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Conduent, Inc. (CNDT)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Conduent Third Quarter 2020 Earnings Results Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to Alan Katz, Investor Relations. Please go ahead.

Alan Katz

Vice President-Investor Relations, Conduent, Inc.

Good evening, ladies and gentlemen, and welcome to Conduent's third quarter 2020 earnings call. Joining me on today's call is Cliff Skelton, Conduent's CEO; and Brian Walsh, Conduent's CFO. Following our prepared remarks, we will take your questions. This call is also being webcast. A copy of the slides used during this call was filed with the SEC this afternoon. Those slides, as well as the detailed financial metrics sheet, are available for download on the Investor Relations section of the Conduent website. We will also post a transcript later this week.

During this call, Conduent executives may make comments that contain certain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995 that, by their nature, address matters that are in the future and are uncertain. These statements reflect management's current beliefs, assumption, and expectations as of today, November 5, 2020 and are subject to a number of factors that may cause actual results to differ materially from those statements. Information concerning these factors is included in Conduent's Annual Report on Form 10-K filed with the SEC. We do not intend to update these forward-looking statements as a result of new information or future events or developments except as required by law.

The information presented today includes non-GAAP financial measures. Because these measures are not calculated in accordance with US GAAP, they should be viewed in addition to and not as a substitute for the company's reported results prepared in accordance with GAAP. For more information regarding definitions of our

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non-GAAP measures and how we use them as well as limitations as to their usefulness for comparative purposes, please see our press release, which was issued this afternoon and was furnished to the SEC on Form 8-K.

With that, I will turn the call over to Cliff for his prepared remarks. Cliff?

Cliff Skelton

Chief Executive Officer & Director, Conduent, Inc.

Thanks, Alan. Good afternoon, everyone, and welcome to Conduents' Q3 earnings call. I really appreciate everybody joining today. I've been the CEO here since August of 2019, and I don't think I need to really remind anyone the amount of change we've all experienced. And, of course, Conduent is no exception to that change. Given that I'd be remiss if I didn't again say thank you to our over 60,000 dedicated associates, most of whom continue to work from home and take care of our clients. You know, in a services business, nothing works without a dedicated team, so I'm very grateful to our team.

Regarding the quarter, it was a strong one. We have numbers to report today that exceeded both our internal and/or external expectations, again, due to the hard work by our associates. As I've said previously, the secret sauce at this point in our company's evolution is really in the foundation centering on the fundamentals. We saw some solid fundamental performance, and we'll take you through some of that in just a moment.

Now, slide 4 just gives you a bit of narrative feedback from our clients and our associates. So, let me quickly go over the agenda before we dive into the details. First, I'll go through the high-level financials for the quarter, and, as always, we'll discuss our sales results. In both cases we were fortunate to have exceeded our previous internal and external expectations. I'll also go through some of the improvements we're seeing from our operations and our delivery teams as well as give you a fly-by of the organization and process model changes we've made here in 2020. I'll then turn it over to Brian to run through some of the more detailed financials and our outlook for the remainder of the year, and, of course, questions at the end as always.

So, let's turn to slide 5 and we'll get started. The third quarter was definitely strong. Revenue and adjusted EBITDA both came in higher than expectations with revenue of over $1 billion at $1.041 billion and EBITDA at $141 million. Brian will go deeper, but let's go over a couple of the highlights. Our Government business performed well in Q3, primarily driven by COVID-19 upside in the payments business and increased subsidy enrollment and eligibility activities. Our Transportation businesses continue to see a more muted impact from COVID-19 than we previously anticipated. In fact, in some states volumes, believe it or not, were pretty close to pre-COVID volumes. In our Commercial activities, COVID continues to create some downward pressure, as anticipated, especially in our claims processing offerings and associated mailroom scanning activities.

Regarding EBITDA we saw even stronger performance with improved margins primarily due to some overachievement in our cost and efficiency efforts and our mix of the revenue. We now see ourselves exceeding $140 million in savings, which was the top end of the range we described to you on the last call. Also and importantly, the government payments revenue, which ramped up with government subsidy efforts is coming in at higher margin due to relatively low incremental expense. Both of these tailwinds are resulting in expanded margins and improved EBITDA. We think that some of this margin expansion may be temporary or at least tied to the duration of the increased subsidy volumes in our Government business.

With respect to sales, we felt like Q3 was also strong, certainly on a year-over-year basis, as we saw twice as much new business in Q3 2020 as we did in the same quarter last year. I'll go through more details on the next slide. [ph] But we (00:06:02) believe we will meet or beat our full-year quota for 2020, which, as you may

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remember, is 160% of last year's actual new business sales TCV. Also, our [ph] IT journey (00:06:15) is also ongoing and remains important. We continue to see progress from our client's point of view, and our metrics show that 2020 is much improved. My sense is that the incremental improvement will always be needed as the environment is and always will be constantly changing. But to-date we feel really good about our progress.

Now, while 75% of our associates are still working from home, we have been able to meet the vast majority of client expectations despite the remote working conditions. While we do have a return-to-work plan, it will remain quite flexible based on geography, pandemic conditions, et cetera. So, in terms of our office footprint, we don't ever really see ourselves getting exactly back to pre-COVID models. But, at the same time, we likely won't stay where we are either.

So, the good news is that given all that our employee base seems to remain motivated and optimistic as evidenced by our most recent survey. Associate satisfaction will always remain critical to our future success, and we're going to stay focused on that as we are today.

So, let's turn to slide 6 and we'll discuss in a more detailed way our strong sales quarter. We signed $468 million in new business signings, double last year signings as I previously mentioned. Annual recurring revenue signings were also up 35% year-over-year. Overall, year-to-date, our new business signings are around 180% of what we signed in the exact same first three quarters of last year. So, let me give you a few examples of the types of deals we signed in Q3.

In our Commercial business, we signed a learning contract with a very large global aircraft and defense manufacturer where we will be running [ph] NDN management of (00:08:05) learning providers. In our Government business, we signed a deal with the Kansas Department of Health and Environment to provide Medicaid in children's healthcare eligibility processing and some support to some long-term care programs. And finally, we expanded our services with the City of Memphis in our Transportation space beyond the Curbside Management and Public Safety Solutions we already have in place. And we're keen to continue to expand these important relationships, so we can continue to drive add-on revenue wherever we can.

As we've discussed in the past growth is always simple to describe and difficult to achieve. It not only requires sales, but it's heavily dependent upon retention and overcoming the lost contracts of the past that have a runoff, too. We clearly think there are leading indicators for growth. Certainly one is client retention where we see renewals up compared to 2019. Now, volume shifts are also always important because in some of our contracts volume swings can come back and forth depending on the performance. In our case, discretionary volume this year is holding its own.

And finally, as mentioned, new sales, and add-on TCV, and annual recurring revenue are on track this year. All three metrics are leading bellwether indications for the future. But while we can't yet predict when the overall shift to growth will take place, primarily due to the continued uncertainty of COVID, all of the components are in place and have moved in a positive direction. The rest of the story is really about time and consistency. So, attach whatever analogy or metaphor to our growth story that suits you, but to use my own, it's clear to me that our ship is turning.

Let's now turn to slide 7 for an update on how we continue to drive change throughout the company. As always, our strategy remains focused on growth, efficiency, and quality. We use these pillars as guideposts for our continuous improvement plan, and we've already started making progress on several fronts. So, a couple of key bullets here.

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We're standardizing the processes and the governance around client implementations and contract ramp. We are strictly governing account management now and incident responses. We'll measure specific commitments from and to clients post sale to ensure revenue ramp is more predictable. We've also added several new leaders to the senior leadership team in operations, customer experience management, government services and payments, and in healthcare. And we've added new leaders in technology, finance, and human resources.

Now, these are proven leaders in the marketplace who have come to Conduent because they believe in the dream. They believe in the promise of the future, and they're already adding value. But our talent focus goes beyond the senior leadership team. We're also driving change to the corporate culture. We're encouraging teamwork, openness and improved communication, all of which seems to be driving improvement to associate engagement. And speaking of our associate engagement, we had a significant improvement in participation and we showed marked improvement in nearly every category. So, things are different and they continue to improve. And I believe our clients are feeling it as well.

We're also focused on efficiency as you would expect. We're leveraging the new shared service model to drive process improvement and cost containment. We're heavily focused on improved associate recruitment and development, where cost can be really high, and we're seeing improvement in associate retention.

As mentioned from a cost perspective in 2020, we now expect to overachieve the high end of the $120 million to $140 million range we gave in the Q2 earnings call. And we're expecting the bulk of these savings to be permanent and bleed into 2021, as you would expect. Regarding technology, our data center modernization efforts continue to go well. Our newly opened IT command center is adding value, especially in the way of improved performance levels.

But the bottom line, before I turn it over to Brian, is we have more work to do across these three pillars of growth, efficiency and quality. While it was a great quarter, I'll say again that more important than one or two or even three quarters is consistency. Our mission here is to do what we say we're going to do minimally and over time, Conduent will become a growth company. We see that path to stabilizing revenue, then showing growth. And I'm confident that what we've been able to do in this most challenging year shows that we're going to get there.

But this is a marathon, it's not a sprint. This growth plan requires that we first must stop the slide from the past. It's not a light switch recovery. This is a rheostat recovery, and it will migrate into 2021, for sure. That all said, these are exciting and unique times, and I look forward to continuing this journey with you and certainly with the team. So, now I'd like to turn it over to Brian for a detailed look at our financials and I'd like to thank you very much for your time today. Brian?

Brian Webb-Walsh

Chief Financial Officer, Conduent, Inc.

Thanks, Cliff, and thanks everyone for joining. As we've done in the past. We're reporting both GAAP and non-GAAP numbers. The reconciliations are in our filings and in the appendix of the presentation. I will start on slide 9 to review the segmented and consolidated estimated impact of COVID-19 on revenue for the quarter and year-to-date.

On the total company, COVID-19 had approximately a $3 million positive impact on revenue driven by higher COVID-related volumes in our Government segment, mostly offset by lower volumes in our Transportation and Commercial segments. Year-to-date, COVID-19 has had a negative impact on revenue of $46 million, leading to a total decline of 6.7%. Excluding the COVID impact, we would have seen year-to-date revenue down approximately 5.3%, better than the 6% to 8% initial guidance range that we gave at the start of the year.

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Looking specifically at the segments. For the third quarter, the negative revenue impact of COVID-19 on the Commercial segment was approximately $48 million. This was driven by lower volumes within our business outsourcing solutions, commercial healthcare, and customer experience offerings, as well as the interest rate impact on our BenefitWallet business within our HR and learning business.

Q3 revenue in the Government segment benefited from COVID-19 by an estimated $68 million. The continued strong activity in our Government business was primarily driven by increased volumes in SNAP and Pandemic SNAP programs, and high volumes in our Unemployment Insurance prepaid card offerings. Revenue was also impacted by a month of the federal unemployment supplement in July and from FEMA-related funds as well as the spend related to excess funds from this program, which remained on the cards from prior months.

In Transportation, we saw tolling volumes continue to recover. However, volumes in the curbside management business remained under pressure and we saw some negative impact to transit. All in, this resulted in a $17 million negative revenue impact to this segment.

Let's move on to slide 10 to discuss the Q3 2020 P&L. As Cliff discussed, we had another strong quarter with results coming in above both internal and external expectations. Revenue for the quarter was down 5.2% compared with our third quarter results last year or 5.4% in constant currency. These results were better than expected primarily driven by COVID-19-related volumes in the Government segment and a faster-than-expected recovery of our Transportation segment. From a year-over-year perspective, the decline was primarily driven by prior-year lost business, partially offset by new business ramp.

Adjusted EBITDA of $141 million showed 11% growth year-over-year. This represents an adjusted EBITDA margin of 13.5%, a 190-basis-point improvement compared with Q3 of the prior year. This was driven primarily by our cost program, which includes both temporary and permanent savings, and the mix of revenue given the higher volumes in our Government business.

Restructuring spend for the quarter was $20 million driven by our cost and expense reduction program, data center migration, and transformation program. We now anticipate restructuring for the year to be approximately $65 million, slightly higher than the $60 million target we discussed on the last call.

Let's turn to slide 11 to go over the segment results. As discussed last quarter, we have allocated a significant amount of our previously unallocated expenses to the segments. These newly allocated costs include certain IT expenses, corporate support and compensation items. We have the details of this change in our metrics file.

In the third quarter, our Commercial business revenue declined 10.4%, primarily driven by COVID-19-related declines and prior year lost business. Adjusted EBITDA was down 36%, while adjusted EBITDA margin of 10.8% was down 430 basis points year-over-year. The adjusted EBITDA decline was primarily driven by COVID-19 and a non-recurring client item. And these impacts were partially offset by our cost actions.

Our Government business grew by 9.1% for the quarter. This was primarily driven by an increase in COVID-related volumes and the ramp of new business partially offset by the loss of the California Medicaid contract. I want to remind you that at the beginning of the year, we had anticipated that the California Medicaid contract would have a 3-percentage-point negative impact to total company year-over-year topline decline. As stated on the last call, this is now expected to be closer to a 2-percentage-point impact in 2020, as we continue to benefit from transition work this year. We have approximately $35 million in transition revenue associated with this contract that will negatively impact the first three quarters of 2021 on a year-over-year basis.

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Government adjusted EBITDA increased by 66%, while adjusted EBITDA margins of 36.8% increased by 13 percentage points. As I discussed earlier, the margin improvement was due to higher volumes from COVID-19-related work and our cost savings program.

Our Transportation segment revenue declined by 12.9% compared to the third quarter last year. This was primarily driven by COVID-19-related pressure as well as the tough compare for the transit business, which benefited from high equipment installations in Q3 2019. Adjusted EBITDA was up 3% compared with Q3 2020, driven by the cost savings program. Adjusted EBITDA margin for the quarter was 20%, up 310 basis points year-over-year.

As I mentioned, we have allocated a significant portion of our unallocated costs into the segments to provide greater visibility into the profitability of each segment. In the third quarter, our unallocated costs were $78 million, higher than in Q3 2019. The increase was driven by a onetime COVID-related item and bringing back our annual employee bonus, which we did not pay in 2019. This was partially offset by our cost reduction efforts. I'll note that bringing back the annual bonus also impacted the segments.

Let's now turn to slide 12 to discuss the strength of our balance sheet and cash flow. Our balance sheet continued to be healthy with $496 million of cash at the end of the third quarter. Our net leverage ratio came down slightly from last quarter and was 2.4 turns in line with our target of 2 to 2.5 turns.

We continue to have a solid liquidity position. In addition to our cash on hand, our revolver had approximately $592 million of capacity available at the end of the quarter. As we show on the debt maturity table, our first major debt maturity isn't until the end of 2022 and we will opportunistically look to refinance all or a portion of our debt over the course of the next 12 months.

Operating cash flow for the quarter was an inflow of $107 million and adjusted free cash flow was $72 million, a $99 million improvement over the same quarter last year. This is driven primarily by working capital timing and a payroll tax deferral related to the CARES Act. CapEx was $35 million for the quarter or 3.4% of revenue. We still expect to spend approximately $140 million in CapEx in 2020.

Let's move to slide 13 to discuss our outlook for how we will end the year. We anticipate that revenue will decline between 6.4% and 7.4%, which would be approximately $4.1 billion to $4.15 billion for the year. We expect to achieve an adjusted EBITDA margin of between 11.25% and 11.75%. We have also provided an outlook on cash conversion from adjusted EBITDA for the year. We expect to convert approximately 20% of full-year adjusted EBITDA to adjusted free cash flow. This would be at the high end of the range that we provided at the beginning of the year.

These guidance ranges do not include any impact that could result from a federal stimulus package and assumes continued recovery in certain businesses such as our tolling operations. Obviously, given the current environment, these assumptions could change. Regardless, I want to note that the midpoint of our revenue guidance range is in line with the initial outlook we gave on the Q4 2019 earnings call in February, prior to any contemplation of a meaningful COVID impact. Also, our adjusted EBITDA range implies a higher outlook than the guidance we gave at that time.

Despite all the challenges that COVID-19 has brought, our business is showing tremendous resiliency. As Cliff mentioned, this is thanks to the hard work and dedication of our team. We are continuing to deliver for our clients

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and our transformation is on the right track. I want to thank our associates, shareholders and clients for their continued support.

We will now open up the lines for some questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] At this time, we will pause momentarily to assemble the roster. The first question today comes from Shannon Cross of Cross Research. Please go ahead.

Shannon Cross
Analyst, Cross Research Group

Q

Thank you very much. My first question is, can you talk about the strong signings that you've had this quarter and it seems like you're on track for that, and how we should think about how they'll roll through the P&L, both from a startup cost perspective as well as a revenue perspective? And maybe, if you can give us an idea of sort of the breadth and depth of where these contracts are coming from. And then I have a follow-up. Thank you.

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

Yeah. Sure. Well, Shannon, thank you. As you can tell, we doubled the new business signings on a quarter-over-quarter basis, though, the difference between Q2 and Q3 is we had a lot more singles and doubles in Q3 and we didn't have these – we had one large contract signed in Q3, but several signed in Q2. And so, what we saw in Q3 is the duration of the contracts are about a year less, about four – a little over four years versus a little over five years in Q2. And what we really want to see is that continued singles and doubles, because the home runs are somewhat episodic. And that's exactly what we found in Q3, we want to repeat that in Q4.

Now, as it relates to the ramp, obviously, the smaller ones ramp faster. A lot of times, those big contracts are in the public sector space and they have a longer ramp. The exact ramp speed and the revenue recognition is kind of all over the place. You got to look at it from many, many factors, as you know, Shannon, whether it's volume swings, ramp-off, ramp-up timing, add-on business, et cetera, et cetera. So, what I can say unequivocally is the ramp-off of business from 2020 to 2021 is much less than we had between 2019 and 2020.

That said, the whole – everything goes into a mixture and it contributes to this pivot to growth question that I think you're somewhat alluding to that COVID kind of confounds. So, bottom line is we're really happy with our retention rate. We're really happy with our sales and our ramp and our ramp discipline. We're starting to mute the downward slide from previously lost business. We're retaining more volume than we had in the past. And once we get COVID under control and understand exactly what the impacts are from COVID, which is very uncertain as you can imagine, we'll know exactly what that means for the growth rate in 2021.

Shannon Cross
Analyst, Cross Research Group

Q

Thank you. That's helpful. You mentioned a bit on the call that you're able to, with COVID, maybe rethink some processes and then, I mean, a number of our companies that we cover have said we had all these cost savings, but some of them are starting to go away because eventually, people will travel and do other things and go back

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to the office. Can you talk maybe a bit about how you think you can maybe fundamentally reshape how business is done and what it means for your company?

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

Yeah. It's a great question. So, the way we look at – in the cost saves for 2020, about a third of them are temporary. So, to your point, as people get back on the road, the travel and all the other things that come with running a business, where 75% of your people aren't working from home, those cost saves are temporary and will start to ramp back up as COVID becomes less significant and we get back in the office.

Just a couple components there. We're never going to probably get back to the same exact place we were pre-COVID. We'll have more work from home, but we're not going to have 75% of us working from home, number one. And so, the other two-thirds of the cost savings are permanent and those will migrate into 2021, as you would expect. But we're not done with these efficiency plays. Most of the cost savings in those permanent plays we had were associated with maintaining operating leverage. As you can imagine with revenue coming down, we can't afford to keep the same variable cost up. So we took some spends and layers out. We changed some of the people models to take some of the cost savings out and those are certainly permanent.

Now, as we get into 2021, we need to migrate into a more shared service operations environment, where we can leverage process improvement, where we can leverage the scale of a shared service and get more marginal, incremental, slowly but surely cost savings, call it efficiency plays expense reductions as opposed to cost reduction. So, it wasn't necessarily COVID related [ph] because of that (00:27:12), it's just where we are in morphing the business to something that's not as siloed and something that's more shared so we can leverage scale. That's where the migration plan is going. Yeah. You bet.

Shannon Cross
Analyst, Cross Research Group

Q

Thanks.

Operator: The next question comes from Puneet Jain of JPMorgan. Please go ahead.

Puneet Jain
Analyst, JPMorgan Securities Inc.

Q

Hey. Thanks for taking my question. A very nice quarter. And it was great to see solid bookings, not just on year-on-year basis, but also relative to revenue base. But I wanted to ask about revenue attrition. You mentioned it's better than last year. But is it at a place where you like it to be? Like how should we think about like the overall attrition, whether it's pricing, whether it's contract loss as percentage of revenue right now, obviously excluding near-term COVID impact?

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

Yeah. So, Puneet, it's a great question and we think it was really unacceptable, the amount of attrition. Remember, attrition runoff in some of these large-scale businesses can take two and three years. [ph] Caymus (00:28:23) is a great example of that. And so, what we lost in 2019 was the accumulation of 2018 and 2019 running off in 2020. What I can tell you is that same runoff kind of framework is significantly lower between 2020 and 2021. But it's a churn. We're renewing business, sometimes there are price reductions. And the ramp from

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new business is a factor, the volume swings. In this business, volume can swing quite significantly within any given contract.

And so, what I would tell you is retention is better. It will never be good enough. Any lost contract, any lost revenue is not good for us in our mind. But it's significantly better retention rates than we had in the previous years between 2018 and 2019 as opposed to 2019 and 2020. So, all that is back, what I said to Shannon, those are all contributors to this equation we're trying to put together that we plan to brief you on in Q1, where we can look at this notion of a trailing 12-month revenue stream. So you can start to get a good view at recurring revenue and then we hope to have some estimates into forward-looking 12 months, so we can have more of a predictive revenue slope in the future.

Unfortunately – and all the things you just mentioned contribute to that. Unfortunately, COVID is throwing a significant wrench into it because it creates quite a bit of uncertainty in the assumptions we put into the equation. But there'll be a lot more to talk about in Q1 once we have more certainty from COVID unless we have this equation drawn out. But the bottom-line answer to your question is much improved. I don't want to commit to an exact amount, but let me just say retention is significantly improved on a year-over-year basis.

Puneet Jain
Analyst, JPMorgan Securities Inc.

Q

Got it. And then, your average contract duration was four years versus below three years last years. And all of second half last year, it was below three years. So, is four years then right level of contract duration and does it indicate lower pricing pressure as renewals come a little bit more [ph] far out (00:30:49)?

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

No. I don't think it's pricing relevant. I think – the sweet spot, we think, is around four years. Some of these big public sector contracts can be 10 years long. And so, that can skew your average and these are – remember, that number is an average number, it's not a median number. It's an average number. And so, that can be skewed pretty significantly. And because our sales efforts were not adequate in 2019 and a lot of the deals we were doing were really small, they were shorter in duration and therefore the tenure was around three years.

We think the sweet spot is about four years where we get a lot of these singles and doubles if they're hitting that three-year contract duration. And then you get some of the big ones that'll skew the average up a little bit. We want both. We want some of the big ones that have long contract tails and high TCV and reasonable ARR, but we want these three-year $30 million, $40 million, $50 million deals, too, because that's the bread and butter for the future.

Puneet Jain
Analyst, JPMorgan Securities Inc.

Q

Okay. Thank you.

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

You bet.

Operator: The next question comes from Mayank Tandon of Needham. Please go ahead.

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Kyle Peterson
Analyst, Needham & Co. LLC

Q

Hey. Good evening. This is actually Kyle Peterson on for Mayank. Thanks for taking our questions. So, I want to touch on the margins, came in really strong this quarter. I know that you guys said maybe like one-third of this kind of cost savings are probably more temporary in nature. But I think last quarter we kind of talked and you had mentioned that maybe like 10.5% to 11.5% would be kind of the right way to think about the EBITDA margin for the next year or so. I mean, is there anything, based on this quarter's performance, kind of implied EBITDA range in the outlook that kind of changes that calculus here over the next few quarters?

Brian Webb-Walsh
Chief Financial Officer, Conduent, Inc.

A

Yeah. Yeah. So, it's Brian. So, what I would say is that we did have strong margins in the quarter, and that was helped by the Government volumes when we have a higher Government mix that are higher margin, and we had good flow-through of our cost savings program. When we think about next year, we will continue to get flow through from the permanent savings, which are about two-thirds of the yield. Over $140 million of savings we're driving this year on permanent. And we think that's about $50 million of the benefit next year. But we also think if COVID starts to normalize, the mix advantage will reverse.

And so, based on those factors, it's really hard, as Cliff mentioned, with the COVID uncertainty to exactly get this right. But we think around 11% margin compared to 11.25% to 11.75% for this year, we'd probably be a little bit closer to an 11% margin, maybe a bit better next year.

Kyle Peterson
Analyst, Needham & Co. LLC

Q

Okay. That's good to know. And then I guess just a little bit on the Government business. Has there been any timing volatility that we need to keep in mind? I know with some of the federal supplement through the FEMA program, I know there was some kind of time drags and delays in getting people some of those extra funds. Should we expect any kind of spillover benefit into fourth quarter as people kind of spend these balances down or is that not going to be a factor in the upcoming quarter?

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

Yeah. Brian can fill in the gaps, but what I would say is there will be modest, very modest spillover. And your guess is as good as ours as to what might change in the subsidy equation at the federal level. As you may know, most of our business is at the state and local level. But these federal subsidies flow through the states. So, the jury is still out on what's going to happen, but there'll be some modest flow-through.

Brian, do you want to comment further?

Brian Webb-Walsh
Chief Financial Officer, Conduent, Inc.

A

Yeah. I would say that in Q3 we benefited from one month of the federal supplement, unemployment supplement, which happened in July, plus, as you mentioned, the FEMA funds. Those are expected to repeat in Q4. So, the positive impact from COVID in Q4 from Government is likely to be lower than Q3. We still see some benefit from SNAP, in pandemic SNAP, and from just higher unemployment, but it won't be as high. We actually expect the net impact from COVID to be negative. And then the only positive in that is the underlying business, excluding

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COVID, we expect a better trend going from Q3 to Q4. So, we expect the rate of revenue decline to improve in Q4 versus Q3 [ph] just normalizing for COVID (35:40).

Kyle Peterson
Analyst, Needham & Co. LLC

Q

All right. That's helpful. Thanks, guys. Nice quarter.

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

Thank you.

Operator: The next question comes from Brian Bergin of Cowen. Please go ahead.

Zack Ajzenman
Analyst, Cowen and Company

Q

Hi. Thanks. This is Zack Ajzenman in for Brian. A couple of questions around the sales force. How should we think about investments over the coming quarters? And also, can you talk about the sales team attribution to bookings in Q3, and are you seeing more broad-based contributions?

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

Yeah. So, Zack, the sales journey here is both from a new business global sales organization perspective as well as an account management add-on basis. Both of those are critical to our future and our success. Think about probably two-thirds of the TCV is coming from the GSO longer term kind of sales organization, global sales organization, and one-third from the account management and add-on. But the inverse is true when it comes to impact to revenue or same-year revenue where two-thirds of the impact to revenue is coming from those account managers in that add-on revenue and one-third of the impact to revenue, even though the ARR is higher, is coming from the global sales organization.

And so, what we've been doing, our journey has really been about leadership, about discipline, about oversight, about focused concentration on sales. We're going to finish the year [ph] worth (00:37:12) about 110 sales execs today, 109, 110. We expect to launch into 2021 with about 120 with constant sort of improvement across the sales force resident along the way and into the future. And so, we see some pretty consistent performance coming out of our sales force.

In the investment, if you're alluding to investment within sales as opposed to investments sort of at large, are really now we think between $120 million to $130 million is kind of the right mix given our portfolio. The new investments are going to be more around training, around training protocols, training software, training discipline, and consistency around account management and portfolio management.

So, it's a journey. It starts with talent. It moves to process, and within that processes is some of the software that I just discussed. But if that's the investment you're referring to, that's kind of what's next for us.

Zack Ajzenman
Analyst, Cowen and Company

Q

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Yeah, good context. Thanks. And just a follow-up, are clients starting to dictate the mix of remote services versus onsite delivery within new contracts or is it still too early to tell there?

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

This is a very interesting question and an interesting dynamic. When COVID first hit, it's a weird journey. When COVID first hit there was a lot of resistance to move from home – to move to home. And then all of a sudden everybody panicked and said why isn't there more at home. And now, as we start – we've created a return to work from work kind of plan. It won't be 75% from the office the way it was. Right now we're 25%. You can't run a print facility from your home. So, the 25% that we have working from offices are really required personnel that need to be there. That'll migrate to somewhere between where we are now and the 75% work from office.

One of the ingredients is what you allude to is what is a client expectation. In some cases, some of the federal – assuming some of the public sector contracts we have, they require that we be in a facility in their state or in their community. It's all part of the game that they have to play as a state leader and trying to get more business and more people to work in their state or the local community. So, in some cases, we're going to need to migrate back to offices. In some cases, the remote workforce is going to be [ph] more allowed. (00:39:50)

So, if I were to guess, I think it's somewhere in the middle. There's more tolerance than we had before. But, in some cases, there'll be contract requirements to be back in an office. And that's all work under way as we speak.

Zack Ajzenman
Analyst, Cowen and Company

Q

Got it. Thanks again.

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

A

You bet.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Cliff Skelton for any closing remarks.

Cliff Skelton
Chief Executive Officer & Director, Conduent, Inc.

Listen, thank you, everybody. These are obviously very different times, but I also would like to thank everyone for joining. I hope you and your family stay safe especially with a lot going on in the communities and I hope everyone has a great rest of the week. And again, really appreciate you joining us today.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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