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Conduent, Inc. (CNDT)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the Conduent First Quarter 2020 Earnings Call and Webcast.

All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

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

Alan Katz

Vice President-Investor Relations, Conduent, Inc.

Good evening, ladies and gentlemen, and welcome to Conduent's First 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 a 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, assumptions and expectations as of today, May 7, 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-

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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 US GAAP. For more information regarding definitions of our 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 now turn the call over to Cliff for his prepared remarks. Cliff?

Cliff Skelton

Chief Executive Officer & Director, Conduent, Inc.

Thank you, Alan. Good evening, everyone.

I hope you're all staying safe and healthy. These are difficult times. And before I start my prepared remarks on the quarter, I want to spend a minute acknowledging that throughout this coronavirus pandemic, the Conduent team has continued to provide critical and best-in-class services to our clients and their end users, while ensuring the health and safety of our greatest asset, our associates.

I'm very proud of the hard work, dedication and decisiveness of all of my teammates. They've had to jump into action over the last two months in a situation unlike anything we could have imagined. It's in times like these where leaders lead and pride in our company really shines. I'm grateful to be part of this team.

Today, I'll go through a business update, including the impact of the current environment, and Brian will cover the financials and our key sales metrics. We'll then take some questions.

Let's turn to slide 4 to review some of the key highlights of the quarter. Despite the impact from COVID, we started the year strong with Q1 revenue of $1.1 billion. This was down year-over-year excluding divestitures, but higher than our internal expectations. The strong performance was driven by increased volume, most prominently in our Government Services business, which helps to offset some of the COVID-related impacts. Q1 adjusted EBITDA was $96 million, down slightly more than expected, primarily driven by the loss of some higher-margin revenue due to COVID-19, additional costs associated with moving to a work-from-home model and timing related to expense-reduction efforts.

In terms of our sales performance, in Q1, we signed $324 million of new business. This is 44% more than we signed in Q1 2019 and a 55% quarter-over-quarter increase. We've seen strong traction in terms of new logos and new capabilities. Expansion with existing clients has been a bit slower, which we believe is due to the clients focusing on navigating the current business environment. Nevertheless, we started Q2 with strong signings as well. We expect to see continued progress on sales as the country opens back up, and we are well positioned given our strong pipeline. One-third of the way through the quarter, we achieved over 70% of our quarterly target.

I'd also like to highlight that our renewal rate for the quarter was 93%, back up to our targeted range. As mentioned in previous calls, client retention goes hand in glove with improved quality. We have seen significant declines in our technology incident rate and time to resolve has much improved. Client feedback on quality has been very positive. Therefore, we expect continued client retention improvement, which should positively impact the year.

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Let's move on to slide 5 to discuss some of the specifics on our responses to the COVID crisis. Our business continuity team started monitoring the virus in January and officially established a proactive plan very early on. We've been working to ensure the safety of our associates, while focusing on delivering critical functionality to our clients. Given the rapid deployment efforts, some of our clients have committed volumes to us that were previously serviced by our competitors.

In addition, we're supporting our associates with a number of specific initiatives, including making improvements to our policies to extend short-term disability, providing extra supplemental sick leave coverage and introducing a hardship leave policy. We've shifted approximately 75% of our workforce to work from home. This took a coordinated effort from our technology team and our site location leaders, while focusing on stringent safety and security precautions. Finally, for those essential on-site employees, we've added increased sanitation, checkerboard floor plans and staggered break times. We're staying connected through leadership e-mails, videos, employee appreciation campaigns and fireside chats. Employee feedback has been very positive along the way.

The focus now needs to be on a safe migration to a work-from-home versus work-from-Conduent model. While still in the planning stages, we believe there are near-term, as well as longer-term approaches to this new normal model and the savings associated with it. Contact tracing and modulating the migration will be required in order to protect our associates and prevent a resurgence of the disease. We plan to use our own Maven disease tracking tool that we sell to public health agencies as a tool to help facilitate our internal moves. Having said all that, there will be an obvious impact to our business from the current market conditions.

While no one can perfectly predict what's in the store for the future, I can give you an indication of where we expect to see puts and takes in the business over 2020 due to both business-as-usual conditions and the impacts of the current and post-COVID market conditions. Let's turn to slide 6 to discuss.

While the COVID impact in Q1 was confined to March, as Brian will discuss, we expect to see greater impact in Q2 and beyond. On the Commercial side, we're experiencing some volume pressure in our Transaction Processing and Customer Experience offerings, partially offset by new volume diverted our way due to our quick migration to work-from-home. Our HSA or BenefitWallet business will also be impacted by lower interest rate which falls straight through to the bottom line. However, this is largely offset from a cash perspective as we'll have lower cash interest expense for the year. Meanwhile, we believe our Commercial Healthcare businesses will remain somewhat constant on a year-over-year basis.

On the Government side, we're starting to see significant increases in several of the services that we provide to our government clients. Our payments activity for Supplemental Nutrition Assistance Program or SNAP, Women, Infant and Children or WIC, and especially unemployment benefits are showing significant volume increases. We're also seeing increased enrollment activity in government health benefits and support programs which we expect to continue.

In our Transportation businesses, it's a bit of a different dynamic. We anticipate continued declines in our tolling and parking volumes and expect delays in project delivery for some of our public safety and transit work. Volume decreases in some of these businesses are often partially offset by portions of the business that have fixed pricing such as in our public safety business.

I mentioned some of the work we do for our government clients. This is a differentiating factor for us and could help to offset volume declines in other parts of the business in a challenging economic environment. Let's spend a few minutes digging into the important work that we do for our clients and their end users on slide 7.

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Our Government Services business provides critical services to citizens throughout the country. In 2019 alone, we disbursed more than $80 billion to citizens for federal and state and local government support programs. Across all of our government programs, we support over 34 states in delivering electronic payments. We manage over 100 prepaid debit card programs, 39 Electronic Benefit Transfer programs for SNAP and WIC and 7 Electronic Child Care programs. This activity tends to increase in times of lower economic activity and we are seeing the benefits from a few of these offerings.

The first I would call out is SNAP or Supplemental Nutrition Assistance Program. We're seeing an increase in the number of cards being issued. We're also working with our clients to expand support for families that may not qualify for SNAP but may qualify for other programs. We also provide prepaid unemployment cards on behalf of 11 states for which, of course, we're seeing significant upswing.

In our eligibility businesses, we provide verification services to eight states. Most of the volumes we support are related to Medicaid eligibility, but roughly 25% are in support of other government programs such as SNAP. We're seeing volume increases in this area and expect this trend to continue for the foreseeable future. Regarding Medicaid claims, while our loss of the California Medicaid contract over a year ago is creating a year-over-year decline in revenue, we see a real growth opportunity in this business moving forward.

And before I close, let me spend a few minutes on our strategic plan and how we're implementing our transformation program. On our last call, we discussed that we continue to be opportunistic relative to divestitures for the right valuation. While the M&A market is in a wait-and-see mode right now, we remain sanguine regarding that possibility in the near future. Regardless of what happens on the divestiture front, we're implementing our plan to pivot our business and position the company to weather the current storm, grow, retain clients through improved quality and become more efficient.

In terms of investment, we had said on our last call that we would target investments in growth opportunities across the spectrum of optimize, enhance and expand businesses. While we do continue to see growth and margin opportunities, we expect to use our CapEx budget in a more modestly paced way to realize more near-term returns, while longer-term ROI-driven initiatives continue to be examined, especially given the learnings of the COVID-19 situation.

The current environment has provided an opportunity for us to look at our business in a different way, beginning with efficiency, cash preservation, revenue retention and foundational improvement. It's important to understand that we need to bring to bear new ways of running our business. This may require near-term efficiency plays such as working-from-home for client-facing associates or the automation of certain functions which may otherwise may have been years away from adoption. Now, they have become more near-term focal points allowing us to lower our cost of delivering services to our clients, while improving the performance.

We intend to minimize the impact of the crisis through aggressive expense management approaches such as furloughs, a reduction in force, vendor and lease contract revisions and project reductions. We intend to lead from the front, including salary reductions for our senior leadership team and even our Board of Directors. The net of it is that this crisis will have puts and takes, but we intend to minimize the damage and fare better than our competition.

From a longer-term point of view, we're not only looking at the continued efficiency and margin plays, but we are looking to use the current situation to also reengineer our operating model, reduce staff and unnecessary

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management layers and establish new ways to deliver not only improved operating leverage, but improved service levels for our clients. No matter what, our priorities remain growth, efficiency and quality.

What we are seeing is that while we must continue to invest especially where there is risk of falling behind the competition, with a more modest, cash-conscious approach, we can continue to see the current quality and stability situation get even better. Efficiency can and will improve through automation and operating model changes, and growth is on the horizon due to the post-COVID environmental changes, as well as upgrades to our people and processes.

We can see that the fundamentals of this business are turning. Our current pipeline, client feedback, sales execution and retention indicators give us an optimistic view toward the future. We believe our plan is taking hold.

Now, before I turn it over to Brian, I want to say that I'm more pleased than ever with the remarkable work our team has done to continue to provide critical services during this time of crisis. While no one would choose to have such a crisis to respond to, we see a silver lining with a blue bird here and there, and our intention is to execute our plan to take advantage of the opportunities where they surface and minimize the downside wherever possible. I can't think of a better team of associates to be on this journey with. Thank you.

Brian?

Brian Webb-Walsh

Chief Financial Officer, Conduent, Inc.

Thank you, Cliff.

These are unprecedented times and we are all proud of the teamwork and sense of urgency and commitment demonstrated by our team. I sincerely appreciate all of the hard work from our associates and partners that has allowed us to keep delivering on behalf of our clients.

Before I begin on the financials, I'll note that throughout this presentation and in the exhibits in the appendix, we'll provide both GAAP and adjusted numbers, which will provide a clean compare by removing the impact of the divestiture that we completed in Q1 of 2019.

Let's start on slide 10 with a review of the impact of COVID-19 on the business in Q1. Despite the slowdown in the economy throughout March, Q1 2020 revenue was above our internal expectations. However, adjusted EBITDA was below expectations. We estimate that the net impact to our top line from COVID-19 was approximately $14 million in Q1, all of which was in our Commercial and Transportation businesses.

In the Commercial segment, we saw declines in volumes in our Transaction Processing business and in retail, travel and tech clients in our Customer Experience business. We estimate that the net impact in our Government business was roughly neutral in Q1. While we started to see the impact of increases in our government programs for SNAP and unemployment, this was generally offset by declines in child support and other nonessential state program volumes. As Cliff mentioned, we're starting to see further volume increases in SNAP and unemployment, and we anticipate continuing to see this trend in a more challenging economic environment.

In our Transportation business, while some of our revenue is fixed pricing or account based, a significant portion of our tolling and curbside management business is volume based. These offerings have been impacted by stay-at-home orders and project delays which have continued into Q2. We would expect the Transportation business

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to decline significantly in Q2 given current trends. This business will likely start to improve once the country opens back up.

In terms of adjusted EBITDA, the revenue declines impacted profit. In particular, BenefitWallet and Transportation revenues were higher-margin drivers. We also had incremental spend in IT as a result of shifting quickly to a work-from-home model. And we incurred other expenses, including the increased cleaning of facilities for essential workers.

Now, let's move on to slide 11 with a more detailed overview of the first quarter financial results. Revenue for the quarter was approximately $1.1 billion, down 6% compared with our first quarter results last year. The decline for the quarter was primarily driven by client attrition and COVID-19-related impacts.

Adjusted EBITDA in the quarter decreased 21% year-over-year to $96 million with an adjusted EBITDA margin of 9.1%, a 180 basis point reduction. One-third of the decline is related to the COVID-19 impact. The remaining reduction was driven by declining revenue and the pressure that puts on the model, as well as some non-recurring impacts. In addition, I'll note that restructuring spend was $7 million in the quarter. We anticipate restructuring to increase as we implement additional cost actions throughout the year, and we now expect restructuring spend for the year to be approximately $60 million.

Let's move to slide 12 to discuss the segments. In the first quarter, our Commercial business revenue declined 6.5%, driven primarily by the runoff of lost business from prior years and COVID-19 impacts, including the BenefitWallet interest rate reduction. Adjusted EBITDA was down 17.3%, while adjusted EBITDA margin of 20.1% was down 260 basis points year-over-year. This was primarily driven by revenue pressure, the impacts of COVID-19 and a couple of non-recurring items.

Our Government business declined by 10.8% for the quarter, primarily driven by the loss of our California Medicaid contract and other lost business. Adjusted EBITDA increased by 11.2%, while adjusted EBITDA margins of 34.1% increased by 670 basis points. The margin improvement was due to runoff of the lower-margin California Medicaid contract and reduced IT costs.

Our Transportation segment revenue grew 2.7% compared to the first quarter last year. This was primarily driven by the ramp of new transit business, partially offset by volume declines related to COVID-19 and lost business from prior years. Adjusted EBITDA was up 14.3% as compared with Q1 2020 (sic) [Q1 2019] (00:18:54), driven by increased revenue and reduced IT spend. Adjusted EBITDA margin for the quarter was 16.9%, up 170 basis points year-over-year.

In the first quarter, unallocated shared IT and corporate costs were higher than Q1 2019, primarily as a result of a prior-year IT credit.

I'd now like to provide some updates on our key sales metrics for the quarter on slide 13. We saw continued growth in the size of our sales force in Q1 with sales head count at its highest level since Q2 2019. New business TCV signings for the quarter were $324 million, up 44% year-over-year, driven by new logos and new capabilities.

Given changes in our sales strategy, we have redefined the way we classify new business. Going forward, we'll report new business in two categories. First, new clients or signings of new capabilities to existing clients, which we will define as new logo/new capability signings. The second new business category is existing add-on signings or expansion of current offerings with existing clients.

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In Q1 2020, the company sold $282 million of new logo/new capability signings, representing 127% increase when compared to Q1 2019. New business wins for the quarter were driven by large wins in the Customer Experience, Transportation and Government businesses. The company signed $42 million of existing add-on signings in the quarter, representing a decline compared to Q1 2019. We are pleased with Q1 sales performance. As we discussed on our last call, we signed a large deal in the Customer Experience space with a client that we had previously worked with.

Signings in Q1 also included several other large deals, including an outbound sales deal in Europe, a print and mail deal in the healthcare space and a Government Healthcare deal, among others. As of the end of the quarter, our total new business pipeline was $21 billion, showing continued stabilization and ample opportunity for continued signings. As Cliff mentioned, total new business signings are off to a good start in Q2 with April coming in strong despite the current environment. We are seeing strong traction in both new logo/new capability and existing add-on signings.

Please turn to slide 14 to discuss the strength of our balance sheet and cash flow. Our balance sheet continues to be healthy with $413 million of cash at the end of the first quarter. Our net leverage ratio was 2.7 turns at the end of the quarter and our long-term target for net leverage remains 2 turns to 2.5 turns.

We continue to have a solid liquidity position. As we noted in our press release several weeks ago, as a precautionary measure, we borrowed $150 million from our revolving credit line. The funds were immediately deposited into interest-bearing accounts and had no impact to our net leverage position. I'll note that we made our final payment related to the Texas settlement litigation in January. The letters of credit associated with this payment were released in early April. Before the release of the letters of credit, our revolver had approximately $518 million of capacity available as of the end of the quarter.

Operating cash flow for the quarter was an outflow of $192 million, primarily driven by the final Texas litigation payment and working capital. Adjusted free cash flow, which excludes the payment related to Texas, was an outflow of $97 million in the quarter. This is largely flat year-over-year as lower operating cash flow was offset by lower CapEx. Overall, cash flow was as expected this quarter.

CapEx spend was $24 million for the quarter or 2.3% of revenue. CapEx came in lower than last year due to timing and lower investments as a result of reprioritization related to COVID-19. We now expect to spend approximately $140 million in CapEx in 2020.

Cash flow is uncertain to some extent because of COVID-19. However, we do want to mention that we will get a benefit from the CARES Act for deferring payroll taxes into 2021 and 2022, which will potentially offset some of the negative COVID cash impacts this year.

We withdrew formal guidance last month, given the uncertainty that COVID-19 brings. We aim to bring back guidance in a more normalized and stable environment. However, I will note a few things. We expect to see a fairly meaningful impact to our Transportation business while stay-at-home orders are in effect. We can also see lower volumes in some of our other businesses as well. Offsetting some of these headwinds, as Cliff discussed, our Government business is where we expect to see increased volumes. This won't entirely offset the negative COVID impact, but it should provide a partial offset.

Additionally, we are taking temporary cost actions to offset the COVID impact and are transforming the business via permanent actions that will strengthen the company as we come out of this crisis. Although we can't provide guidance today, we feel confident in our future.

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I'll note that we also have a modeling consideration slide that provides insight to some of the other drivers.

Before we move on to Q&A, I want to take a minute to again thank all of our associates for their continued hard work and our shareholders for their continued support. We are making significant progress during a challenging time, and we hope that everyone stays safe and remains healthy.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question comes from Puneet Jain of JPMorgan. Please go ahead.

Puneet Jain
Analyst, JPMorgan Securities LLC

Q

Hey. Thanks for taking my question and glad to hear your voice and that you're safe. So, it was nice to see improvement in new business signings in the quarter, specifically given that it was driven by new logos. Can you provide more color on type of work that you are seeing? Are these long-term contracts, or are these near-term projects driven by clients' need to respond to COVID-19?

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

A

Puneet, it's Cliff. Great to hear your voice as well. Yes, the Q1 signings were essentially all long-term contracts. We had a big call center contract, a transportation contract and a large Government Healthcare contract. And as Brian had mentioned, that represented some $280 million or so and then another, whatever, $42 million, $44 million in sort of expansion businesses. So, the majority of Q1 is dominated by long-term, five to seven-plus year kind of contracts, mostly in the government space, but not entirely in the government space. As I said, we had a commercial call center deal as well.

That shifted slightly in Q2 where we're starting to get more expansion business, but we still had another large deal that we signed in the Government Healthcare business, and we continue to see Q2 as pretty positive with respect to long-term opportunities.

Puneet Jain
Analyst, JPMorgan Securities LLC

Q

Got it.

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

A

Not COVID related, though, to be more direct. We did get some volume increases associated with COVID, as you would expect, but those are all retained within our current contract scenario where we expanded what we already had, things like SNAP and unemployment insurance cards.

Puneet Jain
Analyst, JPMorgan Securities LLC

Q

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Right. Right. And I know you talked about a relatively low impact of COVID on Q1 revenue, it was I think 1.5%, something.

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

A

Right. Right.

Puneet Jain
Analyst, JPMorgan Securities LLC

Q

But how should we think about impact on 2Q? Supply doesn't seem to be much of a headwind, but should we expect high demand impact in some of the areas in Transportation, BenefitWallet like you talked about? And are you seeing improved trends from end of March, early April to now?

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

A

That's a good question. So, the BenefitWallet impact is sort of a continuum based on interest rates, and that's not going to vary month-to-month until those rates start changing. The dominant irritant, if you will, or a downside for Q2 is really in Transportation. We think it's modulated somewhat with the increase in volume in the government space. We think based on roughly what consensus said before and you can sort of interpolate from what our previous guidance was, that it's about a 10% downward implication on revenue in Q2 compared to what we would have expected ordinarily and slightly worse than that on EBITDA just because a lot of the revenue reduction in Transportation has some fixed costs associated with it.

Puneet Jain
Analyst, JPMorgan Securities LLC

Q

Got it. Thank you.

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

A

You bet.

Operator: The next question is from Bryan Bergin of Cowen. Please go ahead.

Bryan C. Bergin
Analyst, Cowen and Company

Q

Hi, good evening. Thank you. I hope you're all doing well.

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

A

Hi, Bryan.

Bryan C. Bergin
Analyst, Cowen and Company

Q

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I wanted to ask here on the supply impacts, you quantified some of the costs in 1Q. How should we be thinking about the cost impacts in 2Q? And just so we're clear, what type of supply capacity are you currently at, considering you have remote work-from-home, but I assume some delivery centers still up as well?

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

Yeah. So, the sort of the complexion on the work-from-home, work-from-work, unable-to-work sort of percentages, right now, 75% of our workforce is working from home. Roughly 20% is working from work. As you know, we've got lots of business that you can't really do from home. We got printers and we've got scanning machines, and in some countries, you can't – it's really not – it's not a capability to be working from home. And then, we've got roughly 4-ish percent or so, a couple of thousand people that are just sitting at the ready, waiting to get back into a facility where they can work from work. And so, that's really the downside. It's about a 4% impact, a 4% to 5% impact on our workforce that can't meet the demand.

What we're finding is the supply attribute of the demand and supply situation is pretty strong. We're getting good feedback. In fact, our migration to work-from-home helped us to get some new business just due to the speed at which we got to working from home. So, we're pretty optimistic on the performance and we're seeing really very, very minor – really no SLA issues at all. Client feedback has been very strong. So, from a supply perspective, we're in pretty good shape.

In terms of the cost, I assume the second part of your question was, what are we doing on cost reduction. Is that right, Bryan?

Bryan C. Bergin Q
Analyst, Cowen and Company

Yeah. I'm just trying to frame how much it's going to cost you in the second – the impacts, right, that you're going to cost. And, I guess, you're going to have some net reduction against that. So, I'm just trying to frame how – from a margin standpoint, how we should be thinking about that?

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

So, we're doing everything we can to mitigate any of the EBITDA effects through around $100 million cost initiative. Now, about half of that is what we call temporary. It goes hand in glove with the volume decreases, specifically in the Transportation business. And that, of course, will come back as things modulate back to the new normal. The other half of it we consider to be long-term cost-reduction efforts that will stay through 2021. So, obviously, we want to impact the margin, the EBITDA impacts of Q1 and Q2. So, we want to continue with some permanent cost reductions as well, not just temporary cost reductions in the second half of the year, and it adds up to about $100 million.

Bryan C. Bergin Q
Analyst, Cowen and Company

Okay. That's helpful. And just as we think about the range of potential scenarios for 2Q on revenue, just want to confirm that the last answer you gave to Puneet, that was on – 10% on just the Transportation line, not the overall Street consensus.

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

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That was overall, but that wasn't the overall impact. In fact, it's larger than that. That's over and above what we would have already anticipated for Q2 that was – could have been interpolated from guidance, as well as consensus. It'll be higher than that on a year-over-year basis, obviously.

Bryan C. Bergin
Analyst, Cowen and Company

Q

Okay. Okay. Makes sense. To what extent do you think the tailwinds that you're experiencing in Government can offset some of those tougher areas?

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

A

Well, I mean, we built in the tailwinds – a modest portion of the tailwinds into that 10% answer. But, obviously, it depends on how long this lasts and how long unemployment lasts, how much more it ratchets up, et cetera. But we do see what could be in the neighborhood of $20 million to $40 million in revenue kind of plus up associated with the Government Services business over the course of the remainder of the year to offset any revenue degradation we get in the Transportation business.

Bryan C. Bergin
Analyst, Cowen and Company

Q

Okay. Thank you.

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

A

You bet.

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

Kyle Peterson
Analyst, Needham & Co. LLC

Q

Hey, good evening.

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

A

Hey, Mayank.

Kyle Peterson
Analyst, Needham & Co. LLC

Q

This is actually Kyle Peterson on for Mayank.

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

A

Okay. Hey, Kyle.

Kyle Peterson
Analyst, Needham & Co. LLC

Q

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Thanks for taking my questions. Just want to start a little on some of the new deal signings. It's, obviously, good to see the momentum flowing through. Just how should we think about some of these deals kind of going from pipeline to generating revenue particularly in this kind of virtual environment? Is this kind of a late this year type of time line, or is this more kind of looking into next year that helps the 2021 momentum? Just kind of want to see how these kind of parlay into revenue.

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

Yeah. It's a great question. And it varies, right? The answer is not perfect because it varies. If you look at some of the commercial call center business, that revenue prints pretty quick. I mean, the migration conversion time line, in fact, it's already happening in one of the sales we made in Q1. If you look at some of the activities in Government Healthcare, eligibility, claims processing where we're migrating from a different provider, there is conversion time, buildup time, some of those things. One of the contracts, for example, from Q2 is going to take probably five to six months before we'll start realizing that revenue.

So, it varies, Transportation, somewhat in the middle of those two. So, it's a blend across the board. These are all not backloaded, to answer your question, but they're also not all front loaded. So, we'll start seeing some of that revenue as early as Q2, and then some of that we won't start seeing until Q4.

Kyle Peterson Q
Analyst, Needham & Co. LLC

Okay. That's helpful. And then, I guess, just to follow up trying to get some clarity on the Transportation business since a lot of moving pieces there. I know you mentioned the 10% revenue headwind. Is that just on the Transportation business, or is that on the total piece of the pie, including some of the offsets from the increased Government volumes? Just want to make sure we're kind of thinking about that...

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

Yeah. Right. The Transportation headwind is going to be more than 10%. The 10% is a blended number which would include the – a modest amount of offsets from Government revenue. It'll be higher, and it's higher in a couple of key areas and it, obviously, depends, right? If this sort of staying off the road, staying out of the toll roads, staying off the subways kind of phenomenon lasts well into late summer, into the fall, the number starts to get a little worse. If we can start to see some modulation come back in June, which is what we're hoping and what we're starting to see, especially in some states where people are starting to get back on the road already, it's a little better scenario.

The two businesses – the biggest business that's feeling this is the tolling business, and then second, the parking business. Believe it or not, the enforcement business has been reasonably flat, less people on the road, but more people speeding, and then the transit business, somewhere in the middle. So, we'll see a good – we'll see more than 10% of revenue degradation in the [ph] transpo-alone (00:35:38) business through Q2 and we're modeling sort of the last half of Q2 of a recovery in the Transportation business.

Kyle Peterson Q
Analyst, Needham & Co. LLC

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Okay. And then, I guess, just to clarify, you're talking – that 10%, that's a sequential based on the 1Q number, correct?

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

A

Yeah. The 10% – it's a little misleading. It's going to be higher than 10% in terms of straight revenue reduction in the Transportation business. So, we included...

Kyle Peterson
Analyst, Needham & Co. LLC

Q

Yeah, yeah..

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

A

...and so, it's basically – to think about it is, we already were down 6% to 8% year-over-year in Q2 and this would be 10% on top of that.

Kyle Peterson
Analyst, Needham & Co. LLC

Q

Okay, awesome. That's helpful. Thank you.

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

A

You bet.

Operator: The next question is from Shannon Cross with Cross Research. Please go ahead.

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

A

Hey, Shannon.

Shannon Cross
Owner, Cross Research

Q

Thank you very much. Hi. So, my question is, you talked about the opportunity to reduce real estate over time, and it sounded like sort of rethink how you structure your workforce and where they're working. Maybe it's a bigger picture kind of question, but I'm wondering sort of what lessons you've learned in the last few weeks. And if you had any thoughts on, I don't know, what the workforce of the future might look like and how that could benefit margin. Thank you.

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

A

Yeah. It's a great question and it varies a little bit, whether it's onshore or offshore. So, specifically, onshore, it's – we've got 150-some sites and some of those are pretty small. Most of these sites are more than 50% working from home. And so, the way we're looking at this new model, Shannon, is a short-term, meaning 2020, and a longer-term game plan and three components to the short-term attribute. One is, where can we continue to work

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from home and shut down some sites and save some lease expense? And where are the easy ones, where they're 100% out, we have no contractual issues, it's an easy plug-and-play, shut-it-down, work-from-home.

Where do we need to migrate back into working from work, where we have some government contracts? In some cases, we have government contracts where the mandate is you have to have a site and it has to be in our state and you can't work from home. So, where are those? And when do we start moving those back into place safely, so that you can keep the right social distancing and the right other cleanliness protocols that we think we need to have. And so, you need to meter that slowly. And then, the third leg of that stool is contact tracing. How do we monitor the situation across all 150 sites and the other 70 or 80 sites offshore to make sure that we can manage this crisis and not see a resurgence and do something that we really shouldn't allow to have happened? That's all 2020.

I think during the remainder of the year, we're going to migrate or consider migrating to a more holistic, heavier work-from-home kind of environment where we can continue to save real estate dollars. We spend over $200 million a year in lease expense. We think there is at least a 20% improvement we can get there over the long haul and maybe more. But we want to – we've got to inventory every one of those sites, look at every contract, look at every client expectation and look at whether the work is degraded by working from home. Thus far, we're not seeing huge degradation in performance. So, we think there is a real opportunity here over the long haul into 2021.

Shannon Cross
Owner, Cross Research

Q

Thank you. That's helpful. And then internationally, can you talk a bit about what you're seeing in your sites in the Philippines and Jamaica? And that just in terms of, I don't know, employees' willingness to – again, I'm assuming that some of them are obviously working from home. But I'm curious, given some of the shutdowns in some of those regions, how it's impacted your business or if it's starting to turn back on.

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

A

Yeah. Yeah. So, it's on a gradient. So, on one end of the spectrum, you've got Guatemala and Mexico where we've got 4,000, 5,000 people, where between 95% and 98% of our associates are working from home and doing fine. In fact, we're migrating volume in that direction.

On the other end of the spectrum, you have Jamaica where they've got a lot of tough government rules, where it's not quite so easy. In that space, we've got a little bit less than 50% working from home, in the 46% range, about 11% in the office, working from work, and then the rest of them are just waiting. They can't. And so, what's happened there is – the reason we're okay there is some of the inputted volume are clients whose – the call volume is way down, and where we are getting the call volume there, we can migrate some of that over to Guatemala to cover it. So, that's the other end.

And then somewhere in the middle is the Philippines where we've got about 70% working from home, about 7% or so, less than 10% in the office because the transportation is so difficult from some of the outline areas in the Philippines to get into Manila and Cebu, it's a little harder. And so, we've got some 20-or-so percent in the Philippines that can't get in.

You add it all up and we've got roughly 3,000 or so of our associates that can't get in and they're waiting. No, they're not getting paid, but they're waiting to get to work, and we're starting to meter that slowly but surely. And

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then, of course, India is in the middle, but we don't have call centers in India. A lot of the work we have in India is scanning work and technology work. And right now, it's over 90% in a work-from-home environment.

Shannon Cross
Owner, Cross Research

Q

So, scanning can happen at work-from-home?

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

A

Scanning can happen at work-from-home. It's not – it's really more indexing and taking files in, recrafting the file and sending the file back out into claims world. It's not an OCR scanning. I'd say, I probably misspoke. It's not an OCR scanning machine. It's more of an indexing [ph] work in there (00:41:52).

Shannon Cross
Owner, Cross Research

Q

Okay. Great. Thank you so much.

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

A

You bet.

Operator: The next question comes from Ashwin Shirvaikar from Citi. Please go ahead.

Ashwin Vassant Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

Thank you. Hi, Cliff. Hi, Brian.

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

A

Hey, Ashwin.

Ashwin Vassant Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

Hey. Thanks for the presentation. I hope you and your families are staying safe.

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

A

[ph] Yours as well (00:42:13).

Ashwin Vassant Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

Yeah. Thank you. I guess, my first question is with regards to the contracts that you signed this quarter, prior quarter and the ramps associated with it. And ordinarily, some of these contracts might require a tougher ramp that involves sitting down with the client, things like that. Do you have anything like that that affects the pace of

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the ramp? Do you have – are you seeing any changes in the speed at which clients are ramping signed work, if you can comment on that?

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

A

Yeah. Interestingly, there is sort of two kind of avenues to your question on ramp. Prior experience on ramp in Q1, what we found – one of the reasons we were – we thought revenue was pretty positive compared to expectations, where we had much faster ramp with new signings in Q1 than we might have had otherwise and some of the ramp-down on previously lost business that we've already discussed with you is a much slower ramp-down. In fact, we hope we can drag that down, drag that along even further. So, it's funny, and it depends on the industry.

And so, again, on the new business we signed in Q1, we see really rapid ramp on call centers. We signed a very large deal in the call center space in Q1, and it's ramping very quickly. And then we signed a Government business, a pharmaceutical benefit business in the government space. That's a longer ramp.

And so, we're looking at our initiative planning process to optimize that ramp schedule to get that revenue – that impact revenue on the board as fast as possible and leveraging our relationships with our clients to sort of drag our feet in any previously lost business that doesn't have to be ramped down right away that we can sort of retain as long as possible due to solid performance.

Ashwin Vassant Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thank you for all that detail. The second question I had was with regards to cash flow. I know you don't have formal outlook out there. But if you could kind of walk through some of the puts and takes as you kind of look at the current revenue situation in broad terms, the cost actions you're taking and some of them might also have cash implications, but if you can talk about the ability to generate positive cash flow over the next [ph] three (00:45:12) quarters.

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

A

Go ahead, Brian.

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

A

Yeah. It's Brian. So, what I would say first is that our free cash flow was in line with expectations in quarter 1. And as we think about the rest of the year, it's hard to give guidance given all the dynamics and the COVID-19 issues. But, a couple of points. One, the CARES Act is going to provide about a $70 million benefit this year. $65 million of that is from deferring payroll taxes into 2021 and 2022, and about $5 million is a permanent cash tax benefit.

We also – in our modeling slide, we're taking down CapEx to $145 million, which will help. We're going to have $10 million of higher restructuring, we believe, but we'll also have lower cash interest. So, those things are on a net basis to help. And then, obviously, there's the EBITDA impact from COVID and how much of that we can offset versus not. And so, we'll have to, obviously, give you updates as we progress, but that's how we're looking at it right now. But we do get a pretty big benefit from some of those other items.

Ashwin Vassant Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

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Got it. Thank you very much.

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

A

Thank you, Ashwin.

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

Cliff Skelton

Chief Executive Officer & Director, Conduent, Inc.

Listen, thank you all for joining today. It's certainly been quite an interesting journey for all of us. I know you all are experiencing that. I hope everybody's family is safe.

Here at Conduent, we're very proud of our teammates and how hard everybody is working in these difficult times and taking care of their own families at the same time. We're very optimistic. We're seeing the right signs from the pipeline, from sales, from quality and from client impact. We just need to keep the pedal down. And we're looking forward to the new normal and getting there as soon as possible like everybody else.

So, I want to say to everybody, stay safe. Thank you for joining, and we look forward to seeing you on the next call. Thank you very much.

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

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