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PBI - Q4 and Year-End 2013 Pitney Bowes Inc. Earnings Conference Call

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OVERVIEW:

Management discussed 4Q13 and 2013 results, reporting 4Q13 GAAP diluted EPS of $0.44 on revenues of $1b, and 2013 GAAP diluted EPS of $0.70 on revenues of $3.9b. Guidance was for 2014 GAAP diluted EPS from continuing operations of $1.75-1.90.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Pitney Bowes fourth quarter earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded.

I would now like to introduce your speakers for today's conference call. Mr. Marc Lautenbach, President and Chief Executive Officer; Mr. Michael Monahan, Executive Vice President and Chief Financial Officer; and Mr. Charles McBride, Vice President, Investor Relations.

Mr. McBride will now begin the call with the Safe Harbor overview. Mr. McBride, please go ahead.

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

Included in this presentation are forward-looking statements about our expected future business and financial performance. Forward-looking statements involve risks and uncertainties that could cause actual results to be materially different from our projections. More information about these risks and uncertainties can be found in our 2012 Form 10-K annual report, and other reports filed with the SEC, and 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, there are 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 most of the points we will discuss during the call. These slides can also be found on our Investor Relations website.

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

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

Thanks, Charlie. And good morning, everyone. Thank you for joining our fourth-quarter 2013 earnings conference call. We have a number of important topics to cover, so let's get started.

As you recall, back in May, we unveiled a new business model that we believed would help transform Pitney Bowes and deliver more sustainable value to our shareholders, clients, and employees around the world. We also believed that if we focused our efforts around three key strategic initiatives: stabilizing our mailing business, driving operational excellence, and growing our overall business, especially through our participation and investment in digital commerce, we would begin to unlock the inherent value of Pitney Bowes.

Back then, we described the transformation of Pitney Bowes as credible. But at that point it was only a projection, a plausible plan, in its very early days. With today's announcement, we have further evidence that our strategy is working and that we're on the right track to transform Pitney Bowes.

We still have work to do. But we're off to a strong start and have built a solid foundation. We delivered excellent fourth-quarter results, both in terms of what we were able to get done in a 90-day period, but even more importantly, what we were able to accomplish in terms of progressing our strategic transformation objectives.

Not only do our results validate our strategy, but also give us more confidence that we are focused on the right things to continue moving our Company forward. We are heading into 2014 with good momentum, and are better positioned to capitalize on the incredible market opportunities that ultimately will help our clients grow their respective businesses.

Turning quickly to the fourth quarter, overall revenue grew for the first time in several years. On an adjusted basis, EBIT, net income from continuing operations, and EBIT margins, all increased year over year in the fourth quarter. Each of these measures is an important indicator for the quarter and highlights our progress towards our overall transformation.

Mike will provide more color on our fourth-quarter results in a few minutes. But suffice it to say I was very pleased with our performance against these important metrics.

Operationally, during the quarter, we made solid progress in terms of our strategic objectives. As we have done in previous quarterly conference calls, I would like to continue to describe our progress in three chapters -- stabilization of mailings, operational excellence, and growth of our digital commerce businesses. As Mike and I will outline, we are making progress against the key measures that we will hold ourselves accountable for in this transformation.

In terms of the first chapter of our transformation, stabilization of mailings, we said we could do better than the market and stabilize these important revenue streams. In the fourth quarter, the aggregate of our physical mail businesses, small and medium businesses, presort and production mail, we declined less than 1%, at constant currency.

The decline in the SMB solutions group continued to moderate, declining 2% year over year on a constant currency basis. And once again, equipment sales for all of Pitney Bowes, an important future indicator of our Mail business, increased in the quarter.

Similarly, we made significant progress achieving operational excellence in the fourth quarter. Again, we are using benchmarks inside and outside of our industry to gauge our progress, and expect progress to result in improvements in the income statement and the balance sheet.

SG&A as a percent of revenue decreased 320 basis points in the fourth quarter, versus the fourth quarter in 2012. And the absolute decrease in SG&A for the quarter was $27 million. As a reminder, in May, we committed to reducing our SG&A run rate by $100 million to $125 million, as we exit 2014. Against this benchmark we reduced our SG&A by $71 million in 2013, and are on track to meet or exceed our original commitment.

We continue to see material opportunities to become more efficient, while also maintaining a level of investments to enhance the performance of our Company and grow our business for the future. In addition to productivity improvements in our current portfolio, we have also been addressing fixed costs remaining from the divestiture of our PBMS business, which was close to a $1 billion business, or 20% of our presale revenue base.

In terms of our balance sheet, in May, we described $100 million of opportunities to improve our working capital position, as part of our operational excellence initiative. As a result of aggressive actions to manage inventory levels and DSO improvements, we achieved that goal in 2013, much ahead of the schedule I had envisioned. The combination of our strong operational performance, coupled with our working capital improvements, produced a strong cash performance for the year.

There are lots of different measures of operational excellence for the balance sheet, but one important element is access to capital. Key indicators such as credit default swaps, and cash bond spreads have narrowed significantly over the course of 2013. We expect to continue to fortify our balance sheet in the first half of 2014. The strength of our balance sheet is the basis of our competitive dividend, and over time provides us the operational flexibility to continue to unlock value in Pitney Bowes.

The final chapter of our strategic transformation was to grow our digital commerce business. In the fourth quarter, our digital commerce business grew 18%, at constant currency. This growth was powered by our e-commerce business, which continued to show double-digit sequential growth.

Importantly, our software revenue also grew for the quarter. We continued to see great opportunity in our digital commerce businesses. Again, in aggregate, these markets represent over $40 billion of opportunity.

Finally, in the fourth quarter we signed a multi-year licensing deal with Twitter. We also announced a partnership with Broadridge Financial Solutions to create a digital communications exchange which will sit atop Amazon web services infrastructure. We believe that this is an important step for our digital mail and Volly business, and are excited about its prospects going forward.

Before I turn it over to Mike, let me remind everyone that we are on a multi-year journey to transform Pitney Bowes business. By its very nature, transformations take time, and they're lumpy. And while we are very pleased with our results and the progress we are making, we are still in the very early stages.

Clearly, there is much more to do. In fact, we have just scratched the surface. However, our performance in the last couple of quarters gives us the confidence that we are making the case, and focused on the right things to improve and grow our business.

Now, let me turn it over to Mike.

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

Thank you, Marc. And good morning.

This morning we reported results for the fourth-quarter and full-year 2013. Our full-year results are in line with the Company's guidance for revenue, earnings per share and free cash flow.

As Marc mentioned, at our analyst day last May, we set out three major objectives for the Company. They were: stabilize the mailing business, achieve operational excellence and invest in growth initiatives. Marc has already shared the major milestones that we have achieved to date. And I would like to now discuss how these milestones are contributing to the business trends which have been reflected in our financial results. I think this review will help to explain our fourth-quarter results, and provide insight for our 2014 guidance.

First, we are stabilizing our mailing business. As Marc noted, collectively the revenue in our mail-related businesses were down just 1% in the quarter. In our SMB business, we're implementing a new go-to-market strategy, which has shifted some customer accounts to inside and online sales. This strategy is improving our sales process, and enhancing our client experience, while reducing costs.

While there is still more work to do to implement this globally, we are already seeing improvements in the trend of our equipment sales. Additionally, as expected, the decline in our high-margin recurring revenue stream has continued to moderate, and is contributing to the overall stabilization of our core mailing business.

Second, we are achieving operational excellence. At our analyst day, we announced a restructuring program that will reduce expenses on a run rate basis by $100 million to $125 million by 2015. As Marc noted, SG&A declined by $71 million in 2013 when compared to the prior year, attributable to the new go-to-market strategy in our SMB business, and increased leverage of global shared services.

We are also in the early stages of implementing a new ERP system to streamline and consolidate many of our back office operations. This program will ramp up in 2014 and is expected to be a multi-year process. We expect to make a significant investment in systems this year, but anticipate that our ongoing initiatives to reduce SG&A expense will more than offset the incremental costs. We have more work to do, but we are well on our way to achieving operational excellence for the Company.

Finally, our third objective is to invest in growth areas. In 2013, we continued to invest in our e-commerce offering, which grew sequentially at a high double-digit rate.

In our software business, we brought in new leadership with skill sets that support our new go-to-market strategy. This strategy is realigning our software sales organization with industry and product specialization and a focus on large strategic accounts. Our investment in this new software go-to-market strategy is expected to stimulate revenue growth in the software space.

Other actions we have taken include the sale of the Management Services and Nordic furniture businesses, and the purchase of our joint venture partners' minority interest in our Brazilian business. We will also continue to rationalize our portfolio of products in the geographies in which we operate in order to improve margins and profitability.

Additionally, we completed the first phase of realigning the reporting of our business segments consistent with how we now manage the business. Last year, we introduced segment reporting for the Small and Medium Business, or SMB Solutions Group, the Enterprise Business Solutions Group, and the Digital Commerce Solutions segment.

Starting in the first quarter of 2014, we will shift the reporting of our shipping solutions from our SMB Group where it is currently reported, to Digital Commerce Solutions. We're making this change because this is how we will manage the business in the future, given that our shipping solutions are now principally software-based, and are more closely aligned with our parcel management strategy that includes e-commerce.

Finally, we have taken a balanced and disciplined approach to our capital allocation strategy. We have strengthened our balance sheet, by reducing debt during 2013 by approximately $675 million.

These actions are helping to transform Pitney Bowes into an organization that can help our clients meet the ever-changing challenges of doing business. We and our clients are already benefiting from these initiatives, as evidenced by our financial results. I would categorize 2013 as a year of realignment, and we are looking forward to 2014 as a year of investment and profitable growth.

Now let me take you through our fourth-quarter and full-year results.

Turning to our financial performance for the fourth quarter, revenue totaled $1 billion, which was an increase of 2% over the prior year on both a reported and constant currency basis.

Revenue for the quarter on a constant currency basis grew 18% in the Digital Commerce Solutions segment, grew 3% in the Enterprise Business Solutions Group, and declined 2% in the SMB Solutions Group. The revenue results in the fourth quarter reflect the continuation of the year-over-year improving trend that the Company has delivered throughout the year.

Adjusted earnings per diluted share from continuing operations for the quarter was $0.53. GAAP earnings per diluted share from continuing operations were $0.39, which includes a restructuring charge of $0.11 per share, and a charge of $0.02 per share related to costs associated with the retirement of debt, originally scheduled to mature in 2014. GAAP earnings per diluted share for the fourth quarter were $0.44, which includes income of $0.05 per share from discontinued operations.

Free cash flow during the quarter was $195 million. And on a GAAP basis we generated $131 million in cash from operations. During the quarter, our cash flow was used to return $38 million to our common shareholders in the form of dividends, and we made $18 million in restructuring payments.

Turning to our financial performance for the full year, as I noted earlier, our results are in line with the guidance we provided. For the full year, revenue totaled $3.9 billion, which was a decline of 1% when compared to prior year, on both a reported and constant currency basis.

Adjusted earnings per diluted share from continuing operations for the full year was $1.88. GAAP earnings per diluted share from continuing operations were $1.49, which includes a restructuring charge of $0.21 per share, an asset impairment charge of $0.08 per share, and debt management costs of $0.10 per share. GAAP earnings per diluted share for the full year were $0.70, which includes the loss of $0.78 per share from discontinued operations.

Free cash flow for the full year was $635 million. And on a GAAP basis, we generated $625 million in cash from operations. Overall, cash flow benefited from the Company's aggressive action to improve working capital throughout the year, as well as lower capital expenditures. During the year, our cash flow was used to return $189 million to our common shareholders in the form of dividends, and we had $60 million in restructuring payments.

The remainder of my discussion will focus on the results for the fourth quarter. All income statement-related references and net results are on an adjusted basis.

Adjusted earnings before interest and taxes, or adjusted EBIT, was $195 million this quarter, or 3% higher when compared to prior year. Adjusted EBIT margin was 18.9%, which was 20 basis points higher than 2012. Adding back depreciation and amortization, adjusted EBITDA for the quarter was $239 million, or $1.17 per share.

SG&A for the quarter was $365 million, a decline of $27 million, or 7%, versus the prior year. As a percent of revenue, SG&A was 35.4%, which was an improvement of 320 basis points over the prior year.

In the quarter, we recorded a pre-tax restructuring charge of $30 million for actions aligned with our previously-announced plan to reduce costs.

Net interest expense, which includes financing interest, was $45 million, which was relatively flat to the prior year. Average outstanding borrowings during the quarter were $666 million lower than the prior year. The average interest rate this quarter was 5.4%, which was 74 basis points higher than the prior year.

The effective tax rate on adjusted earnings for the quarter was 25.1%, versus 28.2% last year. This quarter's tax rate includes benefits related to the favorable resolution of certain tax issues.

Looking at the balance sheet, we had $3.3 billion of debt on the balance sheet at the end of the quarter, which was $671 million less than at the end of last year.

Now, I would 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 posted to the pb.com website under the Investor Relations section.

North American mailing revenue declined 4% versus the prior year. Overall North American mailing revenue had the lowest rate of decline in some time.

In the US, equipment sales revenue grew 2% versus the prior year, in part benefiting from the new go-to-market strategy. Total equipment sales growth, however, was offset by lower sales of non-mail-related multi-function devices in Canada.

Recurring revenue streams declined at a lesser rate than prior year, continuing a year-over-year improvement in trends, benefiting in part from positive growth in supplies revenues. EBIT margin was 42.8%, which was an improvement of 470 basis points, versus the prior year as a result of improved gross margin and ongoing cost reduction initiatives.

During the quarter, North American mailing made substantial progress, implementing its new go-to-market strategy, which is enhancing the client experience, and improving the sales process, while at the same time reducing costs.

International mailing revenue for the quarter was $159 million, and EBIT was $19 million.

Year-over-year revenue grew 1%. Revenue benefited from slight growth in both equipment sales and recurring revenue streams, as the international markets continued to experience improving meter population trends.

EBIT margin was 11.6%, which was a decline of about 390 basis points versus the prior year, due to the mix of products sold and higher equipment costs related to currency.

Turning to the Enterprise Business Solutions Group, Production Mail revenue for the quarter was $151 million, and EBIT was $21 million. Year-over-year revenue increased by 6%.

Revenue benefited from increased production of print installation globally, as well as the installation of sorter equipment in Europe. Revenue also benefited from ongoing growth in supplies.

EBIT grew 1% versus the prior year. EBIT margin was 13.7%, which was a decline of about 70 basis points versus the prior year, as a result of the higher proportion of printer sales, which are lower-margin products compared to inserting equipment.

Presort services revenue for the quarter was $108 million. And EBIT was $18 million. Year-over-year revenue was flat to the prior year, which is the net result of an increase in new business being offset by a decline in revenue per piece of mail processed.

EBIT margin was 16.9%, which was a decline of about 500 basis points versus the prior year, in part due to increased labor costs associated with process and year-end volume.

The Presort business also experienced pressure on its margins this quarter and throughout the year because of the USPS postal rate case change that occurred at the beginning of 2013. The rate case reduced the discount spread on certain presort categories of mail. As a result, we have taken a number of actions to reduce costs to mitigate the impact of this change.

Turning to the Digital Commerce Solution segment, revenue was $176 million, and EBIT was $23 million. Year-over-year revenue grew 17% on a reported basis, and 18% on a constant currency basis. This growth was driven primarily by an increase in transactions associated with the Company's e-commerce solutions for cross-border package delivery.

Revenue also benefited from growth in services related software revenue, but was partially offset by a decline in marketing services revenue.

EBIT margin was 12.9%, which was an improvement of 370 basis points versus the prior year, as a result of the leverage related to the scaling of our e-commerce business, as well as lower net investment in Volly. EBIT margin, however, was again impacted by the continued investment in infrastructure and software development for e-commerce.

That concludes my comments on our financial performance this quarter. Now, I would like to discuss our 2014 guidance.

The Company expects to further align business performance in 2014 with what we outlined at our 2013 analyst day. Additionally, we expect there will be no significant changes in the economic and postal environment in 2014 as compared to 2013.

Revenue growth is expected to improve in the Digital Commerce Solutions segment, as it benefits from the anticipated growth in the e-commerce and software solutions businesses. Flat to modest revenue growth is expected in the Enterprise Solutions Group against the strong 2013 production mail comparable. Also, we expect that the 2014 postal rate case will have a modest positive impact relative to 2013 on pre-sort services, based on our network efficiency.

We anticipate a continued improvement in our revenue in the SMB Solutions Group as a result of ongoing improving trends in equipment sales and recurring revenue streams. US mailing business should also benefit modestly from the 2014 postal rate case change. For the first time, the United States Postal Service is offering a $0.01 postage discount for meter users.

We expect ongoing reductions in SG&A costs, which would more than offset the incremental expenses associated with the investment in a new ERP system. The Company expects a tax rate in the range of 29% to 31%. This range reflects our changing business mix.

Free cash flow in 2014 will reflect lower cash from operations, as a result of the sale of the management services business, the further stabilization of finance receivables, and incremental capital investments related to the new ERP system.

Based on the assumptions I just outlined, the Company's 2014 guidance is as follows. Revenue, excluding the impact of currency, to be in the range of a 1% decline to 2% growth, when compared to 2013.

GAAP earnings per diluted share from continuing operations to be in the range of $1.75 to $1.90, which includes expenses of approximately $0.10 per share related to our new ERP system. Excluding this incremental expense, and adjusting for the $0.15 of tax benefits in 2013, underlying earnings per share are showing meaningful year-over-year growth.

Free cash flow is expected to be in the range of $475 million to $575 million. This guidance excludes any unusual items that may occur or additional restructuring actions, as the Company implements plans to further streamline its operations and reduce costs.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ananda Baruah with Brean Capital.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Hi, guys. Good morning. And congrats on what looks to be a really solid quarter here. And congrats on a solid year, Marc, your first year there, and implementing a number of these initiatives.

I had a few things, if I could. The first, Mike, if you could just walk back through the components of the free cash flow guidance, and maybe give us some sense, order of magnitude, to what degree each of those contributes. And then also was wondering -- and you touched on this on the finance receivables -- I just wanted to know, also, if any improvement in sales, or to what degree any improvement in metering sales plays into that aspect of free cash flow, as well.

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

Sure, thanks, Ananda. In terms of the cash flow guidance, there are three very intentional actions that are reflected in the guidance that really make up the difference between our 2013 actual cash flow and our 2014 guidance.

Specifically, they relate to the fact that we sold the Pitney Bowes management services business after the third quarter in 2013. So when we remove the full-year impact of the cash flow of that business out, that reduces our cash flow.

Second is the intention to invest incrementally in the systems of our ERP system, that will yield some long-term benefits to the organization. And third is about the finance assets in the business.

To your point, the stabilization of the mailing business, in particular, beginning to see equipment sales growth in that business, has the benefit of stabilizing those finance receivables. Those are high-yielding assets. They contribute to recurring revenue streams. And so we view that as a very positive development in the business.

Each of those items are worth $30 million to $50 million in terms of our free cash flow. So they really constitute the difference between our 2013 free cash flow and our 2014 guidance.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Okay, great. That's really helpful. Thanks. And then, Marc, on the core business, and on the recurring rev stream, I would be interested in getting your comments on how it is tracking relative to your expectations. You guys have been calling for improvement.

Were you expecting this much improvement this quickly? And, to the extent that you're seeing dynamics that you feel are more favorable, do you think that could -- what is your view on it resonating relative to your long-term model outlook for the industry? And then I have one more quick follow up, thanks.

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

I would say it is broadly tracking to the way I had expected and came the way that Mike had laid out, not just in 2013, but in previous years. To some extent, this is a place where you've got, as we have discussed, pretty good visibility. So, I would say in general, the numbers have unfolded the way we expected.

I would say that the go-to-market actions have yielded better and sooner than I would have thought and have been less disruptive. Typically when you implement a go-to-market change, of the magnitude that we have, you could expect some short-term air pockets. And, to the team's credit, I think they have avoided all of those. So, as that go-to-market matures, and congeals, I think there is upside.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Yes. But then, also, Marc, then maybe for a period of time you could overshoot. And I mean just in a positive way -- overshoot what you think the normalized model would look like in the core mail business.

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

I'm not precisely sure what a normalized model looks like, so I would just go back to my comments. I think it is probably tracking the way we expected.

I'm pleased with how the go-to-market has unfolded. And I continue to be confident that this business can drive real value.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Got it. Thanks. And then just one quick last one for me, guys -- housekeeping.

On the EPS guidance, you're calling out the $0.10 of ERP investment. It would seem that we would want to include that, since you will get benefit from that going forward. But I just wanted to get clarification on how you're hoping that the folks will take that into account in the context of the guidance.

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

The guidance, it was just to give transparency into the numbers. It wasn't anything beyond that.

You can make your own judgments about what to include or not include. But, as I have said at the outset, we want to be as transparent as we can so you can make the right judgments about the Company.

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

I would just add to, and under that, it is included in our guidance number. But what we wanted to do is give the elements of differences between 2013 and 2014 that would allow for comparability.

So if you look at 2013, there is about $0.15 of tax benefits in there. And if you look at 2014, there is this $0.10 of incremental spend in the ERP business. So, normalizing for those two things, the underlying growth in EPS is between 7% and 16%, which is really a reflection of the SG&A benefits, as well as the contribution from improving revenue trends.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Understood. Thank you, guys.

Operator

Shannon Cross with Cross Research.

Shannon Cross - *Cross Research - Analyst*

Thank you. And good morning. My first question is with regard to the e-commerce business. Marc, can you just give us some more color on what you're seeing there?

Maybe the revenue during the quarter, the margin trajectory, when we can expect possibly that business to be in a profitability as opposed to investment. And how we're thinking about things -- you signed Twitter during the quarter, so what are the next goal posts we should be looking for?

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

As it relates to e-commerce I would say it is probably tracking, again, as we had expected, and as we had planned for the year. In terms of the profitability, it is true that we're continuing to make investments. It is also true that the margin improvement in that business, on a contribution level, has, I would say, been slightly ahead of where I would have expected.

So, to sum that up, we will continue to make investments in that business, because we think it has got enormous potential across a broad set of markets and a broad set of clients. But at the same time, we will continue to work on the variable contribution.

As it relates to Twitter, there's lots of different ways to process that. I would tend to put it in a broader context of, again, a reaffirmation of our broader strategy, in that you have a very sophisticated, again, technology company, well placed within the world of social media, choosing our technologies.

And I think it is important to step back and say -- why. And the basic why is social media companies are all working to monetize their model. They do that through lots of different things but commerce and advertising is one of the primary ways. And our technologies, in particular our location intelligence technologies, are well placed to do that.

I think you can get lost in the specific data points, but the broader point is that these technologies participate in secular trends that are moving the right way, whether it is what we're doing with e-commerce or whether it is what we're doing with location-based solutions. And that's why the mosaic of all of these businesses together I find so promising.

Shannon Cross - *Cross Research - Analyst*

Great. And then can you talk a little bit about the ERP system rollout, where you are in the planning and the implementation, and how we should think about it through this year and maybe future years? I don't really necessarily want you to give us deadlines because it seems like with ERPs people always miss those deadlines, so it is probably better not to lay them out. But just in terms of looking at it, how are you going through its steps, processes, teams, what have you?

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

At this point, we're finishing up the requirements definition. And that will take the next several months. And towards the end of this year, we will begin rolling that out around the world.

Typically, as you and I have discussed, ERP implementations take two to three years. This one won't be any different. So, you will see upfront investments, as Mike characterized, at the outset, followed by what I think will be importantly substantial economic benefits.

But also, even more important to my way of thinking, a much better client experience. So when I talked about 37 different billing systems, there is obviously a level of cost and inefficiency that goes along with that. But, candidly, it doesn't present the best client experience either.

So, this is one of those things that is going to have all kinds of benefits assigned with it. But it will take some time to work through.

Shannon Cross - *Cross Research - Analyst*

Okay, great. And then I don't know if Mike wants to take this. I'm curious on the presort business. It is not a huge driver, it wasn't a huge impact during the quarter overall.

But obviously the margins were pretty low relative to where they have been. So, I'm curious as to what normalized margins might be in there, or how you're thinking about changes you might make. Or is this just a new normal because of some of the rate changes that went through last year?

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

The thing about rate changes is there's new rates each year. And so where some of the rate changes in 2013 were a little less favorable to us, as well as we have been restacking labor and those types of things a bit. As we look ahead to 2014, and as I noted, we see opportunities in the new rates to leverage the way our network is configured, to drive improvements.

So despite the fact that the margins were down a little bit, they were still about 17%. So, a very solid margin for that business. But we do see some opportunity in 2014.

Shannon Cross - *Cross Research - Analyst*

Okay. Thank you.

Operator

Kartik Mehta with Northcoast Research.

Kartik Mehta - *Northcoast Research - Analyst*

Good morning, Mike and Marc. I wanted to ask you just your thoughts on where the debt stands for the Company and the free cash flow you're going to generate in 2014. And maybe what your priorities will be.

Is there a certain level of debt you're trying to get to? Is there a certain level of cash that you would like to have on the balance sheet?

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

I think in terms of the debt profile, as I noted, our debt levels are down about $675 million year over year. So, we think we have made good progress on that front. And we see our pension plans at nearly fully funded status in the US qualified plan.

So, as we look at the total capital structure, I think it has improved dramatically, and in good shape. But we will continue to look at the maturities of the debt we have outstanding and decide what we do as we go forward from here. Those are the main areas of focus for us.

In terms of the free cash flow, given the dividend we have, which we think is still a very good competitive dividend rate, the free cash flow is more than sufficient to cover that dividend, and leave us with excess free cash flow that we can reinvest in the business. And some of that is baked into that guidance already. As well as look further at our debt.

So, I think we have more flexibility today than we did a year ago. And we will continue to manage that.

Kartik Mehta - *Northcoast Research - Analyst*

Marc, you mentioned, I think, in your remarks about the software maintenance and investing in the software business. How much of that investment is potentially doing some acquisitions to make the offering stronger, or buy something that you don't have that you think could help further strengthen your offering?

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

As I have said all along, we would look at acquisitions opportunistically. In the main, I continue to think that we have the core of the assets that we need. So that the types of opportunities that we would look at would be very targeted and focused to fill out capabilities that we need. And traditionally, those are make versus buy decisions.

So, it is part of the arsenal, it is part of the consideration. But it would be a very focused and targeted set of moves if we decide to do that.

Kartik Mehta - *Northcoast Research - Analyst*

Thank you very much. I appreciate it.

Operator

George Tong with Piper Jaffray.

George Tong - *Piper Jaffray - Analyst*

Thanks. Hi, good morning. Just a couple of questions on digital commerce to start. First, just wanted to revisit the eBay relationship. Can you give us an update on how many countries you're now serving versus your long-term target? And any plans to potentially add to capacity at your sortation facility?

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

In terms of the e-commerce business, obviously, we are serving eBay as a very key customer, but have other customers in that business, as well. In terms of the eBay relationship, today we're in about 42 countries. And that will continue to evolve in terms of eBay's priorities to get to other incremental markets around the world. And we work with them on a very close basis to ensure that we're meeting their needs as they evolve on a global basis.

In terms of the capacity of our facility, we went through the holiday season in very good shape, handling all of the volume that came through. So we feel we're in good shape to grow with that business.

George Tong - *Piper Jaffray - Analyst*

Great. And just wanted to dig a little bit deeper also on the Twitter deal. Is this a potential source of ongoing recurring revenue streams? And how should we think about the scale and margin profile associated with the contract?

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

In terms of the Twitter deal, we did mention that it was a multi-year agreement, so it is a licensing type agreement with ongoing maintenance. Obviously, it is our first implementation with them around the technology. And we will continue to look at ways to serve their needs as we go forward.

George Tong - *Piper Jaffray - Analyst*

Great. And then margins in digital commerce. Do you see any investment milestones in 2014 that could potentially slow the momentum you're seeing in margin expansion?

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

What you are really seeing in margin expansion there is a combination of two things. One is, as we gain scale in the e-commerce business, even though we're investing into that, we are beginning to get some benefit of the scale within our facility against the fixed costs of the business.

The other is within our software business. We continue to refine our go-to-market strategy, as I talked about, and manage the overall expenses in the business. We have an opportunity to continue to expand that margin as we gain scale in the digital commerce business.

Today, that is about 17% of our total portfolio. Obviously, getting good growth in that business will allow us to scale that further.

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

I would just add one additional point. As we have talked about previously, we are investing in a more specialized sales force. So, while we're doing that within the envelope of SG&A that we had -- read that as not incremental investments -- I would assume that that would be a more productive use of that resource going forward.

George Tong - *Piper Jaffray - Analyst*

That's helpful. And then last question, you have indicated you're expecting a relatively similar environment in the postal industry in 2014 versus 2013. What do you see as potential sources of upside or downside versus your expectations?

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

There was fairly meaningful improvement in FY13, if I look at just from the US perspective, versus FY12. Mail volumes were down 5% in 2012. They were down just 1% in 2013.

And within that, there is obviously components that are growing faster than others, like packages. So, we're in an environment of relatively stable mail volumes. And, so, looking ahead, we're projecting against that type of environment. And that is what I was referring to.

George Tong - *Piper Jaffray - Analyst*

Great, thanks.

Operator

Glenn Mattson with Sidoti.

Glenn Mattson - *Sidoti & Company - Analyst*

Good morning, everybody. Along the same line, with the sales force realignment, could you say where we are in the process, how far along we are, and when those results might materialize?

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

I would characterize it this way, Glenn. The teams have the right uniforms on so they're in the right formation, and we're working on building their skills. We characterize this as an effort that would take 18 months to fully implement.

We started early fourth quarter. I expect incremental improvement in each of the coming quarters and at a normal steady pace towards the beginning of 2015.

Glenn Mattson - *Sidoti & Company - Analyst*

Great, Marc, that's helpful. And on the digital commerce space, what would you say ultimately the goal is to get margins at?

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

That is really going to depend on the mix of business and the opportunities. So, we're early days but, clearly, we're already at a double-digit margin. Obviously, each component of that digital commerce business has a somewhat different profile.

The software business having the highest margin profile. The e-commerce business, because it is a combination of services and software, somewhat less. But our goal is to continue to improve that as we scale both on the software and the e-commerce side.

Glenn Mattson - *Sidoti & Company - Analyst*

Okay, great. And then lastly, what kind of effect do you expect from the $0.01 discount on the meters, if any?

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

It is early days, really, in terms of the opportunity around that. But the important thing is a recognition that the meter provides real value in the overall postal system. And as our customers look at the total spend around this, we can provide incremental value by allowing them to access that discount. So, obviously, we're communicating that to our customers, and looking at ways that we can help them manage their overall postal costs.

Glenn Mattson - *Sidoti & Company - Analyst*

Okay. Is that generating some interest from the customers when you reach out to them on that?

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

Yes. And today we're really building awareness around that because it is just out.

Glenn Mattson - *Sidoti & Company - Analyst*

Okay. Great. Thanks.

Operator

Ananda Baruah with Brean Capital.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Thanks, guys, for the follow-up. Marc, one question that we get with regard to some of the newer growth initiatives, e-commerce, and some of the Twitter/Facebook initiatives, is what is the competitive environment look like in the context of the longevity, or the penetration of the strategy from folks. And I would love to get your comments on what the competitive environment looks like and how you guys feel you're positioned and why inside that competitive environment, both currently and looking out forward. Thanks.

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

There is not a single answer. Each product has a slightly different, in some cases dramatically different, competitive environment. So if you look at some of the things that we're doing around e-commerce, that market is still relatively nascent. Obviously growing very quickly.

That said, I like our competitive positioning. As we look around the industry, and as we get affirmation from clients, and potential clients, all of that seems to line up.

Location intelligence, another side of it, is a more mature market with more entrenched competitors. But, again, when you look at the clients that we're landing, it gives you a sense that you've got real capabilities there.

So, on balance, we spend a lot of time trying to understand the competitive environment. And we are careful and thoughtful about where and how we deploy our resources. That said, I like our competitive positioning in all the markets.

Ananda Baruah - *Brean Capital, LLC - Analyst*

The more mature nature of the location intelligence market, and given the relationships that you have recently struck, would that suggest that you guys actually have IP that is certainly towards the higher end of the industry? And maybe even, therefore, have some kind of competitive barriers given the relationships that you struck?

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

I would certainly affirm the first part of your question in the sense that we like the IP that we have in that business. Competitive barriers -- I'm not so sure I would necessarily try to characterize that. These are obviously very dynamic markets. And you need to keep your eye on the horizon of the competitive environment.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Great, thanks very helpful. Thanks a lot.

Operator

There are no further questions. Please continue.

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

Great. Let me conclude this morning. I appreciate everyone joining the call. I am going to conclude by saying that we had an excellent fourth quarter. Not just in terms of our financial results, but importantly, in terms of our strategic transformation. We are beginning to see the promise of the Pitney Bowes business model unfold.

That said, I want to remind everyone again that transformations typically have ups and downs along the way. And while I'm more confident than ever about our long-term prospects, this will not be a straight shot. We have made excellent progress so far. And in many ways much faster than I would have expected but there is still a lot in front of us.

It has been over a year since I joined Pitney Bowes. And in this very short period of time, I'm continually impressed by our technology, by our talent, and the vision and the passions of our teams in each of our businesses. I'm confident that as we continue to execute our strategy, we will unlock the full value of Pitney Bowes.

Thank you again for joining us. And I believe that concludes this call.

Operator

Thank you. Ladies and gentlemen, this conference will be available for digitized replay beginning today at 10:00 AM Eastern, running through Saturday, March 1, 2014, at midnight Eastern time. You may access the AT&T playback service by dialing 320-365-3844 and entering the access code of 313721.

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That does conclude our conference for today. Thank you for your participation. And for using AT&T teleconference. You may now disconnect.
