THOMSON REUTERS

# EDITED TRANSCRIPT

Q2 2020 Pitney Bowes Inc Earnings Call

EVENT DATE/TIME: JULY 30, 2020 / 12:00PM GMT

## CORPORATE PARTICIPANTS

**Adam David** *Pitney Bowes Inc. - VP of IR*
**Marc B. Lautenbach** *Pitney Bowes Inc. - President, CEO & Director*
**Stanley J. Sutula** *Pitney Bowes Inc. - Executive VP & CFO*

## CONFERENCE CALL PARTICIPANTS

**Allen Robert Klee** *National Securities Corporation, Research Division - Research Analyst*
**Ananda Prosad Baruah** *Loop Capital Markets LLC, Research Division - MD*
**Anthony Chester Lebiedzinski** *Sidoti & Company, LLC - Senior Equity Research Analyst*
**Basel Kanaah** *Northcoast Research Partners, LLC - Research Analyst*
**Shannon Siemsen Cross** *Cross Research LLC - Co-Founder, Principal & Analyst*

## PRESENTATION

**Operator**

Good morning, and welcome to the Pitney Bowes Second Quarter 2020 Results Conference Call. (Operator Instructions) Today's call is also being recorded. (Operator Instructions)

I'd now like to introduce your speakers for today's conference; Mr. Marc Lautenbach, President and Chief Executive Officer; Mr. Stan Sutula, Executive Vice President and Chief Financial Officer; and Mr. Adam David, Vice President, Investor Relations.

Mr. David will now begin the call with a safe harbor overview.

---

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

Good morning. Included in this presentation are forward-looking statements about our expected future business and financial performance. Forward-looking statements involve risks and uncertainties that could cause actual results to be materially different from our projections. More information about these risks and uncertainties can be found in our earnings press release, our 2019 Form 10-K annual report and other reports filed with the SEC that are located on our website at www.pb.com, and by clicking on Investor Relations. Please keep in mind that we do not undertake any obligation to update any forward-looking statements as a result of new information or developments. Also for non-GAAP measures used in the press release or discussed in this presentation, you can find reconciliations to the appropriate GAAP measures in the table attached to our press release and also on our Investor Relations website.

Additionally, we have provided slides that summarize many of the points we will discuss during the call. These slides can also be found on our Investor Relations website. Now, our President and Chief Executive Officer, Marc Lautenbach, will start with a few opening remarks. Marc?

---

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

Thank you, Adam, and thank you, everyone, for joining our call. I'd like to begin the call by thanking all the essential workers, including the Pitney Bowes team for their dedication to their work in what is an unprecedented time. And likewise, our hearts go out to all the lost loved ones to this terrible virus. We continue to operate in challenging times and uncharted territory. And as I mentioned in our last call, times of economic dislocation, and this is certainly that, are times when market share changes hands. Our focus from the outset has been to come out of this period better than we entered. I will let Stan take you through the specifics of the quarter, but from my perspective, the quarter was quite good. We had excellent execution and made the best of a very difficult situation. Looking at the quarter from a longer-term perspective against our objective of coming out of it stronger, similarly, we hit the ball.

First and foremost was the health and well-being of our employees. We made the necessary changes to how we did business to keep our employees safe, and we got high marks from our team. Likewise, we put a premium on our balance sheet, and we exited the quarter in a much improved position. We had already refinanced much of our debt and in the second quarter, we substantially increased our liquidity, exiting the quarter with over $1 billion of cash and short-term investments. We will continue to be diligent about our balance sheet and liquidity position.

In our e-commerce business, we won over 100 new customers and managed through unprecedented volumes. I have heard others in our industry talk about volumes consistent with the Holiday peak. Our domestic delivery volumes in the second quarter were over 2x holiday peak.

I won't say we were terribly efficient in dealing with the volume as the surge initially was a touch off guard, but the bottom line is we moved an unprecedented number of parcels. The net effect of the new customers and the incremental volumes is we will achieve scale sooner than we expected . We will accelerate some investments and will take some time for our expanded team in our new facilities to hit their stride, but they've already made great progress in handling the new volume levels.

It is worth pausing and saying again, our e-commerce business is now well over $1 billion and grew over 40% in the second quarter. This is a business that didn't exist 8 years ago.

Our Presort business performed better than the market and was able to make an important acquisition. The ironic effect of decreased volumes in the presort world is fewer clients and third parties have sufficient volume to achieve 5-digit densities, which is what drives the economics in the Presort World. Net-net, our Presort business is clearly going to exit this pandemic in a stronger market position.

In our Mailing business, our investments in online offerings in tele-and digital channels really paid us in the quarter. Our online offerings, in addition to our new SendPro Mail Station obviate the need for field service teams to physically install an asset and tele- and digital channels are very well suited for offices being shut down.

If you look at the quarter from a longer-term perspective, the investments we have made to move our business to e-commerce shipping, build capacity for that business, the investments at Pitney Bowes Commerce Cloud, new offerings and new channels, all paid off. We have built a more agile, flexible and contemporary business and the second quarter is a clear proof point.

The obvious question we are asking ourselves and you and our investors will ask us is what does all of this mean for mailing and partial volumes going forward. The honest answer is we do not know for sure. Mail volumes saw a drop-through the second quarter, but we are seeing a slightly improved trend through July.

In the world of e-commerce, volumes have taken a material stair-step up. Not clear if volumes will stay at these elevated levels, but there is no doubt that buying behavior has changed. Customers are buying online more frequently, and the number of brick-and-mortar stores is decreasing. The second quarter was also notable in that for the first time in Pitney Bowes history, shipping revenue was the majority of our total revenue. Our going-forward portfolio is weighted towards growth markets, and we are in markets where we have a clear right to win. And in fact, we are winning today.

So while it's hard to be precise about our going-forward mail and parcel lines, I like how we're positioned, and I have no doubt that we're going to come out of this terrible time in a much stronger position.

Now I will turn it over to Stan.

---

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

Thank you, Marc, and good morning. Our continued focus remains on the health, well-being and safety of our employees, clients, partners and communities. As we discussed on our last call, employees that can work remotely, continue to do so. Within our facilities, we are enforcing safe social distancing, staggered shifts and breaks, mandating protective masks, conducting temperature checks in higher risk locations and sanitizing multiple times a day.

All areas of our business have been impacted by COVID, some positively and some negatively.

In the U.S. market, e-commerce as a percent of total industry retail sales increased more than 10 points from 16% in 2019 to, more recently, 27%. We are also experiencing a dramatic shift to e-commerce, which fueled our strong revenue growth this quarter.

In the second quarter, revenues associated with our shipping products comprised 51% of our total revenue, which is the first time our shipping revenues have outpaced mailing. As anticipated, we are experiencing pressure within the mailing related businesses. We are leveraging the investments we have made over the last several years to address opportunities and help mitigate some of the pressure.

We estimate that the incremental costs related to COVID in the quarter were approximately $12 million. These costs largely relate to higher bad debt expense and ensuring the safety of our employees, primarily on PPE, supplies and quarantine pay for exposed employees. In addition, we saw higher postal costs related to injecting parcels directly into the USPS and bypassing our network in order to better serve our clients.

And of course, during these uncertain times, we continue to keep a tight focus on our liquidity position and cash.

Let me briefly recap.

We continue to maintain a strong liquidity position. We ended the quarter with over $1 billion in cash and short-term investments. Free cash flow was $148 million, which is a significant improvement from the end of the first quarter. Through the first half, free cash flow is $101 million, up $68 million over prior year, which leaves us well positioned for the second half of the year.

We have done a lot of work around strengthening our balance sheet and addressing our debt profile. We have no bond maturities until October 2021, and that amount is manageable at $172 million. We will continue to remain focused on our balance sheet. We also announced a draw-down of $100 million on our revolving credit facility, which took place in April. There remains no immediate need for the funds, but we believe this was the prudent thing to do given the continued uncertainty in the market.

We remain focused on working capital, and we continue to reduce discretionary spend throughout the organization.

Compared to the first quarter, we improved DSO by 3 days, and we also reduced OpEx by about $20 million.

We are reprioritizing our capital needs around essential and necessary investments to support our long-term objectives. Last quarter, we estimated that we can reduce our discretionary capital spend by $30 million to $40 million this year versus our original plan to spend approximately $140 million.

Based on the accelerated demand in e-commerce that we are seeing, we are estimating that we will reduce our annual CapEx spend more likely around $20 million for the year.

Within Wheeler Financial, we expect new originations to be no more than $25 million in 2020 as compared to our original plan of $80 million. We remain committed to building out our financial services over the long term, and will continue to be prudent when it comes to committing capital.

Assumed in our cash flow for the year is our intention to continue to maintain our current dividend at an annual run rate of $34 million. And we are limiting M&A transactions and will not repurchase shares in 2020.

Let me now take you through our second quarter's results and discuss some of the trends we saw in each of our businesses.

As in the past, unless otherwise noted, my statements going forward will be on a constant currency basis when talking about comparisons, and on an adjusted basis when talking about earnings related items, including cash flow. Reconciliations of all non-GAAP to GAAP measures can be found in the financial schedules posted with our earnings press release and on our Investor Relations website.

For the second quarter, revenue totaled $837 million, which was growth of 7% year-over-year. Adjusted EPS was $0.04 for the quarter. GAAP EPS was a loss of $0.02 and includes charges of $0.07 for taxes related to the settlement of certain investment securities as well as charges of $0.02 each for restructuring and asset impairments and discontinued operations. This was partly offset by a $0.05 gain on the sale of an equity investment.

EPS this quarter also includes $0.02 from insurance proceeds that we received as it relates to the malware attack that we experienced late last year. This partly offsets the estimated incremental cost related to COVID of approximately $12 million or $0.05 of EPS in the quarter.

Free cash flow was $148 million, and GAAP cash from operations was $153 million. Free cash flow increased over prior year as a result of higher accounts payable and accrued liabilities, driven by growth in the business and higher customer deposits, of which a portion is timing related. We also saw a higher runoff of finance receivables, which benefited free cash flow.

Let me briefly recap where we are on our capital position through the end of the second quarter.

As I stated earlier, we ended the quarter with just over $1 billion in cash and short-term investments.

During the quarter, we used free cash flow to return approximately $9 million to our shareholders in the form of dividends. We made $5 million in restructuring payments and spent $34 million on capital expenditures.

From a debt perspective, we ended the quarter with $2.7 billion in total debt, which includes the $100 million drawdown from our revolving credit facility. In terms of our net debt, when you take into consideration the $1 billion in cash and short-term investments, in addition to our finance receivables of $1 billion, our implied net debt position on an operating company basis was approximately $650 million at the end of the quarter.

Turning to the P&L, starting with revenue performance by line item as compared to prior year.

Business services grew 27%, and rentals grew 2%. We had declines in financing of 7%, support services of 10%, supplies of 29%, and equipment sales of 32%.

Gross profit was $284 million, with a margin of 34%. This is a decline of 8 points from prior year, which largely reflects the shifting mix of our portfolio and impact of COVID.

SG&A was $133 million or 28% of revenue, which was down about $7 million from prior year and an improvement of over 2.5 points as a percent of revenue. This improvement from prior year is a result of actions we have taken around lowering discretionary spend.

R&D expense was $7 million or 1 percent of revenue, which was down $6 million from prior year.

EBIT was $48 million, and EBIT margin was 6%. Compared to prior year, EBIT declined $31 million, and the EBIT margin declined by 4 points, driven primarily by the gross profit decline, which was partly offset by lower SG&A and R&D spend.

Interest expense, including financing interest expense, was $38 million, which was down slightly from prior year.

The provision for taxes on adjusted earnings was about $4 million, and our tax rate for the quarter was 36%.

Weighted average shares outstanding at the end of the quarter were 172 million, which is about 6 million shares lower than prior year, reflecting the share repurchases completed in 2019.

Let me now discuss the performance of each of our business segments this quarter and what we are seeing through July.

In our Commerce Services group, revenue was $517 million, which was growth of 26% over prior year. EBIT was a loss of $6 million and EBITDA was a positive $19 million.

Within Global Ecommerce, revenue was $398 million, which was growth of 41% over prior year. We are experiencing a dramatic shift in the market to e-commerce, which fueled our overall revenue growth this quarter. We signed over 100 new clients in the quarter, including some sizable clients and competitive wins, which is testimony to our value proposition and evidence of our position as a key player in this market. We are diversifying our client base, making it less reliant on certain volume clients. It's also important to point out that most of these new client volumes are not yet in our second quarter results. In addition, market disruptions internationally have created opportunities to expand our U.S. inbound solutions ahead of the new UPU regulation that went into effect on July 1, and we are seeing some volumes migrate to our platform during the second quarter as a result. We expect this to be a go-forward opportunity.

We processed 62 million parcels, a record number in our domestic parcel services, nearly doubling what we did last year and 80% more than that of the first quarter. We saw a continuous ramp-up in volumes for the second quarter, driven by our delivery services.

Our domestic revenue grew 36% over prior year, led by strong growth in our digital shipping API volumes.

Our cross-border revenues declined 6% from prior year, but the trend through the quarter improved. This decline was expected given continued restrictions on international flights, in addition to the impact of a large cross-border logistics client who suspended shipments mid-March, but has since started to ship again with us towards the end of the quarter.

Overall, global e-commerce revenue accelerated through the quarter from 12% growth in April to 67% growth in June.

To date, in July, we are seeing similar trends from the second quarter across the e-commerce business. We entered the third quarter with pent-up demand for some of the new clients as well as some backlog from the second quarter. Typically, this business experiences a step down in the third quarter from the second quarter due to seasonality. And given the current environment, we expect that paradigm to change this year with the third quarter being in line with second quarter levels on the notion that people are traveling less, working remote and continuing with online buying habits.

Looking at EBIT, we recorded a loss of $19 million in the quarter and EBITDA was a loss of $1.6 million, both of which a $10 million improvement from the first quarter despite the impact of COVID.

The second quarter EBIT margin of minus 4.7% was an improvement both sequentially from the first quarter and over prior year, reflecting scale-related benefits in transportation and warehouse cost per parcel, which improved 31% and 45%, respectively, from the first quarter.

The second quarter demonstrates that with scale, the model works. We got leverage out of our warehousing and transportation cost per unit. This was partly offset by higher COVID-driven labor and postal due to the unexpected demand.

Compounding this, we increased our labor force by 80% in 90 days. Labor and postal costs are opportunities where we can improve our performance over time, both through productivity and as demand becomes more predictable.

As expected, we also saw higher direct expenses related to sanitization and safety procedures and higher bad debt expense, all of which are due to the impact of COVID. We are estimating that approximately half of the EBIT loss this quarter is attributed directly to incremental costs related to COVID, of which most of these will continue during this pandemic.

I'm pleased to report that we did not have to shut down any of our facilities during the quarter due to COVID.

The investments we've made over the last few years in our technology, our network and especially the 2 new flagship facilities on each coast at the end of last year have been instrumental in allowing us to handle the volumes we are seeing.

We've always said there are 2 pieces to getting margins to our long-term targets. #1 is scale and #2 is operational efficiency. The accelerated shift to e-commerce has grown volume certainly faster than we anticipated. Especially as it relates to our domestic delivery services, which today is at a lower margin than the overall e-commerce margins. However, we still need to continue to invest in automation and operational efficiencies in order to better take advantage of this growth. As demonstrated with our investments in our new flagship facilities, it is important to invest ahead of the growth opportunity, and we will continue to do so as long as we see that opportunity.

As a result, in the second half of this year, we will be adding 3 additional facilities and expanding 1 other. These new facilities will be smaller in size as compared to the flagship ones we added last year. This will increase our footprint to better meet the growing client volumes and improve service levels to consumers in those metro markets.

Looking at Presort services, revenue was $118 million, which was a decline of 8% from prior year. Our Presort business saw a significant impact on volumes from COVID during the second quarter, but better than the market.

First-class mail volumes, which comprise about 80% of the volumes processed in this business declined 5%. Marketing mail volumes declined 22% from prior year.

We have talked about the investments we are making to process marketing mail flat and bound printed matter in order to expand this business to build a new revenue and profit stream. In the second quarter, our marketing mail flats and bound printed matter volumes grew 36% over the prior year and contributed to an overall increase in our revenue per piece.

Overall, for Presort, the lower average daily volumes were relatively consistent through the quarter.

In July, we are seeing an uptick in average daily volumes as compared to the second quarter. First-class volumes are declining similar to the second quarter in the low single-digit range. And although we are seeing some improvement in marketing mail volumes, those volumes continued to decline double digits. Marketing mail flats and bound printed matter volumes continued to grow in the high double-digit range.

We would expect our Presort mail volume trends to improve from current levels over time as the U.S. returns back to more normal behaviors and a more stable environment. But naturally, this is contingent upon the depth and duration of COVID.

EBIT was $13 million, and EBIT margin was 11%. EBITDA was $20 million, and EBITDA margin was 17%. While down from the prior year, margins were flat to the first quarter despite significantly lower volumes and revenue. EBIT and EBITDA include a portion of the insurance proceeds we received this quarter as it relates to the malware attack late last year, which was offset by the impact of COVID.

Through productivity initiatives put in place and synergies with our e-commerce network, we are seeing improvements in our transportation cost per unit. We are seeing higher COVID driven costs related to sanitizing and safety procedures, which is impacting labor costs.

We remain focused on productivity initiatives and investing in automation in this business. Compared to prior year, we improved pieces fed through our equipment per hour, resulting in 100,000 less processing hours.

We continue to look for opportunities to expand our network. At the second quarter, we closed on a small acquisition in the Dallas-Fort Worth region, which was less than $10 million. This is expected to bring in over 230 million additional mail pieces into our network on an annualized basis and expand our reach in the competitive region.

Turning to our SendTech segment. Revenue was $321 million, which was a decline of 15% from prior year. As we discussed last quarter, we saw the greatest impact on in-period revenues related to equipment sales, which were down 32% as we saw longer sales cycle times in the quarter as well as an elongated install scheduling due to COVID.

As businesses reopened, we saw the equipment sales trend improved through the quarter, from down over 50% in April to down just under 20% in June.

Supplies declined 29% as they relate to demand and usage, which has been impacted by COVID. Similar to the equipment sales trend, the decline in supplies improved from down 30% in April to down about 12% in June.

Based on the backlog and expected shipments in the third quarter, which are a leading indicator for equipment sales, we expect sequential improvement on equipment sales in the third quarter, but still a double-digit decline from prior year, similar to what we saw in June, driven by a tough prior year comparison.

In the second quarter, financing and support services revenues, declined driven by the lower portfolio and decline in client activity.

We've discussed in the past our investments for long-term potential across all of our businesses. Within SendTech, we've invested to diversify our business model and have evolved from purely a hardware-based mailing model to a cloud-enabled shipping and mailing solutions model with analytical capabilities.

Our investments are in 3 primary areas: new product technology, channel capabilities and developing a new revenue and profit stream around shipping. These investments are starting to pay off.

In new product technology, we launched our new SendPro Mail Station, a first of a kind device with a meter in the cloud capability. With investments in digital and web capabilities, we shipped over 5,000 units in the quarter since launching in April, exceeding our expectations.

We have invested in our channel, especially in building our digital channel capabilities, including direct web sales. In North America, 65% of our supplies transactions are now through the web.

Within SendTech shipping, we've invested in digital capabilities, leveraging the APIs from global e-commerce and adding important features like multi-carrier capabilities.

Shipping revenues grew over prior year. Overall, SendTech shipping revenue was about $30 million. Within this, we have built out an innovative online SendPro shipping service. And in the second quarter, the number of paid subscribers grew nearly 40% over prior year. We have also invested in our multi-carrier shipping financing, which is getting good traction, more than doubling the shipping label volume throughput from prior year.

Through these investments, we now have an end-to-end solution for our clients to transact with us both through our physical devices and/or in an online manner, which is a key differentiator for us.

Our business model of shipping and mailing underpinned by financing is manifesting itself in our enhanced capabilities while adding new revenue and profit streams.

During these times, customer preferences for consumption models have accelerated. We are well prepared to meet these changing preferences during this market shift through the channel and digital-based investments we have made, which will also help accelerate the SendTech transformation.

Despite the decline in SendTech's revenue, the EBIT margin remained solid and within our long-term model range. EBIT was $104 million and EBIT margin was 32.5%. EBITDA was $113 million, and EBITDA margin was 35%.

We monitor delinquency rates on a daily basis, and not unexpectedly, saw a slight uptick in the second quarter with greater than 30-day delinquency increasing from first quarter results.

To date in July, early stage delinquency in our leasing portfolio has improved from what we saw earlier in the second quarter, which is an important indicator for future potential write-offs.

Within our postage lending portfolio, we are seeing a nominal increase in early-stage delinquency, largely tied to the resurgence of

COVID in certain areas of the U.S. Although as businesses have reopened, we are seeing more customers pay their bills on-time and in-full versus making minimum payments, which is another promising sign. Despite some signs of progress, we remain vigilant and focused on managing risk in our portfolio.

Before we take your questions, let me recap.

The current environment has created a dramatic shift to e-commerce, and this quarter had a number of notable items. For the first time, our shipping revenues outpaced those associated with mailing.

We exited the second quarter with just over $1 billion in cash and short-term investments. Our next bond maturity is not until October 2021 and is manageable amount of $172 million.

We continue to take actions within our capital and cost structure across the business to maintain adequate liquidity in the event the external environment worsens.

While we continue to reduce discretionary spend, we will continue to invest a portion back into the business around keeping our employees safe through social distancing, providing PPE where needed, and sanitizing equipment and our facilities on a regular basis. This has an impact on our labor productivity, but we will not compromise when it comes to keeping our employees safe.

While historically, our third quarter revenue is typically lower than the second quarter, based on the trends we saw in June and so far through July, and despite the uncertainty in the macro environment, we expect modest improvement in the third quarter as compared to the second. This is being driven by the continued demand in e-commerce, along with some improvement in our mailing-related businesses.

As a result of the revenue improvement, we would expect EPS to also modestly improve from the second quarter, despite additional COVID-related costs, which we expect to continue to impact our results.

And while we are cautiously optimistic about improving trends in the second half of the year versus our first half, there is still a great deal of uncertainty, particularly in the U.S. around the resurgence of COVID. We are seeing states already start to take actions on modifying the original phasing and reopening plans.

Given the continued level of uncertainty around COVID and consistent with the direction we provided last quarter, our annual guidance for 2020 will remain suspended.

With that, we will now take your questions. Operator, please open the line.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Our first question comes from Ananda Baruah with Loop Capital.

**Ananda Prosad Baruah** ***Loop Capital Markets LLC, Research Division - MD***

And I appreciate all that detail. That's really helpful, given all the business cross currents. I guess a few, if I could. Marc, I believe, way back in the prepared remarks with regards to e-commerce, you made a -- a comment was made around achieving scale sooner than anticipated. Did I hear that accurately? And if so, could you give us some context around it? And sort of get it that you're adding the 3 new facilities. But could you kind of walk us through, given that you were essentially breakeven this quarter in e-commerce or darn close to it, how we should think about kind of e-commerce margins going through the rest of this year? And then I have a couple of follow-ups as well.

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

Sure. I did say that. So you heard it correctly. First of all, I apologize. The recording on this side was a little bit -- the line on this side was a little bit fuzzy. So if you didn't hear things, please feel free to clarify. So there's no doubt that in the second quarter, and we certainly saw it in our results, but you've seen it in UPS' results and you see it in USPS volumes, FedEx volumes, that there was a stair-step increase in e-commerce shipping.

So if you kind of think about what the market was pre-COVID, think about a 10% to 15% linear increase. We obviously saw something 3 or 4x that in the second quarter. So that stair-step increase will allow us to get to scale sooner. The unknown is how much of that stair-step increase sticks. So if you look at the volumes in the second quarter and you assume that's the new the new reality, you kind of come to one set of conclusions. If you assume some of that volume is going to stick, but some of it is going to dissipate, then that's another scenario. In either case, our projections are that, that business gets to scale sooner.

In terms of your second question about margins, I'll let Stan elaborate. But our expectation is we continue to see margins improve as we go through the balance of the year. I'd reiterate something that Stan said because it's really hard to underestimate the impact. 80% of the workforce in that business was new. And there's just a certain learning curve as you come up the experience curve in terms of how you work your way around those facilities. So if for no other reason, just the team hitting their stride, we'll get more efficient. But clearly, scale continues to be an important dynamics. I'll let Stan elaborate.

---

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

Let me give a little bit more color, Ananda. The 3 new facilities, they are smaller facilities, so think 100,000 square feet plus or minus, and they're needed to kind of fill spots in our network that we need to optimize. And when you think about that from a CapEx point of view, more like $5 million to $10 million and from an OpEx, maybe about $5 million or so, a little bit less than $5 million for the rest of the year. So we're adding capacity to better serve our clients. Let me spend just a minute on the margin, and Marc hit a couple of the important points.

So the Q2 volume would put us roughly on a $250 million annualized run rate. But there are 2 components to driving improved EBIT margins: scale and then operational efficiency.

So let's start with scale. We've invested ahead of demand with the 2 new flagship sites we opened in Q4. That strategy actually enabled us to handle this dramatic surge in volumes, and volumes doubled on a year-on-year basis. But we are seeing the benefits of scale, and we're seeing it in 2 areas. Transportation costs improved by roughly 1/3 and then fixed warehouse costs improved by over 45%. Where we're not seeing it yet is in labor. And in labor, this really manifests itself in our workforce, as Marc mentioned, growing 80% in 90 days. You can't do that efficiently. And this came largely through temp labor, but adding multiple shifts across the network. And so when we're doing that, you combine that with the COVID impacted spend on the global e-commerce business, which was roughly $10 million or roughly just over half of the impact on EBIT, and you can see that headwind that we have.

I think there's good news within that, though. We are going to get better at the operational efficiency, in particular, around labor, and then adding these new facilities will allow us to better operate on a end-to-end basis. So we've been investing for operational efficiency, which is the second part. So investing in the network and this accelerated growth to e-commerce is certainly faster than we anticipated, but gives us a great opportunity to leverage operational efficiencies. We're in the middle of doing time and motion studies, as an example, and that will improve our ability to operate that labor in a more efficient manner.

And then the addition of those facilities will certainly help us. And Nick Smith and his team, I think, deserve a big knot of the hat for being able to handle that surge in volume and that compressed of a time frame. I mean, typically, we start planning for peak in first quarter, and this all hit in a very sudden fashion.

---

**Ananda Prosad Baruah** ***Loop Capital Markets LLC, Research Division - MD***

That's all very helpful. Just a quick follow-on to that, and then I'll leave the floor. You guys mentioned new customer wins new market opportunities. Is there is share gain, a fair way to think about it? I'm just trying to -- and if not, just sort of any context there? Because what I'm really trying to paint a picture for is regardless of sort of how sort of volumes ebb and flow given COVID, do you think you sort of gained some stickier customer opportunities and relationships, so that you sort of exit this just from a stronger position than you went into a structurally stronger position?

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

I'd say, we gained share. I'd say, we gained customers. I think the important part of those 100 new customers, I mentioned, was they contributed very little incremental revenue to the quarter. So that revenue is still in front of us. So we'll see over the next coming days, but I don't have any doubt that if you look at the as I said, if you look at kind of our peers in the industry, they're talking about volumes that are consistent with peak, we were well above peak. So I think by any measure, we'll have gained share, and I think it's structural to your point.

**Operator**

Our next question comes from Shannon Cross with Cross Research.

**Shannon Siemsen Cross** ***Cross Research LLC - Co-Founder, Principal & Analyst***

The first is in terms of e-commerce, it sounds like, obviously, you've signed a lot of new customers in that. I'm curious are these -- like how is the negotiations going in terms of pricing and scale, and as e-commerce became more of an important way of getting products to people during the pandemic? Do you have pricing power I just -- I'm wondering if anything has shifted there? And then I have a follow-up.

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

So Shannon, on pricing and then negotiations. So this has been an interesting time for us going through this. So we've added over 100 new clients. Their primary mission was getting product to consumers, and that's where we have stepped in and stepped up. So we have done some limited price targeting in areas that help balance out the network and areas that we're experiencing increased costs. But this is also going to come through scale. So as we bring additional efficiency, it allows us to modify our pricing through directing to coast, for example, on inbound from overseas, but we do see some pricing leverage in the market. And we expect with the volumes that, that will continue on going forward.

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

I'd just add a little more color. I mean, so if you look at the industry, our colleagues in industry are taking price up. We've done a little bit of that in the quarter, but I think there's another opportunity in front of us to think about that. The negotiations with customers are different in the sense that there's only a certain amount of capacity in the industry, and the industry is at that capacity. So it does provide pricing opportunity. The other thing that's perhaps not as obvious is once your business gets to scale, the marginal economics of another 5 million parcels isn't the same as when you're below scale. So it makes you think about incremental volume in a slightly different way and gives you a little bit more courage, if you will, to think about pricing.

**Shannon Siemsen Cross** ***Cross Research LLC - Co-Founder, Principal & Analyst***

And I guess, how much of the -- do you have any idea -- well, I'm sure you do. But when the crossover to where we'll really start to see the improvement in margin could come? And I know that with the pandemic and that you're not giving guidance, but I mean, is this a couple of quarters away, just in terms of the volumes that you expect? Is this more -- you're going to have to spend more in that, so it's maybe further out. Just if you can give us an idea of how quickly you think you can start to benefit from some of the scale?

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

Shannon. So obviously, it's an important question that we've stared out a lot. And we have a number of scenarios that we have modeled out. But this is a pretty unpredictable environment. So what we've looked at is we've demonstrated that improvement in scale in transport and warehouse. We're confident that we'll continue to make inroads on the labor side, but that's going to take some time. A little bit of unpredictability is in the -- in overall COVID impacts. And we see it across the U.S. in different areas seeing spikes up, and we can see that flow through some of our numbers.

What I would tell you, is that as we go through the back half of the year, we expect that this business will continue to make progress on a quarter-on-quarter basis. But we're not going to predict the inflection point of when it cuts over. But you should expect that we'll continue to see benefits. I mean we're encouraged by where we are now. And we're encouraged by what we see in the month of July from the volume continuing.

---

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

I just think about -- I mean, just in raw numbers of we're at 150 million looking at STan, parcels kind of on an annual basis before this, we're 250 million now. The original plan called for kind of layering in capital and automation slightly before you saw those increased volumes. So now you got to make a judgment about how much of that volume sticks, and that will dictate the pacing and the sequencing of the capital and the automation. So if it all sticks, then we'll move more quickly in terms of building the incremental capability to handle that officially.

Right now, we're throwing people at it, which is good, and we're able to accommodate the client requests as best we can, but it's not the most efficient.

---

**Shannon Siemsen Cross** ***Cross Research LLC - Co-Founder, Principal & Analyst***

That was helpful. And then, Marc, can you talk a little bit -- you had a leadership change during the quarter or actually, I guess, after the quarter, just with Greg taking over global e-commerce, do you anticipate any changes? Or -- I mean, obviously, you sort of had to jump in with a lot of volume running through the system. So if you can maybe address that a little bit.

---

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

Yes. So important to understand the structure that we had. So as you mentioned, Lila Snyder, who was a great colleague and we miss her and wish her well, left within the last 30 days. She was responsible for global e-commerce and presort. Within Global Ecommerce, Greg ran most of it didn't run the operations. Nick Smith does that. So from that perspective, it's less of a change than it seems. Greg was involved along with Nick and James Fairweather and Lila in the strategy. He was certainly on point for all the client relationships. He was the Chief Commercial Officer, who is responsible for the revenue. So it's perhaps less of a change than meets the eye. So it's a pretty collaborative fluid team. They operated as a foursome. So it's -- we won't miss a beat.

---

**Operator**

Our next question comes from Anthony Lebiedzinski with Sidoti & Company.

---

**Anthony Chester Lebiedzinski** ***Sidoti & Company, LLC - Senior Equity Research Analyst***

Yes. So so just looking at the global e commerce segment, just digging into that a little bit more. So obviously, the fourth quarter tends to be the highest in terms of -- because of holiday shopping season and so on. So I guess, with the new facilities that you're opening or will be opening up soon, can you give us a sense as to -- as far as what the potential will be for improved scale and as far as efficiencies? And I also had a follow-up to that as well.

---

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

Sure, Anthony. Thank you. So as you mentioned, fourth quarter is typically the peak. And as I said earlier, we typically start planning peak right after we finish the last one. And so Q2, was a hit in a very sudden level of volume coming through. We would not have been able to handle that. Had we not invested ahead last year, in particular with the 2 new flagship facilities. Even with that, we are now running essentially 24 hours a day with downtime to do maintenance and temperature checks and things like that across most of our facilities. So adding these 3 new facilities and expanding one other is going to enable us to be more efficient, have a better spread of labor and parcels across our network, better serve our clients, and importantly, as we head into peak, and we expect that these will be up late in the third quarter. But as we head into peak, that will enable us to handle those volumes. We expect that with that additional scale, both the volume and the ability to handle it through the network, that's what gives us confidence that the margin will improve from Q2 to Q3 and from Q3 to Q4. And that's why we've made those investments. We're also investing in things -- I mentioned the time and motion studies, but we're investing in operational efficiencies. Some of that's automation, but a lot of it is improving our processes and taking the best practices across our facilities and leveraging that to improve our overall efficiency. And I'm confident that our team is going to be able to take the experience from Q2 and be able to leverage that.

And as Marc mentioned, when you bring on that much workforce in that shorter period of time, just the learning curve alone is challenging. So we anticipate and are confident that we'll be able to see improving margins as we go through the back of the year.

**Anthony Chester Lebiedzinski** ***Sidoti & Company, LLC - Senior Equity Research Analyst***

Okay. And then when would you expect to complete the time and motion studies?

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

They're ongoing, Anthony. And look, we come out productivity in a number of ways. So we're looking at our cost modeling, our pricing and this business has grown very rapidly. We're adding lots of new clients, lots of new capabilities, but the time and motion studies are always insightful. Because we are standing up new facilities, we're standardizing our footprint of how we want to operate, that gives Nick Smith and our operational team a lot more information on how to streamline the flow of parcels. And we've made a number of changes already that have resulted in our existing facilities to handle far more capacity than they did last year. So those will be ongoing, but they will certainly help us heading into peak.

**Anthony Chester Lebiedzinski** ***Sidoti & Company, LLC - Senior Equity Research Analyst***

Got it. Okay. And then in terms of improved truck routing capabilities, where are you with that initiative now?

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

So we can -- I mean, this is a good example of our transport costs improved by over 1/3. Some of that is just pure scale. You're filling up the trucks more. And then it's also the ability to look at that network and how you do your routing. I would tell you, though, that we spent a lot of time and money reroute parcels in order to meet our clients' needs during the quarter. So even though we improved our transport per parcel by roughly 1/3, I think there's more opportunity there because we had to balance in between our facilities. In particular, the 2 coasts got hit particularly hard from China inbound volume that would come in big surges, and we would use -- we would offload to other facilities to try to balance out the network. That's why adding 3 new facilities is so important. But we also expect that, that will improve our transport costs going forward.

**Anthony Chester Lebiedzinski** ***Sidoti & Company, LLC - Senior Equity Research Analyst***

Got it. Okay. And then last question for me. As far as the incremental COVID costs for the third quarter, do you think those will be comparable to the second quarter?

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

Anthony, it's really hard to predict that. We know there'll be an impact. I mean the pandemic isn't going away. What I would tell you, though, is our preparedness continues to improve. If you think back to where we were in March, most companies, including us, we're getting PPE almost at any cost. So some of that has gotten better. We've also gotten better at handling how do we do temperature check? How do we do staggered shifts? How do we do cleaning in between shifts and maintain our facilities so our employees stay safe? So I expect COVID will still have an impact going into the third quarter. We don't know if that's going to increase or decrease. We said, look, part of that was bad debt and the retail industry is a tough industry. And so some of that could continue to manifest itself. That's why adding new clients is so important. It diversifies our base. And gives us additional protection. But the team did a really nice job on collections through the end of June. And then candidly, collections through July. They're developing strong relationships with the clients. And as you saw that manifests itself in an improved DSO.

**Operator**

Our next question comes from Allen Klee with National Securities Corp.

**Allen Robert Klee** ***National Securities Corporation, Research Division - Research Analyst***

Two financial questions and then 1 follow-up. The financial questions are, could you clarify on your income statement, you have a -- an other income of $17.4 million of what that is? And then for your free cash flow for the quarter, the number was extremely high. I mean, if you annualize it, it's over 100% free cash flow yield. So can you go into kind of what's like normalized in that? Or what were the things that affected that?

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

Sure, Allen. So let's start with the other income. As we said in our prepared remarks, we sold an investment, which is not in our operational results, but it is in our GAAP results. And that investment generated about $12 million gain. And that treatment is consistent with how we've treated others in the past. So again, not in our operational results, but it is in our cash balance, obviously, and then our GAAP results. This was a sale of a 50% joint venture that we had. And so that closes out our participation in that. Again, about $12 million was the gain.

And then if you go to free cash flow, your second question, free cash flow this quarter at $148 million, obviously, was a very big number. Let me break that down. I'd start with -- if you recall, in first quarter, we did not have a strong free cash flow. So -- but if you look at the first half at $101 million, that's up roughly $70 million year-to-year.

Let me start with the second quarter. So for the second quarter, there's a number of drivers. The biggest one was accounts payable and accrued liabilities, that's up about $120 million. And if you peel that back, accounts payable is up about $25 million; customer deposits, up about $35 million; GEC volume, which drives more payables, et cetera, was up about $25 million; and then taxes payable. Those are the big drivers, and they're very operational. The other big driver was a runoff in finance receivables, that was worth about $75 million. Now that's not how we want to generate free cash flow, but it represents kind of where we are. If you think about how this works as finance receivables roll off the balance sheet. Typically, we're re-adding new equipment sales. And with equipment sales down 32% in the quarter, we obviously added less. Compounding that is the installs. So not being able to get into client, not being able to get client activity and get in and install equipment, our backlog went up about $7 million. So I expect, as we go forward, that we'll still have some finance receivable runoff, but that number will mitigate as we are able to do more equipment sales. We saw that improve through the second quarter and as we're able to do installs. Now offsetting that was obviously an increase in AR of about $45 million. So if I take that -- that was on Q2, if I take that to the first half, obviously, net income is down, and that's a driver. But working capital was better. And if you look at that, I rattled off a number of the items, but a lot of these are operational. Accounts payable is better for the first half by $25 million, taxes payable by $25 million and advanced billings by $20 million. And so yes, finance receivables, we expect will mitigate. And I would not draw, obviously, a line off of Q2, but we're pleased with the free cash flow. The team did a great job on collections, it puts us in a good position for liquidity for the rest of the year. We're in compliance with our debt covenants. And when you combine that with a total $1 billion of cash and short-term investments, leaves us in a good position for the second half.

**Allen Robert Klee** ***National Securities Corporation, Research Division - Research Analyst***

My last question is more strategic, and it relates to potentially splitting the company up. I normally won't ask something like this on a public call, but it just seems so compelling and obvious in the current environment where if you look at pure-play e-commerce companies and even ones that are unprofitable, I mean, I can think of Overstock and Wayfair and a bunch of other examples. If you took the multiples that those type of stocks trade at and apply that to your e-commerce business, you could get a market cap or more than the whole market cap of your company today. And the market is just not paying you for for your e-commerce business, and you could create tremendous shareholder value if the company was split up. So the question is, is this something that you guys would consider?

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

So let me take a shot at not answering that question. So the first thing I would say is what we've said before, on a regular basis, the Board of Directors works at all alternative. That's something that's been true since I've been here, and it will continue to be true. The dynamic that you mentioned is obviously one that we've noticed as well, and we study. What I would say is what we've said all along is if an asset is worth more to a different set of owners than it is to our owners, then that would be something that we would contemplate. The second thing I said and it's certainly true with software as well as when we sold a Imagitas, timing is not an unimportant aspect of that. So we understand the dynamics well. It's something the Board works out on a regular basis. I'd reiterate what I said. If it's in the right -- if it's right for the shareholders, then that's something we do, but timing is not unimportant in terms of how we think about that.

**Operator**

And our next question comes from Kartik Mehta with Northcoast Research.

**Basel Kanaah** ***Northcoast Research Partners, LLC - Research Analyst***

This is Basel for Kartik. I just want to ask a general view question. Based on the trend that you have seen in e-commerce, do you expect this similar trend to continue into 2021?

---

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

Yes. I mean listen -- I mean -- so if you look at -- I mean, just look at it from a buyer behavior perspective, I mean, the amount of global e-commerce as a percent of retail went up 10 points, I mean, from like 16% or 17% to 27%. Does it stay at 27%? I don't know. But it's clearly going to be a hell a lot more than 16%. So I think that trend is clear that -- and you look at from the other side, the number of bricks-and-mortar stores are going down, partially because some retailers are going away. But also, for those retailers that are sticking around, they're changing their routes. So I do think the trends will go forward. The question is kind of not -- to me, do the trends continues at what level does the trend continue.

---

**Basel Kanaah** ***Northcoast Research Partners, LLC - Research Analyst***

Okay. Great. And my second question as the Feds continue to maintain interest rate at such a low level, are you guys looking to refinance even further more portions of the debt that are due in 2021?

---

**Stanley J. Sutula** ***Pitney Bowes Inc. - Executive VP & CFO***

So when we look at the debt, I mean, obviously, we've done a ton of work on this. If you go back to the end of last year with the sale of our software business, a new revolving credit facility, a new term loan A, a new term loan B and then using those proceeds to do a waterfall tender, which reduced our towers. We are always looking at the opportunities in the market at all different solutions. Obviously, our next bond maturity is the $172 million in October of 2021, and we will deal with that opportunistically if that presents itself. But we are confident in our ability to refinance that. So we're constantly evaluating the market on what the art of the possible is to make sure we put our money at the best use. So right now, if that presents itself, we'll take advantage of it.

---

**Operator**

Mr. Lautenbach, would you like to make any additional remarks?

---

**Marc B. Lautenbach** ***Pitney Bowes Inc. - President, CEO & Director***

I would. Thank you, operator. First of all, let me just comment on the changes in leadership at USPS. We welcome to the industry Louis DeJoy, who is long-term industry veteran, and we look forward to working with him. At the same time, we wish Megan Brennan, the previous Postmaster General well. Likewise, Carol Tomé inherits the CEO role at UPS. I've known Carol for a long time. She's a great executive and wish her well. And likewise, David Abney, CEO, previous CEO, a great executive and a solid industry [talent].

So let me close with this. When you look at Pitney Bowes from a wider lens, you see a company with over $3 billion of revenue growing mid-single digits in the middle of a pandemic. GDP results will come out today, but we're faring quite well. We've transformed our portfolio and the preponderance of our business is now on shipping. And I think it's worth noting for 100 years, mailing has been the majority of our business in the second quarter, those 2 lines crossed and shipping going forward will continue to be a bigger and bigger portion of the business. We didn't get a lot of questions on SendTech today. I will say if you look at the SendTech results underneath what they are able to do, they were great. And as you think about the transformation of the company, the transformation of SendTech is instrumental to that, and we hope to talk more about that in the coming days. We've done the hard work around our balance sheet. And to stand the last point, we got $1 billion in the bank. So we're in a strong position from liquidity. Our debt is manageable. We've got good cash flow. Let me be emphatic about the following point. We're going to come out of this situation in a much better and stronger company. And that's going to be structural. It's not for reasons they're fleeting. The global e-commerce business is our own version of a unicorn to the question. It is a business that is well over $1 billion, closer to $1.5 billion, and it grew 40% in the second quarter, and it's going to continue to grow at an accelerated rate for the foreseeable future. Within that, and this is something, again, we kind of mentioned in passing. We have built 3 businesses from $0 to $100 million. That's hard to do in any context, and that team has done it 3 times over. We're well positioned in the e-commerce business. You can see it in results, and that's going to continue. You see it in client reaction. And the path to profitability has many different factors to it, but largely now the path to profitability for that business isn't exclusively, but it's largely inside of our 4 walls. We control our destiny. Investments we made in SendTech and Presort are paying off. You see it in new revenue and new profit streams. These are largely around shipping again, which is very synergistic. And again, there is an overall coherence to our portfolio going forward. And we're continuing to make the investments we need in a long-term success. We're a 100-year-old company. And it's -- in many ways, you see that in terms of the values we have and many other positive things. But in the end, to me, it feels like a start-up. You can see it over and over in how this business is reinventing itself. So listen, unpredictable times for sure. We like how things worked out for us in the second quarter, but no one's taking a victory lap. What's going on in this country and around the world with the virus is terrible. And we're mindful of all of those who've been affected by what's going on. So with that, we'll close this call. We thank you for your interest, and we'll talk in the coming days.

**Operator**

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