06-Aug-2020

# Conduent, Inc. (CNDT)

Q2 2020 Earnings Call

# CORPORATE PARTICIPANTS

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, and welcome to the Conduent Q2 2020 Earnings Conference Call and Webcast. 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 Mr. 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 second 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, assumption and expectations as of today, August 6, 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 financial 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 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 the second quarter earnings call here at Conduent. I appreciate everybody joining today. This is my fifth earnings call since becoming CEO about a year ago. A lot sure has changed, certainly here at Conduent, but of course on the world stage. I hope everyone remains safe, hope your families are doing well. Things are tough I understand and I appreciate everybody showing up today, so thank you.

I'd like to start off first by acknowledging all the Conduent associates who have helped us to make a lot of progress. COVID's been tough as I said and with the significance of it our team has really done a great job and I appreciate all of that. As you can see on slide 4, we had some great feedback from a lot of our associates and our clients and those are just some examples of some of those on our performance. The bottom line is the fundamentals of the company are improving. It's really due to the hard work of our team. And as you're going to see today, the early returns say that that hard work is starting to pay off and that's by both some of our new and our tenured associates, so really proud of those folks.

Let me quickly go over the agenda and I'll dive into the details later. We're going to discuss the high level financials for the quarter as always, we'll talk about our improved sales results, we'll certainly touch on both the negative and offsetting impacts of COVID and we'll go deep on Transportation and our Government businesses. After that I'll turn it over to Brian to run through a lot of the more detailed financials and our outlook for the third quarter. We're not going to give guidance for the year, but we are going to talk to you about what we expect in Q3. So we'll go through that. And then, we'll take questions at the end as always.

Now let's turn to slide 5, certainly with everything going on in the world, Q2 was a good quarter. I would say Q2 was actually a really good quarter, especially as you compare it to what we thought of internally and what external expectations were. Revenue and adjusted EBITDA, both came in higher. Revenue was just over $1 billion and adjusted EBITDA of $110 million. Now, as I said, Brian's going to go through the details, but I'll give a brief overview of what happened in the quarter and where we did well, where we outperformed, and then I'll certainly talk about the headwinds and the tailwinds associated with COVID.

So let me talk about revenue first. In our Transportation segment, where we were a little worried, especially in the towing business, where we're showing ourselves to be a little more resilient than we had previously anticipated. While the stay-at-home orders did lead to lower volumes, we're actually seeing traffic increasing, as you can imagine that those increases vary state by state and, in fact, some states are at 90% of pre-COVID volumes and some much lower than that.

Our Government business performed really well in Q2, especially our Government payment business. Clearly, that's due to unemployment and other subsidy volumes. So we've seen some real good volume there and we're looking forward to that continuing.

As it relates to EBITDA, our cost and our efficiency efforts are working and it helped to shore up our margins in Q2. Now back in Q1, we talked to you about a program where we were incrementally reducing $100 million of 2020 expenses. And the good news is we expect to significantly surpass that for the year. The other good news is 60% of those savings are permanent. So we see that effort which is exceeding $100 million and Brian's going to talk about that, it helped contribute to the jump-off point for 2021 which is a really good thing.

Regarding sales, it was a really strong quarter. I'll go through the details on the next slide, but I'll note that it was not only strong, but the strongest quarter of new business signings since we spun to become a separate public company. Now we're always going to be focused intently on operations. We continue to be focused on both operations and quality and we'll talk about that here in a minute. Our technology performance continued to improve compared with last year. Fewer incidents in aggregate and improved operational stability are really helping with client sat and retention, which is helping with our reputation.

Lastly, while we have a lot of associates working from home, 75% of them, we've started a very slow and measured approach to bring some of those folks back to offices where it makes sense. We got to be prudent. We'll continue to be prudent and based on specific COVID conditions in certain geographies we'll pace it. The good news is we can deliver as we are in a work from home environment, in most cases and generally speaking, we're maintaining those expected service levels with that large portion of our workforce still working from home.

So given the current global situation, all in all, I'm quite pleased with the quarter. But, to be clear, we need consistency. We need to do this every quarter and we need over time to show you that we can grow both top and bottom growth and this company has not grown since the spin. Our mission is to change that and we are changing it and it's way too early to make declarations, but I think, we think, Q2 is a good indication that with the right team and the right approach that mission of growth is achievable.

Now let's turn to slide 6, I want to talk about sales in a higher level of detail, which obviously is critical to that long-term growth expectation. As you know with respect to sales in this business, revenue ramp on new business signings can last a while; it can last a year or two. And so we've got to see these strong sales continue, because it's pivotal to both 2021 and 2022 growth. And add-on business, the good news is add-on business and retention contribute directly to near-term revenue achievement.

So, as I mentioned, we had the strongest new business TCV signings since the spin with $623 million of signings. That's 90% improvement year-over-year and 92% improvement over last quarter. Now, longer term deals drove some of that, some of that uptick, and we experienced some longer term deals another year in terms of the deal length. But the good news is we also experienced significant annual revenue increases due to these new signings. So we believe that if we keep that momentum going and continue to focus on retentions due to that improved quality program we talked about previously and some improved account management, it really does bode well for us in the future.

In the first half of 2020, we signed $947 million of new business. That's pretty strong. And that compares with $995 million all of 2019. So you might ask well, why is that? And my view is it's better process. It's a better sales and stronger sales team and stronger sales leadership. We've isolated the sales team and created a dedicated team and we've also created a more selective approach to when to bid and when not to bid, that helps us with better win rates. So we're feeling pretty sanguine on what we think we can do for the year.

Just to give you a little bit of color, we've included a couple examples of wins on the slide, including a new Commercial client where we signed a deal with a leading healthcare company providing managed care services.

The good news out of that is the deal leverages the HSP acquisition you might remember from 2019, that's validating that product in the marketplace.

We also signed a big Government deal with Michigan's Department of Health and Human Services where we're going to provide $1.3 billion in state child support benefits annually. So two big deals. And then finally in the Transportation business, we signed a new tolling contract where we're going to be running Ohio's automated tolling system and we're really looking forward to getting started on that project, it's a big one and we're proud of getting over the goal line on that one. But, as you know, it's not just about new business signings, we need to continue to see client retention and add-on metrics improve and we're seeing that. Our pipeline now is at $22 billion, so there's some improvement there. That provides some real runway. As always that client confidence is going to be critical to our success and quality goes hand in glove with that. And so we're continuing to focus on that to make sure we have better client confidence, better client reference-ability and we think with that we've got, again, as I said, a good runway ahead of us.

Now, Q3, we don't' know whether Q3 is going to replicate Q2. However, I can tell you that we will grow year-over-year in terms of sales growth in Q3. And importantly, we're committed to achieving that 160% 2019 sales performance this year that I talked to you about in earlier earnings calls. And we're halfway there for Q3 already, against quota. So that's good news. And as mentioned we're 60% of our way to our full year goal for the year. So, again, we're very sanguine on sales, but we got to keep the pedal down. And that's what we're doing.

With that, let's turn to slide 7 for an update on COVID. As you might recall on the Q1 call we discussed some impacts of COVID-19 on Q2. First, we said that there'd be significant contraction in our Transportation volumes as a result of stay-at-home orders. We also said that there'll be some impact to our Commercial business including the interest rate impact to BenefitWallet and we also said finally that there'd be an expansion of volumes in our Government Services work particularly the payments work, and we're experiencing all of what we said we would experience, but to varying degrees.

In that Transportation segment, despite the stay-at-home orders, revenues varied by product, it varied by volume changes, it varied by the nature of how we generate revenue. And so the reduction rates that we anticipated were somewhat muted and less significant than we anticipated.

The Commercial business on the other hand was under slightly more pressure than we thought in our initial expectations in the Q1 earnings call, that's due to lower Transaction Processing and Healthcare volumes. And then in that Transaction Processing space it's in the dental space, automotive, travel and even banking where the transaction volume is down generally speaking.

In Healthcare and workers comp, we're seeing lower bill review, mailroom and nurse triage activity due to employees working from home. All that's offset though the good news for us and it reflects the diversity of our portfolio in that Government Services segment that we talked about earlier, where volume was much stronger than anticipated, where there's far more government assistance volume than we modeled initially and talked to you about before. Unemployment insurance, for example, was significantly impacted by the $600 per month of federal payments by the CARES Act. And as you might know, we generate revenue by usage rates and transaction volume, which leads to increases in Q2 revenue as we saw in the results.

Regardless of the additional payments from the CARES Act, that Government Services business is also expected to perform well in Q3, so that's a good thing. So, lot going on in Washington as we know, but irrespective of that we're quite optimistic on that Government Services business. So that's a good thing.

Additionally in that area we might see higher usage of the SNAP cards in the fall as some of these schools are putting school lunch programs on cards through a program you might have heard of called Pandemic SNAP or P-SNAP where kids who normally get subsidized or free lunch at school and get food subsidies while the schools are closed. Obviously, that's a good thing and we'll see our business benefit from that. But as I mentioned it shows how the diversity of our offerings in turbulent markets really help and some of these offerings are actually countercyclical in terms of lower economic activity. So that's again all about diversity. So you might ask what about the rest of the year?

I don't have a crystal ball here. But let me give you some expectations based on what we're seeing. We think the Commercial volume pressure likely stays although we see it start to modulate backup in the second half of the year. We're working to take on additional client volume from competitors where they might not have been able to step it up. And as some of these clients look to outsource more work, which we're starting to see, we're there to catch that ball as they do it as they're trying to work on their own cost pressures.

In the Transportation segment it's really too early to tell. We're watching state by state based on COVID conditions. Your guess is as good as mine as to when things open up and the way things are going, it's going to be more of a state by state equation, as I mentioned earlier.

Back to that Government Services volume, we expect it to stay elevated. Just of note in the unemployment benefit space we sent out 1.4 million additional cards compared with the quarter prior for unemployment benefits. That shows the dramatic increase in claims that we've all been seeing. If you're watching news you're certainly seeing that and we're experiencing it in our business. And back to that SNAP and P-SNAP program, we saw a 25% increase in volume there. So we expect that to [indiscernible] (00:16:39) and even modulate up in the P-SNAP space.

On our last call we said we thought increased volumes from that Government business would lead to an incremental $20 million to $40 million in revenue. We definitely under-called it. We – no one knew the gravity or timelines of COVID. And so we now obviously expect that number to be higher. And, of course, it needs to be higher to offset some of the impacts to Transportation and Commercial. And because of those – some of that reduction in Transportation, Commercial that I previously talked about, we continue to work really hard on efficiency and cost endeavors. And so I want to talk a little bit about those cost savings updates on slide 8.

In view of COVID, our transformation efforts did focus on cost efforts and certainly that efficiency pillar that you heard me talk about previously is a big focal point for us and an increased focal point that allows us to maximize cash preservation which we're doing. As I mentioned, we expect to overachieve that $100 million target and though that target focuses on both temporary COVID-related expense reductions as well as more long-term expense reduction efforts, which will continue into next year, and Brian's going to talk about that some in his remarks.

So with respect to temporary actions related to COVID, we're focused on things like travel. We got furloughs. We got reduced spend for facilities. All those things tend to parallel the timing of the impacts from COVID. And so we're seeing offsets to the COVID impacts because of those expense maneuvers, if you will.

With respect to the permanent or longer term ones, we're looking at things we haven't looked at before like organizational spans and layers, vendor spend. We're looking at increasing our usage of shared services and we hired a new Head of Operations in Transportation whose job will be to drive these efficiency efforts and migrate to a new phase of shared service. He's going to focus on process improvement. He'll focus on lean type efforts. And finally, we intend to implement a different allocation methodology for corporate overhead beginning in Q3. Brian will touch on that as well and we'll certainly be ready to talk about that in Q&A.

So we're finding efficiencies all over the place. We're looking at the real estate footprint and we're modulating to or migrating to a more balanced work from home versus work from Conduent offices equation certainly in the short term and we'll have an equation for the long term as well very soon. So as you can see from the graph, there are savings across each one of these categories and we're going after all these line items to ensure we're running as efficiently as we can, but we got a lot more work to do. While we're well on our way in terms of the efforts across growth, efficiency and quality, we have a lot more work to do. But the good news is we're seeing the fundamental signs of a turnaround. And in some cases across those three pillars, we're already seeing improvement in all three.

So now let's turn to slide 9, if you will, to further discuss more of our transformation efforts. I'll start by noting that well, as always and as we've talked about in the past, while other opportunistic considerations will find their way to our radar, this growth, efficiency and quality strategy we've been discussing has finally started to take hold, it is taking hold, and the plan is critical regardless of the complexion or nature of our portfolio of products on a go-forward basis.

In addition, we continue to top-grade talent, build out the size and strength of our sales team and we will certainly be ready to talk about that in Q&A and drive through a more seamless and coordinated operating model. In that regard, our command center is fully operational, and it continues to support those reduced incidents that I discussed and also improved resolution times.

And interestingly, based on our history, we completed yet another large data center migration without impact to our clients. So we're very proud of our technology teams for that. So we think this transformation program that we put in place should lead to in addition client performance improvement and client retention. We think it leads to continued sales success and we think it leads to a stronger operating environment.

Now before I turn it over to Brian, I want to first acknowledge, it is great to see progress, and I hope you see the same progress that we're seeing, but we are committed to showing more. We aren't satisfied in any way until we can demonstrate consistency and continued improvement that will obviously lead to top and bottom line growth. It'll lead to margin improvement and critically it leads to reputational enhancement.

The good news is those Q2 sales numbers are the green shoots that we've been talking about and hoping for. Two quarters don't make a trend. It's a good indication of how the changes we're making are working, but it's an early indication. This is a journey. In my view, rebuilds are no faster than downturns, in fact maybe quite the opposite. But the foundation for this turnaround is built. It's now time to show you some continuity and some consistency. So that's what we intend to do.

Finally, I'm very proud to have the opportunity to continue to draw talent [audio gap] (00:22:38) Conduent. I'm proud to lead the great talent within Conduent, and I'm very proud to care for the clients who entrust us with their business and we want to keep this machine going. So I want to thank our clients as well.

Thank you very much for your time and I'd like to turn it over to Brian to talk about the detailed financials.

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

Thanks, Cliff. I'll start off on the same note. I'm extremely proud of the hard work from our team. It's great to see progress in delivery, operations and sales. Before I begin on the financials, I'll quickly note that we are reporting both GAAP and non-GAAP numbers. The reconciliations are in our filings and in the Appendix of the presentation. I'll start on slide 11 to review the P&L and the consolidated impact of COVID-19 on revenue and adjusted EBITDA.

Revenue for the quarter was approximately $1 billion, down 8.6% compared with our second quarter results last year or 8.3% in constant currency. These results were better than expected primarily driven by the strong volumes in our Government segment related to COVID-19 and less of a COVID-19 impact in our Transportation segment. From a year-over-year perspective, prior year loss business and COVID-19-related pressure from the Transportation and Commercial segments offset the growth in Government driven by COVID.

As Cliff discussed, we're making progress and trending better than expectations. This is a result of less of an impact from COVID-19, strong execution on our cost takeout program and better top line performance excluding COVID. I want to highlight this positive top line trend that we're seeing in the business. It's most visible when you separate the impact of COVID-19 from how we believe that business would've performed in a business as usual environment. The total net impact to revenue from COVID-19 was approximately $35 million for Q2.

As Cliff mentioned, without the impact of COVID-19, we estimate that the year-over-year revenue decline for the quarter would have been 5.5%, better than the midpoint of the 6% to 8% decline that we had anticipated at the start of the year. Adjusted EBITDA in the quarter decreased 3.5% year-over-year to $110 million while adjusted EBITDA margin improved by 50 basis points to 10.8%. The margin improvement was a result of progress from the cost savings program. COVID-19 had a net negative impact on our adjusted EBITDA of approximately $8 million including the benefit of temporary cost actions. Excluding the impact of COVID-19 and these cost actions, our adjusted EBITDA margin would have been approximately 11.3% for the quarter.

In addition to the temporary actions, we're also taking permanent actions, which should position us well as we enter into 2021. Restructuring expense for the quarter was elevated at $29 million driven by our cost and expense reduction program. We anticipate restructuring through the year to be approximately $60 million consistent with our outlook as of our last call. We are pleased that the business performed better than our expectations for Q2.

Let's turn to slide 12 to go over the segment results. In the second quarter, our Commercial business revenue declined 12.2% driven primarily by the prior year loss business, COVID-19-related volume declines and the interest rate impact in the BenefitWallet business. Adjusted EBITDA was down 27.3% while adjusted EBITDA margin of 18.5% was down 380 basis points year-over-year. The declines were primarily driven by revenue pressure, costs related to a contract exit and were partially offset by reduced IT, labor and real estate expense.

Our Government business grew 1.5% for the quarter. This was primarily driven by increase in COVID-related volumes partially offset by the loss of the California Medicaid contract. Originally we anticipated the California Medicaid contract would have a 3 percentage point contribution to total company year-over-year declines. That is now expected to be closer to a 2 percentage point impact in 2020 as we continue to benefit from the transition work this year.

Government adjusted EBITDA increased by 17.6% while adjusted EBITDA in margins of 36.3% increased by 500 basis points. The margin improvement was due to higher volume from COVID-19-related work and focused cost reductions. Our Transportation segment revenue declined by 14.9% compared to the second quarter last year. This was primarily driven by COVID-19-related volume pressure partially offset by new international transit work.

Adjusted EBITDA was down 4.9% compared with Q2 2020 driven by lower revenue partially offset by reduced IT and labor spend as a result of intense cost focus. Adjusted EBITDA margin for the quarter was 23.6%, up 250 basis points year-over-year driven by cost reductions. In the second quarter our unallocated shared IT and corporate costs were $145 million, 9.9% lower than in Q2 of 2019. This was driven by the cost and expense program. In Q3 2020, we expect to update our segment disclosure to allocated portion of our unallocated cost to the segments. This should provide greater visibility into the profitability of each of the three segments in line with how we expect to review and manage the business moving forward. We plan to provide more detail on our Q3 earnings call.

Let's now turn to slide 13 to discuss the strength of our balance sheet and cash flow. Our balance sheet continues to be healthy with $437 million of cash at the end of the second quarter. Our net leverage ratio was 2.6 turns at the end of the quarter, and our long-term target for net leverage remains 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 as of the end of the quarter. Our first major debt maturity isn't until the end of 2022 and we'll be looking at refinancing options over the course of the next year well in advance of that maturity.

Operating cash flow for the quarter was an inflow of $74 million and adjusted free cash flow was $40 million representing a 36.4% conversion for the quarter and $156 million increase over the same quarter last year. This is driven primarily by working capital timing and we also had an $18 million benefit in the current quarter from the payroll tax deferral related to the CARES Act. CapEx was $36 million for the quarter or 3.5% of revenue. We are still expecting to spend approximately $140 million in CapEx in 2020.

Let's move on to slide 14 to touch on our expectations for Q3. Given the recent trends we're seeing in COVID-19 cases throughout the country, we're going to refrain from reinstating formal full year 2020 guidance. However, we thought it would be helpful to discuss our current expectations for quarter three. We anticipate revenue will be between $960 million to $1.01 billion for the quarter with an adjusted EBITDA margin of between 10% and 11.5%. These expectations are based on the current situation that we see today, but if COVID-19 impacts change significantly, it could push us towards the outer bounds of this range.

Despite all of the challenges that COVID-19 has brought, our business is showing resiliency. We are continuing to deliver for our clients and our transformation is showing progress. 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] First question today will come from Puneet Jain with JPMorgan. Please go ahead.

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Puneet Jain
*Analyst, JPMorgan Securities LLC*

Q

Hey. Thanks for taking my question. Great results and good to see solid traction in bookings, specifically in new business signings that were up so much. So, question there is, so some of the recent deals you won, how long were the sales cycle there? Did pandemic accelerated conversion of some of those deals in the pipeline or in other words what's driving renewed activity in signings for Conduent?

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

A

It's a great question, Puneet. So, there's a couple ingredients to what you just said, very little of what we see in the new business signings has anything to do with COVID. So if you think about the $623 million in new business signings, there is a little bit of P-SNAP in there, but $600 million or so of that is really irrespective of COVID its business as usual, so that's point number one.

Point number two is that the sales process for us is completely different. It's a lot more about process improvement, dedicated teams, upgrading talent, the governance bid management and certainly leadership. And so it's a changed sales environment. We've been in on things we think we got a good shot at and we're not messing around with others.

With respect to tenure of the deals in that $623 million, it is up, driving the TCV up. So we're looking at roughly 5.2-year average deal length versus in previous quarters in the neighborhood of high 3s into the 4s. But the good news out of that, well, it's all good, because it creates longer revenue streams and on top of that, if you look at it from a year-over-year basis or quarter-over-quarter basis, on a year-over-year basis, we're up – excuse me quarter-over-quarter we're up 25-or-so percent on ARR and in some cases upwards of 83% above what we were last year. So not only is the TCV up, but the annual recurring revenue is up and the deal length is up. So we're seeing progress in all three buckets.

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Puneet Jain
*Analyst, JPMorgan Securities LLC*

Q

Got it. Got it. And as you report upside in cost cutting, while that's obviously positive for the near term, but too deep or steep cuts were one of the reasons for revenue headwinds in the past. So how are you balancing benefits from high cost cuts with managing execution?

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

A

The way to think about this $100 million which we'll over-exceed in the neighborhood of 20% to 40% this year and those are 2020 numbers. The way to think about it is it's a little bit different. Roughly 40% of those are temporary cuts that are directly associated with COVID volume. So as the volume goes down, we want to make sure our expenses go down as close to appropriately or correlated as possible. 60% or so of it is permanent. And you're exactly right, we need to pay intent focus on or attention to making sure we don't cut into bone.

And so what we've done this time is instead of just what I might call somewhat arbitrary or just say wide swaths of rifts, we looked at it from a completely different angle. We looked at it from operating model changes, spans and controls, areas where we just don't think we have an opportunity to grow and areas where we can combine talent and create more shared services to drive what I would call efficiency plays that will then along with automation that will drive some of those reductions and it's obviously not just people, but it will involve people as well. But we're going to do it this way more smartly and that's what we're seeing in 2020.

Puneet Jain
*Analyst, JPMorgan Securities LLC*

Q

Got it. Thank you.

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

A

You bet.

**Operator**: And the next question will come from Shannon Cross with Cross Research. Please go ahead.

Shannon Cross
*Analyst, Cross Research*

Q

Thank you very much. I was wondering can you talk a bit about how we should think of the contribution from unemployment and some of the pandemic-related federal money that may or may not continue and how you're thinking about balancing that against the benefit from the new signings. Is this something that in theory could be fairly seamless where, as the Fed money sort of, in theory, falls off and new signings come through or how should we sort of think about that trajectory?

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

A

Well, I don't think the new...

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

A

Hi, Shannon...

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

A

Go ahead, Brian. You take it.

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

A

Hi, Shannon, it's Brian. So, first, I would just want to say for the Q3 guidance range at the midpoint and low end of the range, we're not assuming any extension of the federal government unemployment supplement. The high end though is contemplated being extended for August and September, but the midpoint is that. And then go ahead, Cliff.

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

A

No, all I was going to say is, Shannon, if you look at – Brian's excluded a lot of what we saw – that extra $600 a month he's excluded in what we're thinking about for Q3. And what we're seeing in the current upswing, which is well in excess of what we thought it would be, that $20 million to $40 million we thought it would be, it's mostly unemployment, which we see probably continuing despite not knowing about that $600 and what it might go to and the P-SNAP, which we also see on a continuing basis. But both of those are unrelated to what we see on a business-as-usual basis, which when you net out COVID, we see improvement to last year, definitely or what we expected in our...

**Shannon Cross**
*Analyst, Cross Research*

Q

Okay.

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

A

...budget anyway.

**Shannon Cross**
*Analyst, Cross Research*

Q

Okay. Great. And then when you're signing all these new contracts, how should we think about the margin profile of the contracts you're signing? How are you sort of determining which RFPs you go for versus ones you don't? Just trying to think about when we get through the pandemic and then get into the next set, is this a situation where margin improvement should continue or at least hold in there? Thank you.

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

A

Yeah. So when we're looking at new business deals, we target margins that are better than the current margins of the company. Sometimes, for specific deals, we may take a lower margin, but most of the time the margins we're signing are higher than current company margins.

**Shannon Cross**
*Analyst, Cross Research*

Q

And how long does it take to sort of get to sustainable margins in a contract because there's obviously an upfront investment that's required?

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

A

Yeah. Usually, it ramps over time and it ramps as you go. Through the first couple years you'll have a lower margin, sometimes negative in the first year and then it ramps from there. But it does depend on the offering and we have certain offerings that ramp faster, that make money faster. So it just depends but there is a ramp typically on the margin side.

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

A

Yeah. It's heavily dependent as Brian said...

**Shannon Cross**
*Analyst, Cross Research*

Q

Okay. Clear...

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

A

It's heavily dependent as Brian said Shannon on the product obviously in the public sector where there's more upfront investment, it ramps a little bit slower. Where it's strictly services, it ramps very fast.

**Shannon Cross**
*Analyst, Cross Research*

Q

Okay. Thank you.

**Operator**: And the next question will come from Bryan Bergin with Cowen. Please go ahead.

**Bryan C. Bergin**
*Analyst, Cowen and Company, LLC*

Q

Hi guys. Good evening. Thank you. Wanted to ask on the cost plan. So you mentioned expected outperformance. Did you quantify how much that means and just to date where are you relative to the target?

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

A

So Bryan, thank you. We've got all of it identified. About half of it executed. When I say executed, it's all planned. So we know which ones are executing when across every month. We expect to outperform between 20% and 40%, though if you think on the outside $140 million.

**Bryan C. Bergin**
*Analyst, Cowen and Company, LLC*

Q

Okay. And you're 50% of the way through that [indiscernible] (00:39:05) run rate?

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

A

We're more than 50 – we're 100% of the way to the identification and we're roughly 70% to 80% of the way to the execution. I mean there are people that come out later in the year. So we're 100% identified, call it 70% executed.

**Bryan C. Bergin**
*Analyst, Cowen and Company, LLC*

Q

Okay. I heard the comments on the sales process refinement that you're attributing the success here. Is the current sales force appropriately sized now for the pipeline opportunity that you conveyed or should we expect investment there?

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

A

We're roughly Bryan about 25% over the low point from last year in terms of our head count on sales. Obviously what's most important out of that mix is the quality and the performance and execution out of that team. We expect another, what I'd call, 10% or 20% uptick over the course of the next nine months. So we're not done, but we're 80% of the way there on the body count.

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**Bryan C. Bergin**
*Analyst, Cowen and Company, LLC*

Q

Okay. And just one last one for me, how are you thinking about potential strategic alternative path, is that off the table in this environment or is the performance in any of these businesses now supportive of actions to be taken?

---

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

A

Yeah, it's a great question. Look, it's opportunistically never off the table, right? We think we have the right strategy irrespective of the portfolio. We're starting to see, with green shoots and all the rest, that strategy take hold and it's working irrespective of the portfolio. But it would be foolish of me to say that it's off the table, it's certainly never off the table and we're completely opportunistic, but we want the price to be right. We don't want COVID to be taken advantage of in the mix. And so I would say no, it's not off the table.

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**Bryan C. Bergin**
*Analyst, Cowen and Company, LLC*

Q

Okay. Thank you.

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**Operator**: [Operator Instructions] Our next question will come from Mayank Tandon with Needham. Please go ahead.

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**Kyle Peterson**
*Analyst, Needham & Co. LLC*

Q

Hey, good evening. It's actually Kyle Peterson on for Mayank. Great to see the improving TCV trend for the last few quarters. Just wanted to see if you guys have any thoughts on how quick of a time to implementation in revenue you guys are seeing with some of these project extensions just so we can get a sense of how quickly some of this might translate to revenue and so we can start continuous turning the ship in the right direction?

---

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

A

Yeah. So it's Brian, it's similar to the margin answer. It depends on the offering. Some offerings such as Customer Experience and Transaction Processing ramp fast, others there's an implementation period that can take in some cases a year or more. So it does really depend on the offering. The good news is, through the first half we've seen a good mix of different offerings contributing to the sales numbers. So we will have some revenue in the current year from these signings and others will contribute as we get into next year.

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**Kyle Peterson**
*Analyst, Needham & Co. LLC*

Q

Great. That's helpful. And then just a follow-up with – on margins and longer term thoughts on the margin profile of the business with some of these new contracts coming in kind of at or above current margins plus kind of the over-delivering on these cost take out targets. You guys had given any thoughts or could you give any color on where you think the margin in this business could head in a little more normalized operating environment?

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

A

So, over time, we've said before that this business, if you look at the peers, operates based on our mix at about a 15% EBITDA margin, and over time, we don't see any barriers to getting there. In the near term though, we want to prioritize improving margin somewhat, but also investing to turn the revenue around and that balance will keep it lower than that in the near term, and we've talked about kind of being range bound between 10.5% and 11.5% over the next year or two. And obviously, we had good performance in Q2 and we'll keep driving margin improvement as we can, but we want to make sure we get the balance right between turning the top line around and improving the margin.

**Kyle Peterson**
*Analyst, Needham & Co. LLC*

Q

Great. That's helpful color. Thanks guys. Nice quarter.

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

A

Thank you.

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

A

Thanks.

**Operator**: As there are no more questions in the question queue, this will conclude the question-and-answer session. I would now like to turn the conference back over to Cliff Skelton, CEO, for any closing remarks.

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

Let me say first thank you to everybody for joining today. We feel like we're on track and making progress. We hope to have another good Q3 to talk to you about here in three months or so. It's encouraging to see the green shoots, but momentum is – and consistency is what we're looking for. I'd like to say thank you obviously to our employees for their hard work, for our clients for their business and for our – and to our shareholders for your confidence. And I hope everybody stays safe and keeps your families safe during this crisis. So thank you all very much for joining.

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