the fact that sophisticated clients are buying these products, and moreover, sophisticated systems integrators are making investments in their people to include these products in their solutions.

So for those reasons, I continue to believe that this is principally a channel problem. And I would just -- not that we over rotate on these, but yesterday Gartner again pointed out that we were in the magic quadrant for our CES products.

So any way I triangulate on this, Kartik, obviously we -- moments like this you go back and you look at every one of the assumptions you made in the business and that's appropriate. But I just don't see the evidence for a product issue. I see the evidence more strongly on a channel issue.

Kartik Mehta - *Northcoast Research - Analyst*

Thanks, Marc, I appreciate it.

Operator

The next question is from the line of George Tong with Piper Jaffray. Please proceed with your question.

George Tong - *Piper Jaffray & Co. - Analyst*

You're updating guidance primarily to reflect a more conservative view on software. Can you elaborate on what's changed in the software business, to cause you to be more conservative in your expectations?

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Sure. Our close rates in particular, with our direct sales force, have not been where we thought they would be. So we continue to think they're going to improve, and they haven't. So we simply looked at our pipeline for 2017, applied different close rates for our direct sales force, factored in what we thought the influencer channel would add, and that's how we got where we got.

George Tong - *Piper Jaffray & Co. - Analyst*

Got it. That's helpful. And you lowered 2017 EPS guidance by $0.10, but left revenue guidance unchanged. Assuming margin expansion, and no real changes in the tax rate, the $0.10 of EPS reduction corresponds to about $160 million in lower revenue. Can you discuss whether the updated guidance reflects only reduced revenue assumptions in software, or if you also have more conservative views around margins?

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

I think, George, if you look at the way we give revenue guidance, it's obviously as a percentage as opposed to earnings per share, we give an absolute. So I think if you apply those same percentages to the changed revenue base in 2016, it's a rather modest change in revenue. So we did in effect change the revenue guidance, but kept the percentage change the same it's just off the lowered base.

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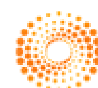

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George Tong - *Piper Jaffray & Co. - Analyst*

Got it.

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

Two other things I would just note in terms of our overall valuation of guidance is obviously we saw a strengthening dollar at the end of the year, and we quite frankly had a more uncertain business environment. So as we looked across, and looked at the opportunity as Marc said, to add some conservatism to our guidance, certainly software was the dominant factor in that, but we considered other factors as well.

George Tong - *Piper Jaffray & Co. - Analyst*

Makes sense. Within North America mailing, you called out some weakness in equipment sales. Is there a residual impact in North America from the earlier ERP cutover, or do you view 6% revenue decline as the new norm?

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

No, I wouldn't necessarily associate it with the cutover in the system. There may be some drag on the recurring revenue streams as a result of the lower equipment sales we had earlier in the year.

But in terms of overall equipment sales going forward, I would say we were a little less than what we would expect in the fourth quarter. In some ways there's a positive reason for that, which is we've launched some new products.

We probably were more conservative in how broadly we exposed those new products to get some early learnings from them. We expect to open those products to a bigger set of our clients as we get into the first quarter of 2017. So clearly, we think there's opportunities for improvement on equipment sales in the SMB business, which ultimately leads to the stream revenues.

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Let me just be clear. We don't consider that the new norm.

George Tong - *Piper Jaffray & Co. - Analyst*

Got it. Last from me. Within e-commerce, marketplace and retail showed strong double-digit growth, but this was partially offset by declines in office shipping. Can you discuss trends in office shipping, and if there's the potential for office shipping to inflect the positive growth?

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

In terms of office shipping, I would say we have different sets of products there in terms of our outbound product. We saw less license sales in that product. We've seen good performance in our inbound product.

We are making some changes to the focus on those products, as we go forward. We've launched some new shipping functionality in our SMB business. So we think that will have the opportunity for improved performance as we go forward, but did have a weak finish to 2016.

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George Tong - *Piper Jaffray & Co. - Analyst*

Very helpful. Thank you.

Operator

The next question is from the line of Shannon Cross with Cross Research. Please proceed with your question.

Shannon Cross - *Cross Research - Analyst*

Thank you very much for taking my question. Can you just remind us what the software business, how integrated it is in the other parts of your business? I think with the Connect platform, that there was a lot of the software that had been integrated in there.

But I'm just trying to figure out are there -- is this something that you need to shed parts of it, you need to find partners? I don't know. I'm sure you've been looking at all of these things, but maybe if you can just talk a little about how much it's standalone versus within everything else?

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Sure. The sales organization is fairly discrete. I would say the product aspects of software, you find different instantiations of in different businesses, and the development organizations are fairly intertwined.

So it has a gradation, depending on which aspect of the organization that you're looking at. As I indicated, we monetized the software assets not just in the software business, but also in our enterprise and SMB and e-commerce business as well.

Shannon Cross - *Cross Research - Analyst*

Thank you. And then with regard to North American mailing, can you talk a bit about the -- I guess what you've heard from customers, following the election, if there's been any change in tone. One of the things that I remember, I think Mike, you talked to me about a while ago, was that Pitney Bowes is positively exposed to small business creation. So if that picks up, then things get better.

So I'm just curious as to how we should think about that. If you think that's changed given more movement online, or if that's still something that theoretically could be a positive this year? Assuming it happens.

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

I think it remains relevant to our business. In particular, as we begin to bring more SaaS based applications, more shipping applications. We just launched an integrated mailing and shipping online functionality.

So new businesses that come online will tend to be shippers, if not mailers. And so we're adjusting our product set to make sure that we have opportunities to capture that new business growth.

Shannon Cross - *Cross Research - Analyst*

Okay. Great. And then from a presort standpoint, is there -- how are you thinking about trying to drive revenue growth there?

That's been a pretty solid business over time. I'm curious, are there new geographies you could go to, or new cities? What are your thoughts within that business?

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Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

I'd say two things about presort. The first is the 2016 results were negatively impacted by the rate case, in the beginning of the year. Conversely, in 2017, there's a different rate case that took effect, I believe the end of January, January 22. So while we had headwinds in that business in 2016, we're downwind in 2017, from an economic perspective, so that will help drive volume into the system.

And then secondly we continue to look for small tuck-in acquisitions to help grow that business, and to take advantage of the fixed costs that we have and put more volume in the network. And finally, I expect that business to grow organically on its own. So 2016 was a different kind of year in presort than -- not than what we expected, but what we had experienced in the past, but fundamentally that business was strong, and I think we'll be back on the growth rate that we had seen historically in 2017.

Shannon Cross - *Cross Research - Analyst*

Got it. And that's my segue to my usual question, just on cash usage, and how you're thinking about it. Given the cash generation target you put out this year, and then what you spent money on last year?

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Well, I'd say, reiterate what we said at investor day in terms of we're trying to create strategic flexibility, and along with that, maintaining investment grade ratios. We'll continue to invest what we need in the business.

I would underline the fact that last year while we were challenged at the top line, we continued to invest in new products, invest in advertising, invest in systems. So we continue to make the investments that, while they're difficult to absorb in the short term, do everything that you want to create long-term value.

Shannon Cross - *Cross Research - Analyst*

Thank you.

Operator

The next question comes from the line of Allen Klee with Sidoti. Please go ahead with your question.

Allen Klee - *Sidoti & Company - Analyst*

In the SMB segment, I'm just trying to understand how you think about how you can do there, relative to your expectation that this is a market that declines 2% to 4%. Can you help bridge to if you still think you can be in that type of range, or there's some other factors working there now?

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

Sure. If you take a look at 2016 and you were to back out what we identified in the second and third quarter specific impacts related to the go-live of our business platform, we were down about 4.8% on the full year. So near the bottom edge of that 2% to 4% range that we say is the market.

Obviously, with the introduction of a number of new products, with more experience on the platform, one of the things we mentioned about investments in 2017 is in digital capabilities. That's really around significantly expanding our digital presence, our digital store capability, our

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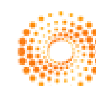

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self-serve capability and our supply sales capability online. So it's a combination of the products, maturing of the investments we've made, and the go-to-market opportunities enhanced with the digital channel.

Allen Klee - *Sidoti & Company - Analyst*

And then in presort, can you just remind me of the January rate case, how that affects the business positively?

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

Sure. In the 2017 rate case, one of the factors is providing high density mail, prepared in a way that the postal service can induct that more effectively into their network. That's the whole concept behind work share.

In looking at our ability, relative to the marketplace, to help customers qualify that mail and meet those high standards of density, we sit very uniquely positioned, given the scale of our network. And so, we believe we can help clients qualify more of their mail, and therefore drive more volume through our network.

Allen Klee - *Sidoti & Company - Analyst*

Okay. Thank you so much.

Operator

The next question is from the line of Glenn Mattson with Ladenburg Thalmann. Please go ahead with your question.

Glenn Mattson - *Ladenburg Thalmann & Company Inc. - Analyst*

On the software business, you talk about close rates a lot. What about pipeline? Can you characterize if it's growing, or stable, or shrinking?

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Pipeline was healthy as we entered the quarter. We, in our judgment, based on historical close rates enough -- more than enough pipe to get done what we need to do. Candidly, when we looked at the large transactions, which to a degree you factor out of the numbers, because they can skew them, we had a positive view of that.

So pipe is healthy. It was healthy in the second half of last year. I would say that was a little bit of a departure from the first half, so pipeline was improved, and as we enter into 2017 we continue to be pretty -- not pretty, we continue to be optimistic about pipe. Back to the earlier question about, is this a product problem, we see in the pipe evidence of demand for our products.

Glenn Mattson - *Ladenburg Thalmann & Company Inc. - Analyst*

And I'll ask this question, because I'll probably get it later today. The large deals that slipped in 4Q 2015, are those related to these, or did those close this year? I know you don't want to talk about deal-to-deal basis but generally the characterization of those deals that slipped last year.

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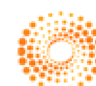

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Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Those were different deals. That's candidly why we made some changes in the sales executive team, that we did. When you have a problem twice -- when you have a problem once, you look by it. When you have a problem twice, you make changes. I hold the senior executives responsible for getting those deals done.

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

Given the nature of some of these deals, and the complexity of them, we would expect they will, to the extent that we capture those deals in 2017, they will come in over the course of the year. Some of them in the first quarter, but they could extend into the second or third quarter, depending upon the specific circumstances of those clients.

Glenn Mattson - *Ladenburg Thalmann & Company Inc. - Analyst*

Okay. And then on the smart meters, you're a couple months now into selling those. What's the experience of the uptake? Are clients happy to convert over? Is it a nuisance for them? Or what's been your experience so far?

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

With the SmartLink product, and that's the ability to connect our traditional analog meters to the web through this digital connection, we've had very good experience. In fact, what we've seen in taking a sample of those customers who have been connected, they're actually generating more volume. And that's because we're giving them insight and analytics back, and tips on you how to use it, how to use the meter more effectively.

So certainly early days of experience with it, but we're also seeing the clients' ability to connect, quite good. In fact, we've been pleasantly surprised that a high proportion of the customers are connecting via Wi-Fi, versus a plug-in type of connection. So that's giving us assurance that it's a relatively straightforward and simple process for people to connect the device.

Glenn Mattson - *Ladenburg Thalmann & Company Inc. - Analyst*

Okay. Great. And lastly on the free cash flow, what is the impact of finance receivables? How does that relate to the free cash flow guidance for 2017?

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

So with respect to free cash flow guidance and finance receivables, one of the reasons why the midpoint is essentially flat to this year's free cash flow, while we have earnings growth, is the fact that we would expect less run-off of the finance receivables in 2017 than 2016. That's linked, obviously, to our expectation of the improved equipment sales performance in the SMB business.

Glenn Mattson - *Ladenburg Thalmann & Company Inc. - Analyst*

Okay. Great. Thanks.

Operator

And the next question is from the line of Hunter Martin with BNP. Please proceed with your question.

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Hunter Martin - *BNP Paribas - Analyst*

One question that was just a follow-up on the last question, just to clarify. These three large software deals that didn't close at the end of 2016, they haven't closed yet, but you expect they'll close spread across Q1 to Q3? Was that correct, based on the comments in the last question?

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

That's correct.

Hunter Martin - *BNP Paribas - Analyst*

Okay. And then the other question.

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

I'll just add one additional piece of color. I said it in my prepared remarks. Those three deals were places where we had done business before, so these were not customers or clients we were unfamiliar with. We knew the buyers to a degree, incremental software into existing deployments. That's a different sale, and one that while we were obviously not able to predict the timing, one that you would have more confidence of to execute.

Hunter Martin - *BNP Paribas - Analyst*

That was very helpful. And then just on potential for corporate tax reform in the US, I seem to recall at the investor day, just mentioned the high tax rate for this year, 31% to 35%. I know there's no clarity yet, but any incremental thoughts on the possibility of tax reform and the impact on your business?

Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

Your crystal ball is as good as mine in terms of that. We are hopeful that tax reform, along with regulation relief, and in particular the ability to repatriate money, which we've got close to $500 million overseas, is all part of the economic reform that gets done. So obviously with the tax rate in the 30%s, anything they're talking about is incrementally helpful.

Michael Monahan - *Pitney Bowes Inc. - EVP and COO*

Given our share of income generated in the US, obviously changes in the US corporate tax rate would have an impact for us.

Hunter Martin - *BNP Paribas - Analyst*

All right. Thanks a lot.

Operator

There are no further questions. Mr. Lautenbach, do you have some additional remarks?

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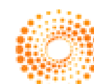

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Marc Lautenbach - *Pitney Bowes Inc. - President and CEO*

I do, and thank you. As I said in my prepared remarks, we were disappointed in our fourth-quarter performance and our 2016 results. That said, failure to get a few transactions done isn't a broad-based failure.

For a Company our size, there's thousands of things that need to go right. Unfortunately, in the fourth quarter we had a few very significant things not materialize. I'd like to spend a minute putting this journey in perspective.

In 2013 and 2014, in many ways we turned around the business, cutting expenses, reducing inventory, improving sales execution, and the results reflected those initiatives. You could see it in revenue growth in 2014, and you could see it in the stock price. At the same time, we're beginning important work to transform the business, and when I say transform the business, I mean to fundamentally change what this Company is.

We moved to new channels, built our brand, improved our products, built new systems. These were the right things to do in order to create long-term value, but they certainly didn't help our short-term results, and in many ways they were disruptive. These were however the absolute right things to do, in order to build long-term value for our Company.

I'm not happy about the disruptions these initiatives caused, and I'm sure there were things we could have done better to navigate our way through the transition. For sure, there's some things I'd like to do over on, but there's no doubt in my mind that to build sustainable long-term value, you absolutely have to be willing to take the short-term hits to build long-term value. We've done the hard work as we move into 2017, and we're poised to take advantage of that what hard work.

That's not to say that things will improve all at once. That's not the way transformations work. They're never a straight line.

However, from where I sit, the evidence is clear that our work is beginning to pay off. You see it in our new products. You see it in new systems. You see it in the new channels.

Finally, I'd be remiss if I did not mention this is Mike's last earning call as Chief Financial Officer. Mike will continue to be an integral part of our transformation as Chief Operating Officer, and will we'll invite him back every once in a while to make guest appearances on this call. I'm sure he won't want to miss that.

Stan will take over, effective today, and we're all glad to have him on board, but Stan's got big shoes to fill, and he knows it. I want to thank Mike for nearly 40 quarters as our CFO, and look forward to working with both Mike and Stan to help transform our Company.

That concludes our call. Thank you very much.

Operator

Thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation, and for using AT&T. You may now disconnect.

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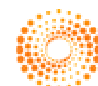

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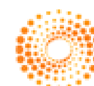

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