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PBI - Q2 2012 Pitney Bowes Inc. Earnings Conference Call

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OVERVIEW:

PBI reported 2Q12 revenues of $1.25b and EPS of $0.50. Expects 2012 revenues excluding impacts of currency to be flat to a decline of 4% vs. 2011, GAAP diluted EPS from continuing operations to be $2.12-2.32 and adjusted diluted EPS from continuing operations to be $1.95-2.15.

CORPORATE PARTICIPANTS

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Michael Monahan *Pitney Bowes Inc - EVP and CFO*

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PRESENTATION

Operator

Ladies and gentlemen, good afternoon and welcome to the Pitney Bowes second quarter 2012 earnings 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 would now like to introduce your speakers for today's conference call, Mr. Murray Martin, Chairman, 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, we will now begin the call with the Safe Harbor overview. Please go ahead.

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

Thank you. Included in this presentation are foward-looking statements about our expected future business and financial performance. Forward-looking statements involve risks and uncertainty that could cause actual results to be materially different from our projections. More information about these risks and uncertainties can be found in our 2011 form 10-K annual report, and other reports filed with the SEC, that are located in our website at www.PB.com by clicking on Our Company and 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. Now our Chairman, President and Chief Executive Officer Murray Martin will start with an overview of the quarter. Murray?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

Thanks Charlie. Good afternoon, and thanks for joining us. I'll start by putting our overall performance this quarter into context. Mike will follow with the details on our second-quarter results and then I will discuss our outlook for 2012. After the presentation, we will take your questions. For the last few years, we have been on a journey to deliver long-term customer and shareholder value. We are fundamentally transforming our business processes, reducing our cost structure, and diversifying our range of offerings beyond physical mail. During the quarter, we continued to make progress against these long-term goals. We also continued to see favorable trends in parts of our business despite ongoing economic uncertainty and fluctuations in currency. Although total revenue declined during the quarter, there was growth on a constant currency basis in three of our seven business segments, and in two of the remaining segments the rate of revenue decline has moderated.

There are drivers, particularly in the enterprise group, that we anticipate will moderate year-over-year revenue declines in the second half of the year as compared with the first half of the year. These drivers include expansion of e-commerce and direct mail opportunities and mail services, new print outsourcing services provided by management services, and increased backlog of equipment orders for production mail. In the quarter, we signed a strategic partnership with ORION holdings to provide print management services that create substantial cost savings and increased value for the global network of inter-public companies, groups, agencies and clients. We will provide a platform that supports ORION printing worldwide, which includes project management, global network of selective printers, print outsourcing expertise and technology that provides visibility, tracking and accountability to each project. Our Volly secure digital mail delivery service continues to add capabilities and the partnerships which we believe will enhance its successful adoption when it launches.

During the quarter, we announced the first partner who will be part of our payment system. The ProfitStars division of Jack Henry and Associates will enable free, one-collect bill payments for consumers in Volly. We believe free bill payment on-site is a critical consumer requirement, and we are pleased to be offering it to our Volly users. We also reached an agreement with SafeNet Inc to enhance the security of digital mail delivery in the cloud. Additionally, we have now signed more than 50 large third-party mail service providers, who will offer the Volly secure digital mail service to more than 6,000 companies and consumer brands. The positive signs that we noted in our SMB business in the first quarter continued this quarter as well. This was led by improved customer retention rates and increased placements of the Connect+ digital mailing systems globally. During the quarter, we launched Connect+ in Germany, and it was approved for placement in France beginning in the third quarter. In the U.S., we also launched the innovative Mailstation2 with pbWebConnect.

It is the world's first cloud-based mailing and shipping system that gives customers the ability to manage mail and packages via the postage meter or online. Customers can also gain access to special USPS discounts not typically available through standard metering systems, in addition to gateway access to a range of applications including the full pbSmart suite of digital solutions. pbWebConnect is already earning high marks from early adopters for the convenience, discounts and the online access that it provides.

We continued to generate strong free cash flow during the quarter, and we also strengthened our balance sheet through the early redemption of $400 million of debt.

Let me now turn it over to Mike for a discussion about our second-quarter financial results.

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

Thank you Murray. Revenue for the quarter was $1.25 billion, which was a decline of 3% on a constant currency basis, and an improvement versus the first quarter decline of 4.4%. Currency had a negative impact of approximately 2% this quarter. As a result, revenue declined 5% versus prior year on a reported basis. The Company experienced continued growth in its software and mail services segments when the impacts of currency are excluded. In the SMB solutions group, international mailing had its third consecutive quarter of revenue growth when you exclude the impacts of currency. However, there continue to be declines in the North American SMB revenue streams. While revenue was also adversely impacted by weakness in the production mail and management services segments due to lower global economic activity, both segments had improving revenue comparisons against the prior quarter on a constant currency basis.

Breaking down our revenue for the quarter between U.S. and non-U.S. operations, U.S. revenue declined by about 3%. Outside the U.S., revenue also declined by about 3% on a constant currency basis. Including the 7% adverse impact of currency, revenue declined about 10% outside the U.S. on a reported basis. Non-U.S. operations represented 31% of total revenue.

Turning to our earnings before interest and taxes, or EBIT, it was $205 million this quarter. The EBIT margin was 16.5%, which was an increase of 70 basis points versus the prior year. EBIT margin continues to benefit from ongoing improvements in our operating efficiencies across the business as a result of our strategic transformation initiatives. Our EBIT margin also includes the impact of investments in new products and services. We expect these investments will accelerate as we approach the launch of our Volly product and continue to invest in new e-commerce opportunities. On a segment basis, EBIT margins improved year-over-year in three of our seven business segments. The North American mailing segment improved its year-over-year EBIT margin for the eighth consecutive quarter. Our mail services and marketing services segments also had continued improvement in their EBIT margins.

Our selling, general and administrative expenses continued to improve, with a decline of more than $41 million in the second quarter when compared with the prior year. As a percent of revenue, SG&A was 31.4% this quarter versus 32.9% in the prior year, an improvement of 150 basis points. SG&A continues to benefit from ongoing productivity initiatives and good credit experience, as well as lower benefit costs this quarter.

When we add back depreciation and amortization to our EBIT, EBITDA for the quarter was $273 million, or $1.36 per share.

Net interest expense in the quarter including financing interest was $49 million, which was relatively flat to the prior year. The average interest rate was 4.87% for the quarter. The effective tax rate for the quarter was 33.4% versus an effective tax rate of 33.3% last year. The tax rate is in line with the 32% to 35% expected rate for the year.

Earnings per diluted share for the quarter were $0.50 compared to $0.49 last year. Earnings per share this quarter included a reduction of $0.03 for costs related to debt management, which included net costs associated with our decision to redeem $400 million of our bonds that were originally scheduled to mature in October. Excluding these costs, earnings per diluted share this quarter were $0.53.

Now let me update you on our cash flow and capital structure. Free cash flow in the quarter was $301 million. In comparison to the prior year, free cash flow increased by $32 million, primarily due to the timing of working capital payments. Free cash flow year-to-date was $512 million. During the quarter, we returned $84 million of cash to our shareholders in the form of dividends, and had $22 million of payments related to our restructuring program.

The Company did not make any voluntary contributions to our pension funds this quarter, nor did we repurchase any shares of our common stock.

As I mentioned earlier, we retired $400 million of debt this quarter, using a combination of free cash flow and cash on the balance sheet. At the end of the quarter, we had no commercial paper outstanding. Since the end of 2008, we have reduced our debt by more than $1 billion. We continue to evaluate our alternatives on how best to manage our remaining debt portfolio. This includes refinancing debt as it approaches maturity with new term debt and/or using cash or commercial paper. At the end of the quarter, about 88% of our total debt was fixed-rate and 12% was floating-rate.

That concludes my remarks. Now Murray will discuss our guidance and will have some closing comments.

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

We have updated our 2012 annual guidance to reflect results year-to-date and weaker than originally anticipated business conditions in the second half of the year. This is due, in part, to prolonged global economic uncertainty, especially in Europe. Our original earnings per share guidance did not anticipate the significant changes in currency that have occurred this year. Year-to-date, excluding currency, our revenues declined 4% and adjusted earnings per diluted share were $1.02, which excludes $0.11 per share of tax benefit in the first quarter. Based on the results to date and expectations for the second half of the year, we now anticipate 2012 revenue, excluding the impacts of currency, to be in the range of flat to a decline of 4% when compared to 2011. This guidance assumes moderating revenue declines for the second half of the year. Additionally, we expect adjusted earnings per diluted share from continuing operations for 2012 to be in the range of $1.95 to $2.15, and GAAP earnings per diluted share from continuing operations to be in the range of $2.12 to $2.32.

The updated earnings per share guidance reflects an adverse impact of $0.04 to $0.06 per share based on current foreign exchange rates. GAAP earnings per diluted share include $0.11 per share of net tax benefits and $0.06 per share from the sale of leveraged lease assets in Canada, both of which occurred in the first quarter of the year.

Based on our strong cash flow performance year-to-date, we are increasing annual free cash flow range by $50 million. We now expect free cash flow to be in the range of $750 million to $850 million. We remain focused on our goals to deliver sustainable value for our stakeholders even as we operate in challenging economic conditions. We have made tangible progress in developing solutions to help customers manage their physical, their digital and their hybrid communication needs. We believe that these are the right strategies, and are committed to enhancing the long-term growth and profitability of our business.

Thank you, and now let's hear from you.

Operator

Are you ready to entertain questions at this time?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

Yes.

QUESTIONS AND ANSWERS

Operator

(Operator instructions).

Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

My first question is just on cash generation, cash usage. Clearly you're using it to pay down debt. You didn't buy any stock this quarter. I'm sure you're painfully aware of where your stock price is at right now. So I'm just curious, near-term and even longer-term, how you're thinking about cash flow generation and use of cash, given all the different things that you can invest it in?

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

In terms of the use of cash, obviously we have taken a balanced approach to how we use the cash we generate. Obviously we provide a healthy dividend, which consumes about $300 million of cash on an annual basis and provides a good foundational return to the shareholder. We've been investing back into the business, both through increased R&D and investments in things like Volly as well as using some cash for paying out on our strategic transformation program. So as we go forward, we will continue to look at a balanced use of our cash, both for returned shareholders as well as to manage our overall debt portfolio.

Shannon Cross - *Cross Research - Analyst*

Okay. If you look at your SMB business, which clearly was under a fair amount of pressure or continues to be, what other drivers -- I notice you talked about supplies for copiers and printers, which I don't remember seeing in any recent releases. So, how much of what went on do you think is recurring versus should start to alleviate, just in -- and is it still just a matter of, we need to look for small business creation before this division starts to right itself?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

I think there are a number of things there, Shannon. One, small business creation at the low end of the SMB market is important for placing units and creating growth. However, we are seeing the initiatives that we put in place starting to have some positive effect on the challenges that have been there. Our retention rates continue to improve with our customer base, so we are seeing fewer customers leave and, in the long term, that will definitely help us from the revenue side. Also, the Connect+ system continues to place. And then, as I mentioned, we have launched WebConnect, which is -- really brings web connectivity to the low end of the meter line, and will then start opening up the ability to add web-based applications for those customers. So those are the areas that we see as mitigating. However, certainly small business creation is what would create the greatest stimulus.

Shannon Cross - *Cross Research - Analyst*

Okay. My last question is -- and I think I know the answer to this, but I just would like to hear what you have to say. The post office, clearly, has this $5.5 billion, or whatever it is, pension payment coming due. I understand that they actually have to fund all of their post-retirement benefits up front, or however that works out, but just can you remind us how we might think about this from a Pitney standpoint? Any issues with, potentially, the post office purchasing large-ticket equipment, just anything that might come from what they are talking about right now?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

Sure. First, we think that the post office has been taking a lot of actions, and should be able to continue to take more actions to address its cost structure. And we are supportive of them in their initiatives in that regard. As to the effect to us, we do not sell large-ticket items to the post office. We really are a provider for them. We provide services. So in our mail services business, we continue to see growth there as we handle more and more mail in the pre-sort and now in the standard area, so both first class and standard. So we don't see there -- any issues there coming back directly. Certainly, any uncertainty about the post office can create people wondering, which could have an indirect effect, but there would be no direct effect.

Shannon Cross - *Cross Research - Analyst*

And just to be clear. In terms of an increase in postage, or anything that might come out of that, there's been no sort of announcements around that at this point, I believe. So in theory there's -- sometimes you have some ups and downs in terms of sales.

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

Yes.

Shannon Cross - *Cross Research - Analyst*

Depending on when rate increases and concerns around that. There's nothing that's pending in the next couple of quarters?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

Not that we see. There are -- under postal reform, there are limitations on what rates can change when and by how much, so those are pretty well baked into the system. And the postmaster has said that he's not looking to go outside of what their regulatory agreement is, or ask for anything special at this point.

Shannon Cross - *Cross Research - Analyst*

Great. Thank you very much.

Operator

Julio Quinteros, Goldman Sachs.

Julio Quinteros - *Goldman Sachs - Analyst*

Hi guys. Maybe just to come back to the first set of questions earlier, around -- the way, I guess, I was thinking about it was more around the pressures in the business, the declines that you're seeing. How long and how far can this last, and you guys still be able to generate the free cash flow? Because it seems like that's the -- that's the disconnection that -- I think when we talk to investors the most, that they seem most focused on. Where you have a steadily declining income statement, if you will, but the offsets on the free cash flow side continue to surprise in that it is pretty resilient. So if you can give us, maybe, some view on how much more pressure you guys can tolerate before this annual free cash flow actually would start to decline more meaningfully -- in a more meaningful fashion, that would be kind of helpful?

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

Yes, Julio, it's Mike. Just to touch on that, I think there's obviously a couple of factors that drive free cash flow, and certainly earnings are one. And I think what we have shown over an extended period of time is an ability to manage our cost structure relative to the change in the revenue profile of the business. And that's represented in the fact that, in that core mailing business, we have had eight consecutive quarters of improving margin. So in -- as we go through the transition of the business, we have been managing the cost side of it.

The other is, we have been evolving to a model that requires less capital in terms of capital expenditures back into the business. And that's come down substantially over the last several years as we've moved to more digitally-based products and lower cost in terms of delivering our products to our customers. In terms of the business model, obviously as Murray talked to, there's a number of things that we are doing from a product and services perspective to diversify the revenue streams within the SMB business to be able to drive growth in the business on a revenue-per-customer basis. Obviously, lower rental asset investments, but maintaining those revenue streams. And the finance receivables is where we see the biggest change over the period, and obviously that's why we focused on equipment sales as a key driver to driving that finance receivables balance as we go forward.

Julio Quinteros - *Goldman Sachs - Analyst*

Maybe just to put it more maybe around -- some [context] around numbers, if the revenue falls to 8% or 10% level, can you still achieve the $750 million to $850 million in free cash flow?

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

Well, to put it in context. The North American mailing business is now around a third of our revenue base, so when we look at our overall cash flow, it's generated across the entire portfolio of businesses. And so as we look at the enterprise businesses and the opportunities we see there, that obviously has a mitigating factor to the core mailing business. And obviously our objective in the core mailing business, as we have done in the international side of the business, attained stable meter base in Europe, which has been relatively flat for a few quarters now. The revenue has been up just slightly for the last three quarters. We are looking to drive a change in the US or the North American business as well. We have also experienced positive meter growth in Canada as well, so we are seeing, particularly in the international market, some leveling of those businesses.

Operator

Ananda Baruah, Brean Murray.

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

Thanks very much for taking the question. Yes, just was wondering if I could a little more context around, Mike, your free cash flow thoughts for the second half of the year? Lowering the EBIT and lower -- raising by $50 million? I know you got the $50 million this quarter. So really, if you could just walk us through the mechanics of lowering the EBIT and keeping the base free cash flow assumptions the same for the second half of the year?

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

Yes. In terms of free cash flow for the second half of the year, obviously our annual guidance is based on what we have achieved to date and then looking out at what we would expect for the second half of the year. While the range of EPS has changed somewhat, that is not the single -- necessarily single biggest contributor to the free cash flow. Again, we are seeing a need for less capital in the business. We have seen a little bit more of a runoff in the finance receivables relative to what we had originally incorporated in the guidance, but actually seeing less runoff than we saw last year. So it's less of a contributor to the free cash flow. So overall I would say it's strong asset management, good working capital management, and continued focus on the costs. As you've seen, we had margin -- EBIT margin expansion and significantly lower costs, which are helping support the EBIT number.

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

And with -- I think OpEx as a percentage of revenue, what was it, 34.1% this quarter, what -- reasonably speaking, and you've been reducing that, how-- what's the reason -- how low can that reasonably go over some meaningful period of time, do you think?

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

What we do is focus on the absolute level of costs, and then ultimately that margin or the ratio is going to be driven by our revenue performance. So I would say the fact that we were able to reduce it by 150 basis points despite revenue decline says that we have an opportunity as we go forward and able to drive more positive revenue performance, we have opportunity to bring that ratio down as we go forward.

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

Got it. And I know it's a bit early yet, but just to help us, guide us a little. What's -- free cash flow levels or generation potential for 2013, is there any sort of framework you can give us at this point of how you're thinking about that, and how we should?

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

Yes. I would say, obviously we haven't given any guidance around 2013. I would say, if you look over the last several years, it's -- gives you the best indication of what drives our free cash flow, and I think we have been consistent in a range over the last several years.

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

Got it. So a similar range wouldn't be unreasonable from your perspective right now?

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

Like I said, we haven't given any '13 guidance at this point, but obviously you've got our '12 guidance.

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

And just -- last thing for me. Just pension cash contributions for the remainder of 2012, what should we expect? And just directionally for 2013, do you think they will be similar or lower?

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

Yes. As far as 2012 is concerned, we made a major voluntary contribution in the first quarter. I don't expect any significant contributions over the balance of the year. There may be a small amount of contributions around international plans, but nothing significant. In terms of 2013, there has been some adjustments to the regulations around pensions that would allow companies to not make contributions in 2013. So we will evaluate that as we get closer to 2013, but we don't believe we will have a mandatory requirement at this point. And today we are over 90%, 92% funded in the plan, so we will take that into consideration as we look at 2013.

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

Got it. Thanks a lot.

Operator

Hale Holden, Barclays.

Hale Holden - *Barclays Capital - Analyst*

I had three quick ones. Can you talk through the decision to redeem the -- or call the note early with cash versus refinance? What I'm specifically trying to get is, where you think the right debt structure for the Company is over the next couple of years? Do you continue to shrink the balance sheet with revenue, or do you grow it because there's chief financing or hold it in place?

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

Yes. In terms of redeeming the debt, we looked at the opportunity to, with that debt coming due in October, we obviously monitor the markets. We were in a situation where we had sufficient free cash flow and cash on the balance sheet that we were able to redeem that debt, give ourselves flexibility. Obviously, we are focused on our ratings and, given the contraction in the revenue -- or in the finance receivables base, we wanted to make sure that our debt portfolio was in align as well. And so we chose to redeem that debt. As we go forward, obviously, what we would do from a debt perspective is dependent upon the growth in our business. Obviously, finance receivables is one of the biggest reasons why we have the debt on our balance sheet. And obviously, if we grow those finance receivables in the future, we would look at providing financing for that. And that obviously has a good return on it, so it would be a good use of debt. If we don't have uses for the debt, we will look at continuing to manage the balance sheet, keeping in mind both what's available in the markets, the cash we have available to us, and what investments we have or need to make in the business.

Hale Holden - *Barclays Capital - Analyst*

Along those same lines, can you give me a sense of what the US cash balance was? And then if the working capital gains are permanent? Should we expect that to swing back at some point?

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

Let me answer the second one first. In terms of the working capital, we are pretty much in line on a year-to-date basis to where we were last year. We actually had some swings between the first quarter and the second quarter, which really had to do with the timing of payments at the end of the quarter. So don't see that as unusual per se. There was some benefit on a year-over-year basis. In terms of the cash balances in the U.S., yes, we had, in the U.S., about $200 million altogether. Some of that is related to our banking entity, capital associated with that. Some of it is on deposit with the postal service related to our Imagitas business. But we obviously used a fair amount of our available cash in paying down the debt that we redeemed in the second quarter.

Hale Holden - *Barclays Capital - Analyst*

Great. And then my last question is, on the WebConnect product, if I understand it correctly, it could be a replacement for the postal meters in small businesses? Can you talk through the pricing to the customer on that? Is that cheaper for customers to take? Is it economic for customers to take, are the margins higher for you? There would be no financing receivables associated with it, right?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

So first on WebConnect, I could break it into a couple of segments. There's what we call PBSmartPostage, which is a non-meter, cloud-based postal system. And that is -- and that does both postage and shipping and that's in the $10 to $15 a month range. Then you have the installed meter base, which tends to be in the $20-plus range. What WebConnect does is, it adds the cloud functionality of the non-meter based equipment to the meter, so the people that have a meter for doing postage can now do shipping easily out of the cloud. They can do printing sheets of stamps, et cetera, on their local printer in addition to their meter. So it creates a hybrid opportunity for the existing customer base to expand their capabilities around the device.

It also then connects them via the internet or broadband, rather than telephone, for updating their rates, updating their software, et cetera, and makes the experience significantly better on the meter. The meter does have advantages on many applications where people have things in the envelope before they go to print, and that you can't do through a printer very easily. It usually -- it jams or causes problems, and it doesn't require sticking things on the surface of the envelope. So we see, really, two markets, the non-meter market, which we will grow with SmartPostage. And then the expansion of the SmartPostage into WebConnect, which creates a hybrid product that gives all the functionality of the cloud-based offering plus the functionality of meter brought together in one connected environment.

Hale Holden - *Barclays Capital - Analyst*

Great. Thank you guys. I appreciate it.

Operator

Shannon Cross, Cross research.

Shannon Cross - *Cross Research - Analyst*

Just a couple of follow-ups. My first is, can you talk, both geographically as well as on a vertical basis, just what you're hearing from your customers? Are people feeling any better? Are people feeling worse? Hopefully not, but that might be the case. Just can you give us some idea of linearity in the quarter? Any economic color you can give would be great.

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

I came back from Europe a couple of weeks ago, Shannon, and I would say, there we are seeing a mixed environment across the different companies -- or countries. We are not in any significant way in the ones that have the biggest direct challenges, but certainly in the other larger companies that are involved in financing those, it does create an uncertainty in the market and concern about what their availability of cash will be. We have noticed it particularly in the government sector in our software business. Governments, which are a significant portion of our software business in Europe, have really pulled back as they are sitting on the concerns about debt in Europe and are uncertain, I would say, is the way I look at how they are going to proceed. And that has had some effect.

Business itself, we are actually still seeing production mail moving reasonable in Europe, but it has -- it certainly has concerns around big-ticket as the environment is there. When you come to the U.S., we have noticed a change in the index on confidence in small business, that that has compressed somewhat. And that is there, but we haven't seen anything particular. Certainly in the large-ticket in financial services, we did see some slowing in the first half of the year, but we are starting to see, as we have in the past when there's a slowdown in that market, it is factory-based equipment that will require replacement. So we are seeing the backlogs improving in that space.

Shannon Cross - *Cross Research - Analyst*

And during the quarter, did it get -- just within the quarter -- I know, I'm probably picking nits here -- but I'm just curious. Did things get worse or better or was it a similar decline rate you saw through the quarter in general?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

I think it sort of fluctuated from week-to-week and month-to-month. I don't think there's any consistent trend up or down.

Shannon Cross - *Cross Research - Analyst*

Can you provide any more details on the business plans for Volly? How we should think about how you're thinking about charging for it, if there's been any change over the last quarter or so as things have evolved? And perhaps how much of the revenue would come from the Australia-types relationships versus just a traditional biller that saves money by utilizing Volly?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

The financials will be based on the biller, not on the Australian market. That will occur only in very small markets where we might choose to partner, but that isn't really our focus. Our focus is on the biller's cost-to-date and what Volly can do for them, and our ability to share in that cost reduction. So that is the model that we see rolling out, and the model that we have been signing billers up on, so we don't see any change there. We do see the enhancement, which I talked about, of adding payments so that it becomes an integrated solution. This is what our vision was from the beginning, and we have now brought our first payment provider in and are integrating that now. And that should be available at launch so that people will be able to receive and pay the bill in one closed environment.

Shannon Cross - *Cross Research - Analyst*

And I would assume you're looking at bringing in as many payment options as possible so that it just becomes very seamless? Is that fair?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

Yes. We will -- certainly don't want to make it confusing, but the payment vehicle that we have brought in actually is fairly broad-ranged so that people will be able to use both credit cards and bank for making payments. And that is a change from what most payment availability is today. It will also allow multiple banks so people that have multiple banks to make payments will see this as a system that can deal with multiple banks, multiple bank accounts, and multiple credit cards and match those to what the biller will accept.

Shannon Cross - *Cross Research - Analyst*

Okay. Great. Thank you.

Operator

Chris Whitmore, Deutsche Bank.

Chris Whitmore - *Deutsche Bank - Analyst*

Thanks very much. I wanted to ask about equipment margins in the quarter. Those were a bit weaker than I was expecting, and down materially year-on-year. Can you provide some color on that line, please?

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

Yes, Chris, there's a couple of things affecting that. One is that, in the core mailing business, we did do more new equipment placement versus lease extension, so there is a little bit, as we talked in the past, there's a favorable margin on a lease extension. There's obviously a little bit more cost when you have a new piece of equipment. That's a piece of it. The other two things affecting that equipment sales, if you remember that DMT also drives that line. We did have a higher percentage of printer sales, the large-production printer sales in DMT this quarter than we did last quarter. That has a lower relative margin because it is an OEM product. And then we have some ancillary businesses, including office furniture in the Nordics, and they had a good size deal there this year that, again, given the nature of the product, doesn't have as high a margin as the traditional core mailing business. So those weighed on the margin as well.

Chris Whitmore - *Deutsche Bank - Analyst*

Similar question for software. That also looked a little light coming off of last quarter's relative strength. Little color on that line?

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

In terms of the software margin, I don't think there's anything particularly unusual there. I think there's a little bit around the mix of the license deals. I think last quarter we had a couple of pretty large license deals. The mix of licensing is a little bit less this quarter relative to the recurring revenue streams that don't have as much. There was also some investment in the channel as well that, in terms of being able to put some of our products like Portrait into more global markets.

Chris Whitmore - *Deutsche Bank - Analyst*

Okay. And I wanted to follow up on some of the earlier cash flow questions, and specifically ask you about your credit rating and where do you place maintaining your credit rating versus all other priorities for use of cash? In other words, would you sacrifice the dividend to maintain a credit rating? Or achieve a certain credit rating?

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

Yes. In terms of our credit rating, it's obviously important to us. I think a number of the actions that we have taken, including reducing the debt outstanding, are consistent with maintaining investment-grade credit rating. In terms of the dividend, when we look at our free cash flow, our dividend is in the neighborhood of about 40% of our free cash flow, so we don't see this as a choice between the two. We believe we generate sufficient free cash flow to support the dividend and we think we are taking the right actions to maintain a healthy credit rating. And we think we can achieve a good balance between the two in the way we manage the business.

Chris Whitmore - *Deutsche Bank - Analyst*

Have you received any feedback from the agencies?

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

We meet with the agencies regularly, but certainly no feedback based on this quarter. Obviously, we are just out with it. But we meet with the rating agencies regularly, and they review both our public information as well as look at debt. And we believe, certainly from a debt ratio standpoint, we are in the bounds of the ratings that we have today. And then obviously they apply their own assessment to the other factors that affect their view on ratings.

Chris Whitmore - *Deutsche Bank - Analyst*

Okay. And then last one for me is around just an update on the general view towards restructuring. Where are we in terms of the last transformation initiative? Is that now fully complete? That's part one. And then part two, as you look at the demand environment and taking down your organic revenue expectations, et cetera, are you at the point where you're contemplating additional restructuring actions going forward? Thanks a lot.

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

Sure. In terms of the strategic transformation program, the remaining activities are principally in Europe. We started Europe a little bit later than we did in North America. There's also a more involved process when you're doing changes in the organization, to work through those changes. So we think that the European piece will be substantially complete by the end of this year. Obviously they will get the annualized benefit of that in '13. There are other, I would say, remaining bits of programs going on now in the U.S. as well, but most are complete. I would say, though, that a number of the investments we have made in the strategic transformation program were geared at creating an infrastructure that gave us more flexibility, more variability of our costs. So as we evolve the portfolio and the revenue base, we have greater flexibility to continue to manage our costs relative to our revenue performance. We have a continuous improvement program that continue to look at costs across the business, so that is our primary focus today. We always look at the business for opportunities to further improve the cost structure.

Operator

Ananda Baruah, Brean Murray.

(Operator Instructions)

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

Thanks guys. Just a couple quick ones for me. I believe meter installs actually improved in the March quarter. I think they were down mid-single-digits, or maybe down double-digits, if I remember correctly, in the December quarter. Can you tell us how they did in the June quarter?

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

Yes. In terms of overall meter base you're talking about Ananda?

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

Yes. I think just the shipments for this quarter, Mike, I thought you gave the -- just on the cost, I thought you gave the metrics the last couple of quarters.

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

We haven't given specific changes in the meter base, but we have seen improved retention rates in this quarter relative to last quarter and last year. And that's through a number of programs that we have in the business. It's through products like pbWebConnect that Murray referenced as well, and through placement of products like Connect+, that is serving both the high end and the upper end of the mid-market.

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

Got it. Okay. Maybe that was it. Just the last one for me is, the 6,000 companies that your 50 -- that the 50 mailers have access to. Are those companies -- do you know if those companies, those 6,000 are currently enrolled in Volly?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

Say that last part again.

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

Do you know if the third-party mailers have signed up the 6,000 companies yet into Volly.

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

They have not signed the 6,000. They are in process of working -- the way the implementation goes is, we sign the biller. We then begin implementation of what is required for that particular biller to bring them and their client base into the network. They then move from there as we are putting in what I would call the pipes to connect them. They then begin the work with their billers, and so that's an ongoing process. So we are starting to connect, excuse me, connect those billers now, the 50. So that work is in process, and as that work progresses, they then go and progress with theirs.

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

I got it. Thank you Murray. That's very helpful.

Operator

Barbara Noverini, Morningstar.

Barbara Noverini - *Morningstar - Analyst*

I know you mentioned this a little bit previously, but can you talk a little bit about what is -- what you think is driving your improved retention rates in SMB? Is it discounting? Is it that you're offering a WebConnect deal to your meter customers? Maybe just a little bit more color on why you think that metric is improving?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

I think there are a number of things that affect that. Firstly is, we launched the Connect+ product, which is really significantly differentiated from other products in the market. So at the high end of the marketplace, we are continuing to see positives there. We are seeing reasons for customers to stay with a higher-end machine rather than migrating downmarket. We've also been very focused over the last year -- or two years, actually, as we have gone through transformation to change the customer experience and change how we manage our customers, how we support our customers, and how we interact with them. And take away some of the challenges we might have had with customers in the past. We believe that is always an area for improvement, and we have seen that occur.

We also have been very proactive on looking at our customer base and seeing what the needs of the customer are that could create behavior changes. So if we are seeing changes in how they work, we can then proactively look at what they are using and how they are seeing value and helping them. So it's really using the tools that we are creating to help our customers help their customers, applying the same thing to us in our relationship with our customers. So I really think it's across the board. It isn't really focused on price. It's really focused on changing the interaction with the customer and insuring that the right value proposition is in place for the customer.

Barbara Noverini - *Morningstar - Analyst*

Got it. Thanks for that additional detail. And I know that last quarter you guys had mentioned your agreement with Facebook, and do you have any additional detail or any updates on that?

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

That deal is in place. It is -- the implementation has been rolling into Facebook this quarter. They will start developing apps on top of that platform and creating their database. So that is -- it will be multi-quarter for them to be able to take the technology and begin the embedding into it. So we are working with them on a constant basis on putting that technology in and making it available for their developers.

Barbara Noverini - *Morningstar - Analyst*

Okay. So early innings, then. Very good.

Operator

And speakers, there are no further questions at this time.

Murray Martin - *Pitney Bowes Inc - Chairman, President and CEO*

Thank you. During the quarter, as we have mentioned, we have continued to make some tangible progress against our long-term goals to create more value for our stakeholders despite the uncertain macroeconomic environment. Though total revenue declined during the quarter, there was growth on a constant currency basis in three business segments, and revenue decline lessened in two other segments. We believe there are drivers that will moderate our year-over-year revenue declines in the second half of the year, including the expansion of e-commerce and direct mail opportunities in our Mail Services business, new print outsourcing services provided by Management Services, and the increased backlog of equipment orders for Production Mail. We continue to develop and launch a range of new solutions to help customers manage their physical, their digital, and their hybrid communication needs in the quarter such as Connect+ and pbWebConnect, as well as made ongoing progress in the preparations for the launch of Volly. We believe that these are the right strategies, and we are committed to enhancing the long-term growth and profitability of our business. Thank you.

Operator

Ladies and gentlemen, that does conclude our conference for today. We thank you for your participation, and for using the AT&T executive teleconference. You may now disconnect.