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CNDT.OQ - Q2 2024 Conduent Inc Earnings Call

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PRESENTATION

Operator

Welcome to the Conduent second quarter 2024 earnings conference call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to turn the call over to Giles Goodburn, Vice President, Investor Relations. Thank you. You may begin.

Giles Goodburn - *Conduent Inc - Vice President, Investor Relations*

Thank you, operator, and thanks, everyone, for joining us today to discuss Conduent's second quarter 2024 earnings. I'm joined today by Cliff Skelton, our President and CEO; and Steve Wood, our CFO.

We hope you had a chance to review our press release issued earlier this morning. This call is being webcast, and a copy of the slides used during this call as well as the press release were filed with the SEC this morning on Form 8-K. This information as well as the detailed financial metrics package are available on the Investor Relations section of the Conduent website.

During this call, we may make statements that are forward-looking. These forward-looking statements reflect management's current beliefs, assumptions, and expectations and are subject to a number of factors that may cause actual results to differ materially from those statements.

Information concerning these factors is included in Conduent's annual report on Form 10-K filed with the SEC. We do not intend to update these forward-looking statements as a result of new information, or future events or developments except as required by law.

The information presented today includes non-GAAP financial measures. Because these measures are not calculated in accordance with US GAAP, they should be viewed in addition to and not as a substitute for the company's reported results. For more information regarding definitions of our non-GAAP measures and how we use them as well as the limitations to their usefulness for comparative purposes, please see our press release.

And now I'd like to turn the call over to Cliff.

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Thanks, Giles, and welcome, everyone, to our Q2 earnings. This earnings today will be just a little bit different, and we'll have Steve begin with the financials today, and I'll follow with a strategic discussion regarding progress on our strategy framed by the categories of people and organization, our processes and objective products and our technology.

But in summary, Q2 adjusted revenue and adjusted EBITDA were $811 million and $29 million, respectively, at a 3.6% margin, all exceeding expectations. New business signings were $142 million, up sequentially and flat year-over-year in net of the large State of Victoria deal last year in

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our Transportation business. This was all characterized by some recent strength in Commercial sales, some weakness in Government, and our Transportation business holding its own.

Finally, the net ARR number was negative for the first time, representing the low point due to the timing and sequence that Steve will discuss in a moment. All of this points to a consistent theme. While we're at the low point in our journey in the trough, as we say, we continue to be exactly where we said we'd be, in fact, a little better in terms of revenue and EBITDA.

And we've said all along that this is part of a continued path to a 2025 exit rate parameter, lowered net debt leverage ratios, sequential margin improvement, and less capital intensity. Meanwhile, our divestiture activity is progressing as planned, allowing us to deleverage our balance sheet and buy back some of our own stock, including that formerly owned by Carl Icahn, which has also allowed us to simplify and streamline our Board and, in fact, create some new strategic dialogue. Steve will explain the effect of those divestitures and discuss where we are in that revenue EBITDA cycle.

So let me hand it over to Steve. Steve?

Stephen Wood - *Conduent Inc - Executive Vice President and Chief Financial Officer*

Thanks, Cliff. As we have done in the past, we're reporting both GAAP and non-GAAP numbers. The reconciliations are in our filings and in the appendix of the presentation.

Let's turn to slide 5. I want to highlight again the progress that we're making towards our $1 billion of deployable capital exiting 2025 that we've previously laid out for you in our investor events and earnings updates. We've made significant progress with rationalizing our portfolio.

During the quarter, we completed the second and final tranches of the BenefitWallet transfer, receiving the remainder of the $425 million of proceeds. The Curbside and Public Safety divestiture closed on April 30 for which we received $174 million at close, with a further $61 million deferred over the next nine months. Also in the quarter, we announced the sale of our Casualty Claims Solutions business for a price of $240 million, subject to certain purchase price adjustments, which we anticipate will close later in Q3.

These combined proceeds, along with an updated and more favorable view on the tax drag associated with these divestitures, puts us in the upper quartile of the $600 million to $800 million of targeted net proceeds. To date, of the $1 billion of targeted deployable capital, we've deployed around 66% or $660 million against debt prepayment and share repurchases.

During the quarter, we prepaid $300 million of our Term Loan B and repurchased approximately 43.3 million shares. I'll cover more detail on this later in my presentation. Suffice to say, we’re where we said we'd be vis-a-vis this key component of our overall strategy, we've made significant strides in reducing our debt against a business that was traditionally too highly levered. And even post these initial divestitures, Conduent retains a rich portfolio of assets that we continue to believe have strategic value.

And Cliff will talk about a number of different aspects of that later in the call. But first, let's get through the earnings part of the narrative. Our reported numbers have started to deviate from the guide that we laid out at the beginning of the year because of the two closed divestitures. And so consistent with the approach I outlined then, we are reporting Q2 numbers on an adjusted basis, fully backing out the divestitures as well as providing a guide for the remainder of 2024 for adjusted revenue and adjusted EBITDA.

I'll also give you our expectations as to how this will look for Q3, consistent with our past practice of guiding the upcoming quarter. We have published a full set of historical adjusted financials in our investor metrics file, which you will find in the Investor section of the Conduent website.

In our Q3 earnings, we'll likely be updating our full year guidance once more to adjust for the closure of the Casualty Claims Solutions business. It's important to note here once again, that we will continue to work on the removal of stranded costs through 2024 and into 2025. And so, the annualization of these will be fully reflected in our numbers until the back end of 2025. Finally, we'll continue to provide you with an updated walk to our 2025 exit rates, so you can bridge between our actuals, our 2024 adjusted guide, and the 2025 exit rate outlook we've laid out.

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Let's get into the slides. Turning to slide 6 and reviewing our key sales metrics. As you look at all of the sales metrics on slide 6 and 7, it's important to note that we've adjusted all of these to exclude the two completed divestitures. As I prefaced in Q1 earnings, Q2 sales rebounded from the soft start to the year with ACV coming in at $142 million as compared to $97 million in Q1 and $205 million in Q2 2023. As a reminder, Q2 2023 was the quarter in which we signed the State of Victoria Transit deal, which contributed about $65 million of ACV and over $1 billion of TCV.

While pleased with our rebound in Q2 sales, we're looking to continue improvement in the second half of the year. Adjusted for the effect of the two completed divestitures, we're expecting a full year outcome of between $525 million and $575 million of ACV. We have some bigger deals in our public sector markets during the second half, where precision in predicting timing can be an issue.

Within Commercial, we're expecting to see the strong second quarter continue into the second half of the year. Double-clicking on the Q2 ACV number, as I stated last quarter, we see renewed urgency to address cost and drive technology upgrades and business transformation through outsourcing both in the CX and BPaaS spaces where we play strongly with a broad set of offerings. This translated to a strong Q2 ACV sales attainment in our Commercial segment of $82 million of ACV.

We've had an encouraging start to the third quarter, and we're making some targeted investments to expand delivery capacity in some of our strategic global locations. Our Government and Transportation segments achieved strong add-on business from our existing clients, which drove an increase in NRR in the quarter. The Government Healthcare business continues to have a strong pipeline relating to the requirements for states to modernize and modularize their Medicaid technology environments.

Turning to slide 7. We've covered many of the metrics on the previous slide, but just a couple of extra pointers here to comment on. The net ARR activity metric turned negative this quarter, consistent with how I messaged in last quarter's earnings, at negative $49 million. Adjusted for the two closed divestitures, we expect the metric to stand at around $80 million to $90 million by the end of 2024, with a recovery to a positive number in the third quarter.

The reason that it was negative in the quarter, as I said previously, is that there was pronounced asymmetry in our notified losses last year with them being far more weighted to the back half of the year. These rollout is the trailing 12-month view in the coming quarters. And additionally, we have confidence in the sales pipeline for the remainder of 2024. And really, that's what's driving this purposing effect that you're going to see in this metric while this asymmetry remains.

Now let's turn to slide 8 and discuss our Q2 2024 financial results. Adjusted revenue for Q2 2024 was $811 million, as compared to $851 million in Q2 2023, down 4.7% year-over-year and down 4.6% on a constant currency basis, slightly ahead of our internal expectations. I'll cover the segment level detail in a minute, but the overall view is that we continue to make progress in our cCommercial and Transportation segments. However, the trajectory of recovery in our Government segment will continue into 2025.

Adjusted EBITDA was $29 million for the quarter as compared to $64 million in Q2 2023, and the adjusted EBITDA margin was 3.6% for the quarter as compared to 7.5% in Q2 2023. This conforms to the low single-digit margin I guided for Q2. We're anticipating a sequential climb now each quarter as we progress through the remainder of 2024 and into 2025 and the drivers of this are threefold.

Firstly, the cost efficiency work that we built into our original 2024 guide to compensate for the losses and contract roll-offs naturally have more impact as we get deeper into the year and continue to add incremental benefit in 2025 as they annualize. We're in good shape with these cost efficiency programs with over 90% of the target having been actioned as we head into the second half of the year. These cost efficiency programs were baked into how we originally built our 2024 guide of an 8% to 9% adjusted EBITDA margin, and we'd still be in that range without taking out these divestitures, albeit probably at the low end of that range.

Secondly, you've got our stranded cost and additional margin expansion work, which we're just getting into. We're anticipating around $15 million of that $100 million to manifest in 2024 with more in 2025 and clearly annualizing to that $100 million as we exit 2025, consistent with how we laid out the walk for you in our exit rate outlook that we've been sharing.

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Finally, there's a little bit more revenue in the third and especially the fourth quarter from ramp and open enrollment in our Healthcare verticals. So now let's turn to slide 9 and go over the segment results.

For Q2 2024, Commercial segment adjusted revenues were $425 million down 3.8% as compared to Q2 2023. The topline story for the Commercial segment this quarter continues to be one of working off the effect of some prior year lost business.

We still expect the growth gap to narrow due to improving sales performance and retention and the segment coming closer to flat as we exit 2024. Adjusted EBITDA for the Commercial segment in Q2 2024 was $41 million, down 12.8% as compared to Q2 2023 and the adjusted EBITDA margin of 9.6% was down 100 basis points year-over-year, driven by the impact of losses and some volume fluctuation.

As a reminder, Commercial segment EBITDA margins have reset due to the high-margin nature of the BenefitWallet business we divested, which is now not in these adjusted numbers. Obviously, you'll recall that this business was totally dependent on high interest rates.

Over time, this will be offset through our work to remove stranded costs, other operational efficiencies, and improved operating margin as well as margin mix as the segment begins to move towards growth. We expect some modest sequential improvements to EBITDA margin as we move through the next few quarters.

For the Government segment, Q2 2024 revenues were $245 million, down 9.3% as compared to Q2 2023. The decreases you see this quarter and as we progress and lap them going into 2025, are driven by three very discrete items. Firstly, is the effect of the Government Healthcare contract we referenced in February, where the contract was terminated for reasons other than performance. We'd hope to retain some scope of work there, but that didn't materialize, and so the revenue ran off at the end of the first quarter.

The effect then in Q2 is approximately 4.5 points of the 9.3% year-over-year decline. In Q3, this is going to be approximately 6 points of decline. And in Q4, 5 points of decline, both as compared to prior year. This effect is then lapped as we move into 2025.

Secondly, there's lower PSNAP volumes in our Government Payments business as fewer states continue with the supplemental programs due to the change in funding structure as well as a lost client. This is about 2 to 3 points of revenue decline in the quarter, and when compared against prior year for the remaining quarters of 2024, it's about the same. This effect is then similarly lapped as we move into 2025.

Finally, there's a price down on a large state Eligibility program that started to take effect here in Q2, contributing around 1.5 points of revenue decline in the quarter. It will be 2 to 3 points of decline per quarter as compared to prior year and until we lap this effect midway through Q2 2025.

Just so we can complete the math on this one, there's about 1 point of all other growth in Q3 revenue and 3 points of growth assumed in Q4, both as compared to prior year. And that will get you to an overall 9% down in Q2 and an expected 11% to 12% down in Q3 and 6% to 7% down in Q4 against prior year compares with only the price down on the large state program having any annualization of impact into 2025.

Overall, this adjusts our full year expected outcome for Government revenue to be down about 7.5%, 2024 versus 2023. We previously expected to be able to make up some of this with new business. However, as previously discussed, sales performance has lagged expectations so far this year. And so the revenue from new business in the Government segment will likely now manifest in 2025.

It's important to reiterate it's driven by a few items. And absenting these, we feel good about the base revenue with a lot of pipeline opportunity to convert in front of us. The Government segment makes up a disproportionate amount of our forward pipeline of $4.2 billion of ACV. Adjusted EBITDA for the Government segment in Q2 2024 was $49 million, down 36% year-over-year. The above mentioned three discrete items are again, most of what drives this, as well as some short-term elevated expenses related to a couple of implementations in flight that should normalize later in the year.

Transportation segment adjusted revenues in Q2 2024 were $141 million, up 1.4% year-over-year. The implementation ramp from our large Transit project in Australia was $22 million, however, almost completely offset by a long-anticipated reduction in scope and pricing adjustment for our large, long-term client in our tolling business.

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For the Transportation segment, adjusted EBITDA for the quarter was $3 million as compared to $9 million in Q2 2023, and the adjusted EBITDA margin was 2.1%. The primary driver here was revenue mix specifically between the two contracts noted previously and partially offset by improved operational performance.

There's been a margin reset within transportation because of the divestiture of the Curbside and Public Safety businesses. And this is one area we have several initiatives underway to remove stranded costs, drive incremental operating efficiency and continue to build scale back into our Tolling and Transit businesses.

In the next couple of quarters, you are going to see EBITDA margin in this sort of range, absenting any effect from discrete items, but our path forward is the levers that I highlighted above, and these should drive incremental improvement as we progress through 2025.

Let's turn to slide 10 and discuss the balance sheet and cash flow. We ended the quarter with approximately $307 million of total cash on balance sheet and our $550 million revolving credit facility was largely undrawn at the end of the quarter. In the quarter, we made payments on debt of $328 million, including voluntarily prepaying $300 million on our Term Loan B. We have additional authority to repay debt up to $200 million from future divestiture proceeds, which would deal with our near and midterm maturities.

In the quarter, we deployed approximately $150 million in repurchasing 43.3 million shares at an average price of $3.46. This included the opportunity to repurchase all the shares owned by Carl Icahn through certain of his affiliates for an approximate aggregate purchase price of $132 million.

You've seen from our work on how we've deployed the $1 billion of capital that we think our steady-state cash need in the business is somewhere around the $350 million-mark. We ended the quarter a little bit below that because of the opportunity to enter into the repurchase of the Icahn shares.

If we look forward over the coming quarters, we're expecting to receive net proceeds of approximately $200 million in relation to the expected closure of the sale of the Casualty Claims Solutions business and an additional $61 million of deferred purchase consideration on the sale of our Curbside and Public Safety businesses.

The combination, then, of a stronger outlook in the second half of the year on operating cash flow as we reached some important billing milestones on some large contracts as well as the inflows from our divestiture program has us in good shape to continue to prepay debt as desired, manage our leverage, and maintain our desired level of liquidity.

Our net leverage decreased to 1.7x below our previous target range of 2x to 2.5x. You'll see in our exit rate outlook for 2025, our medium-term target, considering some additional debt prepayment, is around 1x of net leverage. Capital expenditure in the second quarter was 3.6% of revenue, and we expect it to be at about 3% of revenue or slightly below that for full year 2024.

Let’s turn now to slide 11 and cover our outlook for 2024. You heard me say earlier that within the Government segment, we expect the revenue decline to be in the 7% to 8% range for 2024. But overall, I'd say that we're still above the midpoint of our original guide on revenue for 2024, had we not divested the two businesses with Commercial and Transportation doing slightly better. And for EBITDA, again, as I said earlier, my sense is that we'd be somewhere around the lower end of the guided range we laid out then, about 8% without taking out these divested businesses.

As you now look at our adjusted outlook on the page here, you'll see that the basis for our guidance has been restated to adjust for the two closed divestitures. We expect full-year adjusted revenue to be in the range of $3.325 billion to $3.375 billion. At the midpoint, that's about 3% down year-over-year. And we expect adjusted EBITDA margin to be in the range of 4% to 5%, with sequential improvement from Q2 here on. We expect these ranges to be further adjusted in our Q3 earnings for the anticipated close of the Casualty Claims Solutions business, which will equate to approximately $150 million of revenue and about 1 point of reduction in EBITDA margin.

In terms of some of our other modeling considerations, we expect adjusted free cash flow as a percentage of adjusted EBITDA to be around 0. This is due to the loss of the adjusted EBITDA from the divested businesses from the point of closure, partially offset with cost efficiency work and a substantial reduction in our interest expense.

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To reiterate, this is not a fully adjusted metric. We don't break out discrete cash flows at the level of these divested assets, so we've moved it down in the table here and are removing it from our fully adjusted guide for the time being to present it as an additional modeling consideration. Finally, you'll see CapEx reducing here with the effect of the divestitures with more to come when we complete the expected Casualty Claims Solutions divestiture in the third quarter.

Moving on to slide 12. This continues to be an important view, giving you a walk to that exit rate in 2025, and remains how we think about the journey we're on over the next 18 months or so. You will notice that we've added incremental detail here to complete the 2025 exit rate view. We've also made some minor adjustments to this work.

Firstly, we've reduced the divested revenue from $500 million to $450 million to account for some revenue streams that we've retained from the three announced divestitures versus those originally contemplated. The three announced transactions account for approximately $400 million of divested revenue and the loss of EBITDA from these three divested businesses is approximately $135 million.

With more clarity related to the proceeds from the three announced divestitures and more specifically, a reduction in the anticipated tax drag, we're increasing the net proceeds from the three announced transactions to $750 million, an increase of $50 million and in the upper quartile of our targeted range of $600 million to $800 million of after-tax proceeds. We've refined our margin expansion assumption to be in the range of 2% to 2.5%, reflecting certain expected pricing and contractual outcomes on a large Federal contract renewal within our Government Payments business.

Many of you will know we run the card processing for the Federal Government Direct Express program on behalf of a large regional bank. It's been informally reported that this contract is being negotiated with another bank and processing vendor and that negotiations will continue through this year.

At this stage, we have not included this as a notified loss in our net ARR metric for the full year 2024, as we understand that the notification was both informal and preliminary. Nor does it adjust our 2025 revenue outlook as we minimally expect to have this revenue into 2026, given the likely long transition timeline needed to move this complex program that we've run for over 15 years.

At this point, the margin refinement in our work removes the incremental pricing we intended to achieve on this renewal in order to make this contract attractive for us to retain. For size, it's approximately $100 million of revenue and is very marginally profitable and dilutive to the Government segment as currently priced. Our capital allocation plans include an additional $200 million of Board authority to prepay debt.

Over time, as EBITDA recovers sequentially, this will drive our net leverage ratio towards our new target range of approximately 1x. Interest expense will be approximately $38 million on $600 million to $700 million of debt, and this results in an adjusted free cash flow range of between 25% and 30%. The strength of our sales pipeline and proven programmatic approach to cost reduction already underway, gives us confidence to remain convicted in achieving these 2025 exit rate targets as well as our ability to generate and deploy the $1 billion, of which 66% is already deployed.

In terms of Q3, adjusted for the two divestitures completed, we are expecting adjusted revenue to be in the range of $815 million to $825 million. And we would expect to see a sequential improvement in adjusted EBITDA margin for the third quarter to be in the range of 3.75% to 4.25%, as we continue our work on our cost efficiency programs and remove stranded costs.

That concludes my financial remarks for the quarter, and I'll hand it back over to Cliff for the broader business update because there's a lot going on there as well. Cliff?

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Thanks, Steve. Let's turn to slide 14 and spend some time talking about the business and where we are with respect to this journey. As you may recall, five years ago, we embarked on an operational and technological stabilization and optimization plan. While never perfect, that outcome is largely intact. And then just over a year ago, in March of 2023, we outlined a three-year plan that would build on our strengthened foundation to

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create a more nimble technology-led business process solutions company with better synergies, more cohesiveness, different leaders, lower debt, less capital intensity, and a clear and charted path to market-driven growth.

That growth will be enabled by focusing on our clients' success to further penetrate existing and prospective clients, doubling down on strategic initiatives for each of our businesses and continuing to strengthen our leadership in our culture. A narrative also discussed how we would leverage our cloud-based and AI-infused technology platforms across our core competencies in order to grow in both the commercial and public sector markets.

We talked about our portfolio diversity as a strength and an offset to economic cycles. We discussed how we would continue to optimize our business by rationalizing our portfolio, allocating approximately $1 billion of deployable capital in the most optimal manner. 15 months into this three-year plan, I can tell you that we have made and continue to make strong and steady progress with more to do. We're on track to deliver against those commitments. And our Q2 results demonstrate for those that have been following our journey that we continue to be where we said we would be.

Let's turn to slide 15 to give you a representation of the change we've made tactically to advance that three-year plan. First, we continue to strengthen our people and our organization. We've simplified our operating model and now operate the commercial and public sectors with new group presidents leading them. That will help reduce the corporate overhead and the overlaps. We'll still measure ourselves and lead those more granular business individually, but from a corporate point of view, we have streamlined our shared services.

Adam Appleby, formerly President of Transportation, will now lead our public sector organizations. And we will very soon welcome a new Head of Government Solutions, who is a seasoned industry veteran to lead that very important growth business for us within the public sector. That announcement is coming in the next week or two.

For the commercial sector, Mike McDaniel is the new Group President. Mike joined us in July from DXC, where he was President of DXC's Modern Workplace business. Prior to DXC, Mike spent 14 years at Accenture in senior positions, including leading the North America sales organization.

As you can see, we're reaching from outside the organization to onboard known and proven growth leaders who know the client base and have experienced what great growth companies do well. We've also created a dedicated Chief Client Officer role to focus entirely on client retention and drive expanded wallet share. Randall King will move from his role leading the Commercial businesses to this role uniquely targeted at our top revenue-producing clients and their customers.

Again, to leverage portfolio diversity as a strength, we must penetrate and retain that group of clients that represent high outsourcing needs. And we have some very impressive clients with some very important opportunities to pay attention to.

With regard to our culture, we've been recognized by both Newsweek and the Disability Equality Index. We're particularly proud to have been named for the second year running to Newsweek's Global Top 100 Most Loved Workplaces. It may be cliché, but in our business, our people are our strength because clients will buy from people they trust, and we're certainly proud of our team.

Regarding our processes and our objectives, we're making strong progress. We're beginning to see strong sales momentum broadly across our commercial solutions, especially our offshore and nearshore delivery models. And we're investing in additional capacity in several locations to meet demand as we see increased propensity to outsource from existing clients and new logos.

When economic conditions require improved efficiency, opportunity comes our way, especially when our geographic model can differentiate. Interestingly, we're also seeing cross-segment opportunities as we drive sales and partnership opportunities in key public sector markets for Human Capital Solutions, Finance, Accounting and Procurement Solutions, as well as our Customer Experience Solutions.

For example, we have multiple opportunities in various states for our Human Capital Solutions Pension Plan Administration, and we're seeing consolidation across the reinsurance industry, thus creating the need for scale in the administrative space.

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In Finance, Accounting and Procurement, we have several states interested in our FastCap solution, which provides a comprehensive analysis of an organization's procurement data to deliver insight into accounts payable to uncover cost savings opportunities, such as automatically detecting duplicate or erroneous payments and analyzing tail spend. And recently, RTW, a toll collector in the Netherlands, engaged Conduent to provide customer support for new toll road in the Netherlands, which is opening at the end of the year.

The bottom line is that while governments buy differently than commercial businesses, many of our products are ubiquitous. As Steve mentioned, a hallmark of our strategy is our portfolio rationalization efforts, and the use of proceeds from those divestitures in large part to pay down debt, demonstrating our commitment to a lower net leverage ratio, and a strong balance sheet.

Regarding another important use of capital in the quarter, as I mentioned, we repurchased all shares previously owned by Carl Icahn and affiliates. We believe that decision was a very important one that will help streamline decision-making and capital allocation planning.

Following the third column, we made considerable progress in our products and our technology. We're continuing to progress our generative AI initiatives. We worked on real use cases in a methodical manner, and we're excited to share that several of our pilots are showing promising results that will create unique value for our clients and open new adjacencies. I'd like to mention a few examples.

We completed a successful pilot on improving fraud detection related to account takeover where we apply traditional rules-based AI combined with Gen AI. This approach will allow us to materially improve upon the traditional fraud approach while improving on the cardholder experience. As you know, we provide fraud detection capabilities as part of the many government disbursement programs we support, and we believe we can increase the volume of fraud detection by up to 150%.

Secondly, our pilot work in the documents management space related to unstructured documents is also looking promising. Using Gen AI paired with traditional OCR technologies, we can provide classification of the document at a more granular level. This will improve the queuing and the routing of documents and allow for faster processing saving clients' manual effort and should allow us to do more work traditionally performed by our clients. Finally, we believe we can now open new adjacencies, such as processing correspondence documents or appeals for healthcare claims because of this new capability.

Now, cybersecurity is on the front burner for every CEO and every Board of Directors. We're seeing a gap in the industry, whereby when companies experience a cyber event, they need help in dealing with the scale and the speed necessary for a quick response to that event, especially when notifications are required for personally identifiable information and protected health information notifications.

Conduent is teaming up with a leading cybersecurity company to introduce an innovative method to quickly and accurately identify PII and PHI within affected data. To do this, we can provide a combination of eDiscovery experts in our technology platform to develop a tailored client-specific privacy review plan that will identify PII and PHI quickly. While we're just getting started with this plan, it will also include an on-demand print and mail capability that can help with notifications.

We were named a Leader in CX Transformation, HR Transformation Services, and Healthcare Payer Operations by NelsonHall, demonstrating continued solution leadership. With respect to CX transformation, while Gen AI is adding a lot of new capability, we continue to see the need for human interaction with an expectation of higher quality and a better price.

Finally, we've made some modest adjustments to some of our exit rate assumptions as Steve talked about, as we move through 2024 and into 2025. And we're confident that Conduent is on the right trajectory and moving our business to sustain topline growth, sequential margin improvement, less capital intensity, and improved cash flow conversion. As always, I'd like to thank our shareholders, our clients, and our nearly 60,000 associates for their support and recognize our associates for the great work they do every day.

Thank you, everyone, for listening, and I'll now turn it back to the operator to open up lines for questions. Operator?

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Pat McCann, NOBLE Capital.

Pat McCann - *NOBLE Capital Markets, Inc. - Analyst*

Hey. Good morning and thanks for taking my questions. I just have a couple of questions, and then I'll pass the floor on. Number one, I wanted to circle back to the Carl Icahn share divestiture. After repurchasing his shares and him no longer being in the stock, how does that affect the decision-making process for you guys going forward? Does that really simplify your strategic decisions? Could you -- any color you could provide there would be great.

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Yeah, Pat, it's Cliff. Thanks for the question. As many know, Carl, as an activist had, three board members out of our eight. And as you can imagine, when you go from eight to five, decision-making certainly gets easier. You got to -- get an extra three, you've got a lot of cooks in the kitchen for sure. And from time to time, activists will have a little bit of a different agenda vis-a-vis things like how much of capital do you want to keep inside the company, how much capital do you want to distribute, and what timeline, et cetera.

As everybody knows, a Board's primary job is governance, and of course, keeping or not keeping a CEO is front and center. But in addition to that, capital and asset allocation, M&A strategy is always going to be a primary concern of Boards. And frankly, that just got easy for us. And I can't tell you what it means in terms of actual decisions that are going to happen, but I can tell you the process is easier now, and we feel a little bit -- I might call it a little bit liberated in some ways.

Pat McCann - *NOBLE Capital Markets, Inc. - Analyst*

Great. Thanks for that. And then my second question was just if you could give a little bit of commentary -- additional commentary to what you've already said about how you -- where your confidence comes from for your full-year target, given the results you reported for Q2?

Stephen Wood - *Conduent Inc - Executive Vice President and Chief Financial Officer*

I think, our confidence in terms of the full year is really resident in the walk through 2025, right? We've talked about the fact that we've got these cost efficiency programs underway that we're heavily through that work. It's going to become more resident in the second half of the year as we get into that. And we're going to see this sort of modest sequential improvement in EBITDA as we progress through the year. And there's a little bit of incremental kind of sales ramp again resident in the guide in the second half of the year.

But I think probably as important to that, just to reiterate, right, we now see this as a sequential journey that we're going to see quarter-over-quarter as we process through the remainder of 2024, and then quarterly through 2025 to get back to that exit rate outlook that we've outlined, and we've got a high degree of confidence that we've got the plans and the execution in place to deal with both the revenue side and the cost efficiency side as we work through that.

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

I think that's absolutely right, Steve. The lag effect of the cost reduction efforts is going to manifest a little more in the back half. Some of the sales efforts are beginning to ramp up a little bit of a slow start in Government that we think is going to finish. We hope we'll finish strong compared to the first half. All those will affect our impact revenue on our EBITDA for the second half of the year.

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Pat McCann - *NOBLE Capital Markets, Inc. - Analyst*

Great. And if you don't mind, if I could squeeze in one more. It just -- it seems as though given the divestitures you've already announced your -- you made significant progress there. And it seems as though the march forward is towards the other side of the divestiture efforts, if you will, seems to be becoming the focus now. I was just wondering, though, if there are -- how you view the possibility for any other maybe minor divestitures, if there are more opportunities there? Should we expect more announcements in the future before you're done?

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

I think, Pat, the way we would look at it, and Steve can fill in a gap he sees fit in. We don't see any major compartment and divestiture activity on the horizon. There are a couple of small things we might consider. As you may recall, the whole process was center posted on how do we get as many synergies with RemainCo as we can get, how do we take scarce assets from the outside point of view and monetize those to pay down debt primarily, and then how do we grow what's remaining as fast and as well as we can. And we think we we're kind of over that target. There's some puts and takes that we think we're over that target in terms of carve-outs, if you will.

Stephen Wood - *Conduent Inc - Executive Vice President and Chief Financial Officer*

Yeah. Just one thing further to add, Pat. If you think about the divestitures we've made, we've targeted businesses that met a couple of different criteria. We thought they had scarcity value on the outside. We thought they weren't necessarily sort of one plus one equals three businesses inside of the portfolio. But we have a -- still have a very rich portfolio of assets that have strategic value, either by themselves or in combination.

And so, we like the way that the portfolio is shaping up. We like our commercial and our, I'd say, our public sector markets to kind of give balance to the business. And I think the mission will continue to be to work strategically as Cliff has outlined, to drive those -- all of those businesses towards growth, to drive towards those exit rates that we've outlined, but that doesn't necessarily take off the table that there might be some attractive offer that comes along on the outside for a particular discrete asset that we would accommodate and entertain as needed.

But as obviously, you can see we are towards the top end of the range of what we've outlined for divestiture proceeds, but we're not at the top end of the range. And so it gives us room to do more if we deem it to be in the best interest of what we're trying to get done.

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Yeah. I mean the way I would characterize it in metaphorical terms is the radar is still open and operating in terms of opportunistic ideas, but we believe we've got a portfolio we can grow. And if you look at these assets, some of them we're going to double down from a capital perspective. Some of them we're going to optimize, and get more efficient. And some of them, we're going to continue to just drive as is. And so, we see what we have is what we need.

Pat McCann - *NOBLE Capital Markets, Inc. - Analyst*

Great. Thanks, guys, for the thoughtful commentary. I'll pass the floor on.

Operator

Thank you. Our next questions come from the line of Marc Riddick with Sidoti & Company. Please proceed with your questions.

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Marc Riddick - *Sidoti & Company, LLC - Analyst*

So I really appreciate all the detail that was put into this and provided as well. I wonder if you could talk a little bit about earlier in the year, there was the announcement of the deal with Microsoft on AI. I was wondering if you could talk a little bit about the partnership, I should say. And if you could talk a little bit about maybe what you're seeing from client receptivity and what your early read is on that?

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Yeah, it's a good question. Look, I mean, you can't turn the TV on without those two letters coming up everywhere. I think the hype is starting to settle into real execution. We try to kind of weather that storm and find our ways to some pilots and some early partnerships, including Microsoft.

Some of those pilots, as I mentioned in my prepared remarks, are starting to bear fruit, especially around fraud and scanning and indexing. You know, Healthcare has got some real opportunities. So -- and of course, everybody is focused on what we can do in the call center space.

So we're using those pilots. And also what I mentioned about cyber, we think is a great new idea. There's an AI implication there as well. But what I would say is Microsoft is leading the charge in many ways in the industry, and they've got a lot of partners that they can select from or not. And we've done some work. I met with their head in North America just last week to talk about what we can do from a go-to-market perspective with respect to AI. And the horizon is very bright.

But we're going to be narrowly focused initially on those things that I just talked about. The partnership with Microsoft, obviously is beneficial for them because they can use Azure for a lot of the hosting. But their salesforce is quite strong, obviously. And we want to make sure that we can partner up as much as possible.

But again, we're going to stay narrowly focused on those three or four or five proven pilots that we've already executed on, and we're going to move forward with those initially, and that's where we're going along with the partnership with Microsoft and a go-to-market perspective.

Marc Riddick - *Sidoti & Company, LLC - Analyst*

Okay. Great. And then I wanted to just sort of follow up on the status of the Government Direct Express contract and so your thoughts there. Is there a sense of -- I guess, just maybe -- if you could maybe put a little more color around that. And then I have one final follow-up around cash prioritization.

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Yeah, yeah. Well, look, Steve told you in his prepared remarks what we don't know, which is we don't know where this thing is going because we have any official messaging at all. We have what our bank partner told us is a negotiation with another bank, and they have their own technology partner that is equivalent of ours. But here's what we do know.

We do know that after 15 years, this is a very, very complex arrangement, and it's very risky for the government. We've got $1.6 billion of deposits that happen every month for social security recipients, VA recipients. And we -- our technology distributes those disbursements. And the fraud risk is inordinately high. The operational risk is inordinately high and it's been attempted to shift to other partners in the past and failed.

So I would say the risk is significant to a conversion. And we're -- notwithstanding the fact that it probably takes a year or two for that to manifest. Even if it does happen, we think there's a high probability that this thing could be retained, but we don't have formal messaging on -- in any way from our bank partner or the government. I just would tell you that we know this is a lot more complex than on the surface.

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Marc Riddick - *Sidoti & Company, LLC - Analyst*

Okay. And then the last thing for me, it's certainly when you're looking at the walk that you have there and sort of getting to certainly reduce leverage and the like. Can you sort of maybe talk about, and it might be a little early for this, but maybe future thoughts on returning capital to shareholders and sort of whether that takes the form of on thoughts around the potential dividend, share repurchase, that type of thing -- Any thoughts or early thoughts on sort of when you sort of get to the other side of the walk, how that might evolve? Thanks.

Stephen Wood - *Conduent Inc - Executive Vice President and Chief Financial Officer*

Mark, I'll take that. So if you think about the $1 billion of deployable capital that we've talked about generating and deploying and we're 66% through that, but if you piece together the various comments that we've made and think about debt that we've already prepaid authority to pay down more debt that we've got from the Board, the repurchase of the Icahn shares and then the other share repurchases that we've been making, we're sort of upwards of $880 million of that $1 billion already sort of earmarked, I would say, for deployment.

So it's about $120 million to $140 million to go that we haven't been declarative on. And so right now I feel that we're pretty good being in that situation. I think we've got to work through the remainder of the divestitures and get that stuff done. Clearly, we've got to -- which is kind of resident in how we're thinking about the second half of the year, we've got to get operating cash flow moving in the right direction. And then we've got about $120 million at some point in the medium term -- short- to medium-term, we'll be able to start thinking about deployment.

But I think we feel good right now with the path to generating the $1 billion. And I think we feel pretty good about having allocated and earmarked around $880 million of that, reducing the leverage, giving out a target -- net leverage ratio of 1x. And obviously, we've made significant strides to reduce the share count.

So that's the way we feel about it right now. We feel pretty comfortable about where we are. But obviously, there's a little bit more to come as we get through the next few quarters.

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Yeah, I think that's right. And I think a lot of those are Board decisions. And what I would say is Steve's got it exactly right, in the near term, we're going to stay the course, as Steve outlined.

Marc Riddick - *Sidoti & Company, LLC - Analyst*

Excellent. Thank you very much.

Operator

Thank you. Our next questions come from the line of Gowshi Sri with Singular Research. Please proceed with your questions.

Gowshihan Sriharan - *Singular Research - Analyst*

In the last previous call, I think you mentioned healthcare as a sector where you're seeing increased outsourcing. Is that the only sector you wanted to highlight? Or are there -- is that across the board, you're seeing an increased interest in outsourcing?

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Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

We're seeing certainly in healthcare, certainly in logistics. Certainly, anywhere where they in turn are being squeezed from an efficiency point of view. We're starting to see increased interest in outsourcing. And not just outsourcing, in many cases, refinement of the outsourcing relationships we already have and an increased appetite, believe it or not, for nearshore and offshore capabilities, which is obviously where the margins are quite a bit stronger for us, and we'd be far more interested in pursuing. And that's across the product spectrum of certainly CX, but also scanning, indexing, some FA&P. But we -- I would say, primarily healthcare and logistics, but I don't think it's contained only to those two. Steve?

Stephen Wood - *Conduent Inc - Executive Vice President and Chief Financial Officer*

I think actually the other thing I would add on is think about kind of Cliff's remarks about how we're seeing new opportunities to deploy some of the solutions that we've traditionally thought about commercial solutions in the -- into our public sector market.

And so, I think we think of that as an interesting market adjacency that's where we're seeing good fit for some of the solutions that we've traditionally thought of as being just in the commercial market.

I think, in addition to logistics and healthcare, we've got kind of strong -- we've always had strong positions in the travel and entertainment sector and also in automotive. And so, I think we're seeing that propensity to address cost and transformation pretty broadly across many of the verticals that we operate in.

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

That's a really good point. I think one of the secret sauces here, Gowshi, is to stop thinking in silos in terms of product suites and sectors. In other words, we have massive call center capabilities that could be deployed in the public sector. We have accounts payable and procurement capabilities that state and local governments need. There are a lot of cross functionality here that heretofore has not been tapped. So, I think it's not confined or contained to any one industry, and also it involves the public sector. So, it's coming from everywhere. We just got to execute on it.

Gowshihan Sriharan - *Singular Research - Analyst*

Okay. You also mentioned that when clients are considering offshoring to countries that they haven't previously considered. What new geographic markets are emerging as attractive outsourcing destinations? And do you guys have capability in that -- in those regions?

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Well, I think there's a little bit of -- and Steve can -- Steve runs a lot of our geographies in terms of country managers, so let him comment as well. But I think there's some experimentation going on. I mean there's quick looks at places like South Africa and Egypt. I don't think there's any widespread movement in those directions. The traditional places remain strong. Philippines remain strong. India remains strong. We've got a large presence in Guatemala and Jamaica. And so, I think we're seeing certainly some growth in the Philippines for sure and a resurgence in India. But Steve, what do you think?

Stephen Wood - *Conduent Inc - Executive Vice President and Chief Financial Officer*

Yeah. Only a little bit really to add there. I think that's right. I think the key clearly is to have a mix of nearshore capability and offshore capability. I think we like our geographic mix. I think as I said in my remarks, we're adding some capacity in a couple of places there because we're seeing increase in demand. I think there is that -- there can be a tendency to want to go and explore slightly more esoteric geographies. But I think the key in our business is building scale in key markets and driving cost efficiency in those locations, which is what we're focused on. And so, I think we're very happy with our geographic mix. I think it's a nice balance, and we're seeing continued demand for those geographies.

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Gowshihan Sriharan - *Singular Research - Analyst*

Thank you. Just one last question. So I'm relatively new to this name. Just in case -- I'm trying to understand how a typical revenue model with the Gen AI-Microsoft collaboration work? What would the typical engagement be like? And how does that collaboration -- the revenue model work for you?

Clifford Skelton - *Conduent Inc - President, Chief Executive Officer*

Well, it all starts with a go-to-market capability. Look, I mean, as you know, Gen AI takes a lot of compute power, which means data centers being built everywhere and a lot going into the public cloud and specifically Azure. And so, Microsoft's interest in the partnership, which by the way is very early in terms of what we hope to achieve. It would be, look, more business we get, the more business they get because the business is going to be hosted in the public cloud in Azure. And so that's a growth strategy for the company -- for their company.

In our case, we want to get more Gen AI out in the marketplace, and we want to prove that our products can be enhanced with Gen AI. So it's not like there's an exchange of revenue back and forth. It's basically we both win at the same time is sort of the model. I don't know if that got to what you were after, Gowshi, so maybe ask it again if I didn't answer it exactly.

Gowshihan Sriharan - *Singular Research - Analyst*

I think I understand. That's all I had for right now. Thank you, guys, for taking my question.

Operator

This does conclude the question-and-answer session. And with that, concludes today's teleconference. We appreciate your participation. You may disconnect your lines at this time. Enjoy the rest of your day.

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