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Unisys Corp. (UIS)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Unisys Corporation Third Quarter 2024 Financial Results and Conference Call. All participants will be in a listen-only mode. [Operator Instructions] Please note this event is being recorded.

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

Michaela M. Pewarski

Vice President-Investor Relations, Unisys Corp.

Thank you, operator. Good morning, everyone. Thank you for joining us. Yesterday afternoon, Unisys released its third quarter financial results. I'm joined this morning to discuss those results with Peter Altabef, our Chair and CEO; Deb McCann, our CFO; and Mike Thomson, our President and COO, who will participate in the Q&A session.

As a reminder, certain statements in today's conference call contain estimates and other forward-looking statements within the meaning of the securities laws. We caution listeners that the current expectations, assumptions and beliefs forming the basis for our forward-looking statements include many factors that are beyond our ability to control or estimate precisely. This could cause results to differ materially from our expectations. These items can also be found in the Forward-Looking Statements section of today's earnings release furnished on Form 8-K, and in our most recent Forms 10-K and 10-Q as filed with the SEC. We do not, by including this statement, assume any obligation to review or revise any particular forward-looking statement referenced herein in light of future events.

We will also be referring to certain non-GAAP financial measures such as non-GAAP operating profit or adjusted EBITDA that exclude certain items such as post-retirement expense, cost reduction activities and other expenses that the company believes are not indicative of its ongoing operations as they may be unusual or non-recurring. We believe these measures provide a more complete understanding of our financial performance. However, they are not intended to be a substitute for GAAP. The non-GAAP measures have been reconciled to the related GAAP measures, and we have provided reconciliations within the presentation. The slides accompanying today's call are available on our investor website.

With that, I'd like to turn the call over to Peter.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Michaela. Good morning, everyone, and thank you for joining us to discuss the company's third quarter results. It was another solid quarter of execution and we are pleased to be raising our full-year non-GAAP operating margin guidance, and have an improved outlook for 2024 free cash flow. Third quarter revenue grew 8.2% in constant currency, which keeps us on track to achieve our full-year revenue guidance range.

Our results provide a number of encouraging signs for future revenue, and our ability to accelerate growth next year. For example, new business TCV was up significantly year over year again this quarter, and with a higher contribution from new logo signings. We generated solid sequential growth in our pipeline with solutions that are well aligned to market demand. We expect an incremental $40 million of revenue upside this year in our L&S solutions, and we are slightly increasing our previous L&S forecast for the next two years.

Our results also demonstrate year-over-year expansion in our gross margin and non-GAAP operating margin, which are benefiting from our delivery and operational efficiency initiatives. Over the coming quarters, we expect to further enhance our pre-pension free cash flow as new business signings generate increasing revenue, we execute our efficiency plans and as legal and environmental payments decline through 2025 and 2026.

Looking more closely at our third quarter client signings, new business TCV grew 50% year over year and is up 32% year to date. Similar to the first half, new logos were a strong contributor to new business in the third quarter, and new logo TCV more than doubled year over year for the third consecutive quarter. Adding new clients to our base is important for future growth as they increase our potential to generate revenue from new scope and expansion opportunities. We have a number of these opportunities with new logos signed in the first half of the year.

In C&I (sic) [CA&I] (00:04:55), new logo signings were particularly strong, including in application development and cloud service engagements with public sector clients. For example, one of the most popular cities in the United States chose Unisys to transform, simplify and streamline its licensing and permitting processes. As part of this engagement, we will partner closely with this client to create an innovative city-wide system with a single point of entry, secure identity management and data protection.

In DWS, we also had a notable public sector new scope win with an existing large non-profit US hospital system client. Unisys will provide a variety of digital workplace solutions to modernize and upgrade end user devices and operating systems and work with individual hospitals and offices to ensure compliance with system-wide standards. This new scope adds to the IT support we already provide to nearly 200,000 end users at this point.

In ECS, there is demand for specialized services to modernize the infrastructure and application adjacent to our platforms. As an example, during the quarter, we signed a new scope to modernize mission critical infrastructure for an existing large European financial services client. In sales and marketing, we have accelerated our go-to-market speed, improved sales processes and technology adoption, including the adoption of new AI tools, are helping us prospect, scope, price and propose at a faster pace, leading to faster average sales cycles and our third quarter signings. Targeted solution focused campaigns and relevant thought leadership are improving the quality of our leads and new logo win rates, which are higher in the first three quarters compared to 2023.

I'll now discuss some of the trends we are seeing in our pipeline. Total pipeline grew 9% sequentially, including 10% growth in our Ex-L&S pipeline and positive sequential pipeline growth in all the geographic regions. We are building awareness of our innovation with existing clients through our client technology officers, and new business pipeline with existing clients increased more than 20% sequentially in our Ex-L&S solutions.

In CA&I, we have strengthened relationships with large key public sector clients where we saw an increase in new opportunities, driven by interest in our application development capabilities and security managed services. In DWS, we have a number of new opportunities in communication and collaboration, unified endpoint management solutions, and front line worker enablement. Many opportunities in our new logo pipeline include solutions from both DWS and CA&I. Initially engaging a new client in multiple segments increases the stickiness of the new relationship and also provides access to more adjacencies for expansion.

In the ECS segment, we are seeing new opportunities to help existing clients modernize and expand the digital capabilities in their application layers, especially in the financial services and public sectors, where our teams have deep industry and data expertise. We are seeing client demand for AI-enabled solutions in all three segments, and we are increasing adoption of AI in our delivery and internal corporate functions. There are more than 120 active AI projects across the company. The majority of these projects include generative AI, and many are forming the basis for standardized solution architectures. About 50 of these projects are in production, and about 40 of them are client facing. As an example, in DWS, our Unisys Service Experience Accelerator is a generative AI foundation and knowledge generator that we can deploy within a client's trusted environment, allowing it to securely leverage operational data and maintain data sovereignty.

In CA&I, we are custom engineering and education companion for one of our higher education clients. This generative AI offering uses specified open source textbook content, while interacting in multiple languages. It reduces barriers to education caused by language limitations and the need for physical textbook ownership with the result of making education more accessible to a diverse student body. We expect specialized generative AI knowledge assistance that are specific to an industry, function and organization to become commonplace productivity drivers. These systems can quickly identify gaps and inconsistencies in knowledge and generate content to accelerate cogeneration, solution development and training, building shared intelligence across delivery and solution architect.

In DWS and CA&I, we are deepening our capabilities in managed services that are required to run and optimize AI workloads such as multi-cloud management and data center management solutions. This includes managing and servicing data and, where applicable, the physical infrastructure required in AI factories. In our corporate functions, we have engineered specialized generative AI assistants to navigate internal systems and policies more efficiently.

In ECS, we are innovating our travel and transportation solution portfolio. This includes Unisys Logistics Optimization, our cargo capacity, warehousing and routing solution that leverages both AI and quantum annealing. We are enhancing this solution by expanding cargo and container types for capacity optimization, and are adding revenue management capabilities to enable financial forecasting and contract optimization through the platform.

We will also begin offering multi-modal routing in the near future. Recognizing our innovation in Travel & Transportation, Avasant included Unisys as a disruptor in its Air Freight and Logistics Digital Services RadarView published during the third quarter. We are also increasing awareness in our travel and transportation portfolio enhancements with our base of airline and freight forwarder clients. These existing relationships position us as a known provider in the industry for scaling new solutions such as Unisys Logistics Optimization. Also in the third quarter, we added a new airline client through our Cargo Portal solution, which will allow this top five global air cargo carrier to sell capacity to freight forwarders booking through our portal.

I'll now touch on the progress we are making from our workforce initiatives. Our success with new logos has created a host of new opportunities for associated development. And our initiatives to map talent and facilitate mobility have allowed us to improve internal fulfillment rates on new logos. As part of our internal efforts to improve delivery efficiency, we are also increasing campus hiring and optimizing our labor markets. We are investing in technology, process improvement and talent initiatives that prioritize skill development and career growth for our employees, while expanding our capabilities in areas relevant to our clients. Our trailing 12-month voluntary attrition is low at 11.8%, which compares to 13.3% a year ago.

Before turning the call over to Deb, I want to share some of the recent acknowledgments we received from third-party analysts and advisors. These industry experts influence client decisions and access to RFPs, and we have been building awareness and relevance with this group. Unisys has received a number of new recognitions from these industry experts. Since June, Avasant, Everest, ISG and NelsonHall have published reports recognizing our solutions. These include leader designations from ISG in global digital workplace services; from Everest in a new report for Digital Workplace Services for Mid-Market Enterprises; and from NelsonHall in End-to-End Cloud and Infrastructure Management Services.

I'll now hand the call over to Deb to discuss our financial results in more detail.

Debra McCann

Executive Vice President & Chief Financial Officer, Unisys Corp.

Thank you, Peter, and good morning, everyone. As a reminder, my discussion today will reference slides from the supplemental presentation posted on our website. I'll be discussing total revenue growth both as reported and in constant currency, and segment growth in constant currency only. I will also provide information excluding License and Support revenue or Ex-L&S, to allow investors to assess the progress we're making outside of the portion of EPS for revenue and profit recognition is tied to license renewal timing, which can be uneven between quarters.

As Peter discussed, we continued to lay a strong foundation for future growth in the third quarter. Growth in new business signings remained strong on a year-over-year basis, and we are attracting new clients which will fuel new scope and expansion. Backlog is up from the prior year and our pipeline grew sequentially. Additionally, ECS revenue and profit is exceeding our forecast, and we are delivering on our efficiency plans, translating to profit and free cash flow upside for the full year.

Looking at our results in more detail, you can see on slide 4 that third quarter revenue was $497 million, an increase of 7% year over year or 8.2% in constant currency. Growth was driven by L&S. Excluding License and Support, third quarter revenue was $393 million, a decline of 1.3% year over year and 0.1% in constant currency. Year to date, Ex-L&S revenue was up 0.9% year over year or 1% in constant currency. We expect full year Ex-L&S revenue growth near the low end of our previous range of 1.5% to 5% in constant currency, primarily due to lower in-year revenue from our mix of 2024 signings. New logos were a much stronger contributor to our growth in new business signings year to date. Many of these were long-term contracts that expand our revenue base, and give us increased confidence we will grow Ex-L&S revenue closer to our long-term target rates in 2025.

I'll now discuss our segment results in constant currency terms. Digital Workplace Solutions revenue was $131 million, a 7.1% decline compared to the prior-year period, as expected. The third quarter and year-to-date declines were primarily driven by lower discretionary volume with clients, including third-party technology revenue. New business signings in the DWS segment are up 46% year to date. The majority of those signings in the second and third quarter are just beginning to generate revenue, and will support revenue growth into 2025.

Cloud Applications & Infrastructure Solutions revenue was $132 million, a 1.5% decline compared to the prior-year period. The decline was driven by some lumpiness in non-recurring revenue and project volumes with commercial clients in the United States. Enterprise Computing Solutions revenue was $158 million in the third quarter, an increase of 29.2% compared to the prior-year period. Specialized Services and Next-Generation Compute Solutions revenue grew 2.5% in constant currency, led by growth in specialized services with commercial sector clients and application services revenue with financial services clients.

License and Support revenue within ECS was $105 million, an increase of 57% year over year in constant currency. This exceeded the $90 million we had expected for the quarter, predominantly due to a third quarter renewal we had expected in the fourth quarter. We now expect approximately $415 million of L&S revenue for the full year compared to our previous outlook of approximately $375 million. The majority of this upside is related to an increase in deal sizes within our expected fourth quarter revenue. We do not anticipate this revenue and profit upside will negatively impact our future overall expectations.

For 2025 and 2026, we anticipate annual L&S revenue of $370 million on average, a slight increase from our prior expectation. It is important to remember that the timing and exact amount of L&S revenue can be difficult to forecast with precision, given it is dependent on renewal timing, which can change based on client budgeting decisions and renewal size, which can change based on consumption levels and contract duration, among other factors. We exited the quarter with a backlog of $2.8 billion, up 18% year over year, with aggregate DWS and CA&I backlog up nearly 25%. Trailing 12-month book-to-bill is 1.2 times for both the total company and our Ex-L&S solutions.

Moving to slide 6. Third quarter gross profit was $145 million, a 29.2% gross margin. This compares to gross profit of $95 million, and a 20.5% gross margin in the prior-year period, an expansion of 870 basis points. This was primarily driven by L&S solutions with additional benefit from increased profitability in the remainder of the business. Excluding License and Support, gross margin was 17.9%, up 390 basis points year over year. As a reminder, in the third quarter of 2023, we also recognized a revenue reversal related to a previously exited contract, which had a 200 basis point impact on Ex-L&S gross margin. The remaining 190 basis point improvement was due to improved delivery efficiency through workforce optimization, and increasing use of automation and AI.

On a sequential basis, our third quarter Ex-L&S gross margin included an incremental 70 basis points of impact from workforce optimization investments we made to drive future gross margin expansion. We are pleased that our improved profitability year to date is being driven by improvement in our Ex-L&S solutions and we continue to expect full year Ex-L&S gross margin to expand towards the 150 basis point to 200 basis point range that we are targeting annually through 2026.

DWS segment gross margin was 16.3% in the third quarter, up 150 basis points year over year, driven by delivery improvement. Future DWS margin improvement is expected to come from a combination of higher value new business and frontline worker delivery improvement, where we continue to invest in technology and training to improve associate utilization and productivity.

CA&I segment gross margin was 16.3% in the quarter, up 100 basis points year over year. Workforce optimization initiatives, including expanded campus hiring, are continuing to yield positive results. Going forward, we expect to see increasing gains from the use of automation and AI, and are focused on further optimizing labor markets. ECS segment gross margin was 60% in the third quarter, up from 50.2% in the prior year due to increased revenue from our L&S solutions over a relatively steady cost base.

Moving to slide 7, third quarter non-GAAP operating profit margin was 9.9%, up from 0.1% in the prior period, and above the mid-single digit color provided last quarter, primarily driven by L&S revenue. Operating expenses also declined on a sequential and year-over-year basis, driven by a decline in legal expenses, as well as G&A cost savings. We remain focused on streamlining corporate functions, rationalizing real estate and centralizing IT, while also investing in go-to-market. We are targeting run rate SG&A expenses of approximately 17% of revenue by the end of 2026.

Third quarter adjusted EBITDA was $77 million and adjusted EBITDA margin was 15.5% compared to 8% in the prior-year period. For the first nine months, our adjusted EBITDA margin was 13.7%, an expansion of 100 basis points. Third quarter GAAP net loss was $62 million, a diluted loss per share of $0.89. This compares to a net loss of $50 million or $0.73 in the third quarter of 2023. The GAAP net loss includes both a non-cash goodwill impairment of $39 million related to the DWS segment, or a $0.56 impact to GAAP EPS as well as a tax accrual established for certain foreign subsidiaries of $29 million or $0.42 impact to GAAP EPS. The tax accrual is related to historical profit generated in those jurisdictions and increases our flexibility to allocate this capital more optimally across the business. Excluding these two non-cash items, GAAP net income (sic) [net loss] would be a gain of $6 million or $0.09 per share. On an adjusted basis, third quarter net loss was $6 million or diluted loss per share of $0.08 compared to a loss of $22 million or $0.33 per share in the prior year. Excluding the net impact of the tax accrual, we would have generated adjusted net income of $23 million or earnings per share of $0.34.

Turning to slide 8, capital expenditures totaled approximately $18 million in the third quarter and $59 million year to date, which is relatively flat year over year. As a reminder, a significant portion of capital expenditures relates to research and development for our L&S platform, and we are maintaining a capital-light strategy. Free cash flow was $14 million in the quarter compared to negative $26 million in the prior-year period driven by L&S renewal level, and a $9 million benefit related to a favorable settlement of a Brazilian tax matter, for which we recognized a gain in the first quarter. These were partially offset by working capital dynamics related to L&S collections that are expected to benefit the fourth quarter. Year to date, free cash flow is negative $0.4 million compared to negative $8.5 million in the prior-year period. Excluding pension and postretirement contributions, environmental, restructuring and other, and certain legal payments, which includes the tax settlement, adjusted free cash flow was $28 million in the third quarter and $38 million for the first nine months.

Moving to slide 9, cash balances were $374 million as of September 30, compared to $388 million at year-end. Given our increased cash generation outlook, we expect year-end cash balances to be up on a year-over-year basis. Our net leverage ratio is 0.4 times, down from 0.6 times at second quarter. Including all defined benefit pension plans, our net leverage ratio is 2.8 times compared to 3.3 times last quarter. Earlier this week, we strengthened our liquidity position by obtaining a three-year extension on our ABL facility, which has capacity of $125 million with an accordion feature up to $155 million, and matures at the end of October 2027. Our ABL remains undrawn, and this expansion aligns the facility with our $485 million senior secured notes maturing November 2027.

I'll now provide an update on our global pension plans. Each year-end, we provide detailed estimated projections for expected global cash, pension contributions and GAAP deficit, which change based on factors such as financial market conditions, funding regulations and actuarial assumptions. We also provide quarterly updates, which are estimated and do not have the same level of detail. Based on asset returns and market conditions, we estimate that as of September 30, 2024, both our GAAP deficit and expected cash contributions for the next five years, which is 2024 to 2028, are essentially unchanged from year-end 2023.

Turning to slide 10, I will now discuss our financial guidance. For the full year, we continue to expect total company revenue growth of negative 1.5% to positive 1.5% in constant currency, which based on recent foreign exchange rates, now equates to reported revenue of negative 1% to positive 2%. Non-GAAP operating profit margin is now expected to be between 6.5% and 8.5%, an increase from our previous guidance of 5.5% to 7.5%, primarily due to higher expected L&S revenue. In the fourth quarter, we anticipate approximately $20 million of legal, environmental, restructuring and other charges in aggregate, primarily related to restructuring and other as we continue to streamline our portfolio and accelerate our G&A efficiency initiatives.

For the full year, we now expect approximately $30 million of free cash flow, up from prior expectations of approximately $10 million. The increase is primarily due to improved profitability and lower legal, environmental, restructuring and other payments, which is partially offset by fluctuations in working capital largely related to L&S collections. We continue to expect declining legal, environmental and other payments during the coming years, during which we also expect an approximate $30 million partial reimbursement of certain environmental costs, once cleanup work has been approved and finalized. The remainder of the assumptions underlying our free cash flow expectations are essentially unchanged, and can be found on slide 10 of the supplemental presentation.

With that, I'll turn the call back to Peter.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Deb. Before taking questions, I want to emphasize three important points we hope you take away from today's remarks. First, we are increasing our 2024 profitability guidance, primarily due to an increase in our L&S revenue expectations. And we are slightly raising our outlook for average annual L&S revenue in 2025 and 2026. Second, we have increased our full-year free cash flow expectations from $10 million to approximately $30 million, and obtained an extension on our ABL, strengthening our liquidity position. And third, our new business signings are up 32% year to date and 50% in the quarter on a year-over-year basis, driven by long-term contracts that expand our recurring Ex-L&S revenue base.

Operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question today comes from Rod Bourgeois with DeepDive Equity Research. Please go ahead.

Rod Bourgeois
Analyst, DeepDive Equity Research

Q

Okay. Thank you. Hey. So, I want to first ask about the L&S revenue outlook. You had an above expected renewal in L&S in Q3. Sometimes, that can pull from future revenues, but you're increasing your L&S revenue outlook for the next couple of years. That's encouraging. I just wanted to ask about what is enabling you to increase your L&S revenue outlook? Thanks.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. Thanks very much. And for those of you new to this call, that's Rod Bourgeois. And I will have two folks on the call with me, Mike Thomson, who is our Chief Operating Officer and President; and Deb McCann, who you've already heard from as the CFO. And so, the three of us will go back and forth on questions.

At a very high level, Rod, thanks for your question. And you're exactly right in what you took away from our discussion. We did raise in-year L&S revenue guidance or projections, and we specifically slightly increased the 2025 and 2026 average. And we also made a reference in the remarks to the fact that we do not expect that these changes will lower the expected revenue that we have from L&S in the future. So, we really believe these are incremental additions to our overall profitability, and we're enthusiastic about it. Again, we only slightly raised the 2025 and 2026 L&S projections, so not the same level as the changes in 2024, but we're not reducing them anywhere. Mike, any further insight into that?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Thanks for the question, Rod. Just maybe a couple of things, and I know you know this business well, but for the group on the phone here. Clearly, it's a very sticky business. If you recall, back when we were doing our Investor Day, we talked about that average being around $360 million per year, as Deb indicated, we've increased that to $370 million. I think what you've seen from us over the last several years at business is that we've continued able to have strong pricing power in that, and we continue to see strong consumption in that business. And that's the reason for the incremental uptick in that business.

So, to Peter's point, it's not a pull from the future, although, obviously the short-term aspect of renewal and the length of that contract term is. But in our long-term projections, as indicated, we're taking those both up in 2025 and 2026, albeit slightly. But again, I think a good proof point on the stickiness of that business, our ability to maintain pricing in that business and the continued consumption in that business. So, hopefully, that gives you a little color, Rod.

Rod Bourgeois
Analyst, DeepDive Equity Research

Q

Yeah. Just a quick follow-up on that. I mean, there is a view that the L&S business is a legacy business that has the propensity to fade over time, but yet, your revenue outlook is going up. And you mentioned increased consumption volumes. I think that trend started over a year ago, and it seems to be continuing to happen. Does that mean when you renew an L&S deal, the renewals, are they coming in at higher – consistently at higher volumes and that's what's contributing to the somewhat better revenue outlook? Is it the renewals embedding higher volumes, is that what's going on?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

I think some of it is embedded higher volume, some of it is also increased pricing as you think about the longer-term aspect of the support component of that. As you know, Rod, these deals are three, five and seven year, if I look at them in those three buckets. So, I think there is a mix of what I would consider consumption and pricing power, when we talk about that. But internally when we think about this business – you used the term a legacy business. And it's true that it's been a strong business for us for decades. But we think about it through the lens of L&S, ClearPath 2050 and our roadmap and the things that we've done over the course of the last, I'll say, three to five years in building that business up and really making it future-proof, making it cloud-enabled, open AI. We have a lot of apps development and modernization around the perimeter, and we continue through that apps modernization to drive traffic to the core L&S.

So, we have a very long-term view of this business. And I would say at least in the client signings that we've seen recently where we've been surprised in the sense of enhanced revenue. It's really around the extension of these deals. And I think again, that speaks to the stickiness of it and the support from our client base for long-term view on support of this business. A five-year deal turning into a seven-year or a three-year turning into a five or seven year really gives us great comfort that there's strong support for the continued growth in this business.

Rod Bourgeois
Analyst, DeepDive Equity Research

Q

Okay. Got it. And then, just real quick, in the DWS business, you cited some weakening in the discretionary volumes in that business. Can you just give some color on the discretionary business that weakened? And then, is the outlook there more stable or is there further -are you seeing any further risk on the discretionary side in DWS?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. Let me take that first, Rod, and again, hand it over to Mike. We expect our signings for DWS over the course of the year to be very strong. What we have seen so far in the year is that the signings have been largely longer term and less project work. So, they have resulted in less revenue in an immediate context, because it takes longer-term contracts longer to begin to be revenue producing. That's why when you see our year-to-date new business in DWS, it's very strong, but less strong from a revenue standpoint. We also expect a strong quarter of DWS signings in the fourth quarter.

So, from our perspective, it has been a bit weaker in the discretionary short-term project work. But long term, we feel very good about the prospects for DWS. We believe that that market in general is still beginning to kind of work its way through. We have been committed to that market. We stay committed to that market. We think that's a differentiator for our company, and we intend to get market share as some other people do not necessarily focus on that market. So, we feel very good about that market. But for the short term, it has had slightly less short-term discretionary revenue.

Mike, thoughts on that?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Look, I think you covered the primary points, Peter, on that. The only thing I would add, Rod, as you know and see, the market in general has still been a little soft. I would say we are seeing at least based on our pipeline, a kind of a little bit of a reduced exposure in that. Clearly, the deals that we've signed already, to Peter's point, are longer term deals. As you know, we've got a three to six month transition. So, that backlog in those businesses we see, as Deb indicated on her comments, a strong backlog, which really support growth in that business in line with our expectations in 2025 and beyond.

And the other thing, I'll say, is there has been a little bit of a mix shift in that business in the sense that when I look backwards, there's a third-party component in there that has not been as fully resonant in the current quarter. But we still expect as we progressed forward that that will pick back up. So, probably a little lighter third-party component, which is some of the weakness that we're seeing on a quarter-over-quarter or year-over-year expectation. But the reality is, the backlog already has these longer-term deals in it. And as Deb indicated on her comments, when you have that support in your recurring base, it is a growth opportunity on top of that and new scope and expansion post the revenue recognition normalizing. So, to Peter's point, we feel really good about the strength of that business, really good about the ultimate growth potential in that business aligned with our expectation and probably starting to see some benefits from a little stronger market demand.

Rod Bourgeois
Analyst, DeepDive Equity Research

Q

Great. Thank you, guys.

Operator: Next question comes from Joseph Vafi with Canaccord. Please go ahead.

Joseph Vafi
Analyst, Canaccord Genuity LLC

Q

Hey, everyone. Good morning. Thanks for all the color. Just following up on Rod's question on L&S, I get the dynamics on maybe pricing and consumption, but it does feel like the upside in Q3 was pretty big. And then, Q4 is clearly looks like it's going to come in pretty strong. And when you kind of add up that upside, it seems more than a kind of fine-tune up to the outlook. So just wanted to drill down into that a little bit more. And then I'll have a follow-up. Thanks.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. This is Peter. Thank you very much, Joe. So, the upside in the third quarter numbers, as Deb mentioned, is largely a pull-through from – pull-through is wrong word, it's largely revenue that we had been expecting in the fourth quarter that's coming into the third quarter. The upside in the fourth quarter is not. So, the upside in the fourth quarter is revenue that was not in our guided numbers and was not reflected in, let's say, the 2025, 2026, and is really incremental revenue. So, that's revenue coming in from a variety of sources. There's not just one thing, but we consider that incremental revenue.

And while we are slightly increasing the 2025 and 2026 average, we're obviously not pulling that incremental revenue into a year-to-year analysis, but we're excited about it. As Mike said, it's all good news and I think it does show the strength of really our approach to ClearPath Forward. Chris Arrasmith, who leads that team for us about two years ago, started what Mike referred to as ClearPath Forward 2050. And ClearPath Forward 2050 really provides a roadmap not just for the next year or so, but a really a long-term roadmap around all sorts of things. And that includes, going out in the future post-quantum encryption. So, it's very vibrant. It shows the clients that not only are we investing, but we're investing effectively in that market. We will always have up and downs depending on cycles and contracts. We could have a quarter up or a quarter or we can have a year up or a year down. But it is a vibrant, important part of this company. And I think you're seeing that in the numbers. Mike?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Again, I think you covered a bunch. And, Joe, I think we picked up a handful of these on Rod. But again, I think consistently over the course of the last couple of years, we're seeing strong consumption. When we typically have a client that ends up either signing early or wanting to extend, that's usually a byproduct of enhanced consumption. And maybe getting a little bit of inside baseball here. But when we talk about that, it's really that we have a consumption model embedded in a contract. And when they consume that and they go beyond that need, they typically have an uptick in pricing.

So, what ultimately happens instead of paying the uptick in pricing at kind of list pricing rates, they come back and they want to extend the contract for a longer duration. And then, obviously, there's an upfront revenue recognition with that. But at the end of the day, it's about they're using that consumption and then some, and it also proves the pricing power and value of the ClearPath Forward operating system to those particular clients.

So, again, feel really good about the longevity of that, feel really good about our ability to maintain that base, in fact, enhance that base slightly, and then feel really good about the continued use and our ability to modernize around that base, so that the end user experience is enhanced utilizing the legacy tools. So, it really gives us a lot of vectors to kind of attach to that existing client base. And I think that's – what you've been seeing over the course of the last couple of years and what you're seeing as the basis for the increase in 2025 and 2026.

Joseph Vafi
Analyst, Canaccord Genuity LLC

Q

Perfect. Great. That all makes sense. And it's nice to see. So – and then maybe just secondly, it does feel like new TCV signings are up, which is great. Maybe kind of just – and I know you talked a little bit about duration on some of that TCV, that new TCV. Maybe kind of touch on renewal dynamics outside of new contract TCV, and how that's trending and how that may affect or influence the outlook moving forward? Thanks a lot, guys.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

And Mike, that one is for you as well.

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Thanks again, Joe. Look, I would say, as Deb indicated on her commentary, the signings were all primarily for longer term contracts. The one thing we probably didn't note in there, it should have, there are also multi-segment, right? They're primarily a mix of DWS and CA&I, which as we've talked about in the past is a much stickier proposition for us. Most of those signings are kind of three-year duration type things, which are pretty consistent to our managed service base. And so, when we see the, I'll say, the average contract length, it's been pretty consistent across the board, and we continue to have very strong renewal rates, right? We talk about that in the 95-plus-percent range from renewal base on the existing client base. So, that continues to trend in that same manner. We're not only maintaining those clients.

I would also add that a lot of those renewals that we do end up being renewals-plus, right? We've been able to effectively add some new scope or expand that renewals. So, we talk about those renewal rates and it's really important for us to maintain and keep that base to support our future growth. But most of that is coming with renewal-plus. And that plus can be either new work, new scope, bringing in some of the new solutions or ultimately modernization and/or helping our cross-sell opportunities. So, we feel great about the renewal base as we have historically. And I think that speaks to our really strong NPS scores, and CSAT scores that our clients continue to renew with us at that group level, and then, are continuing to add to those renewals.

And then, the new base that we brought in, Joe, just adds to that renewal base. And as you know, we have a very strong – if you think about our renewal base year on year, 80%-ish of our revenue is kind of recurring and that we keep adding these longer term contracts to the renewal base that allow for continued expansion in the future. So, from a strategic point of view, very happy to see that, and very consistent with what we talked about even back in our Investor Day from 2023, very consistent with that model, and very directionally consistent with that model.

Joseph Vafi
Analyst, Canaccord Genuity LLC

Q

Great. Thanks for that color, Mike. Thanks, everybody.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Thank you, Joe.

Operator: The next question comes from Anja Soderstrom with Sidoti. Please go ahead.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Hi, everyone. And congrats on the nice progress this quarter and thank you for taking my questions. I have a follow-up on the L&S revenue as well and the outlook there. To what magnitude you expect it to increase in 2025 and 2026?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Anja, this is Peter. I got most of the question, L&S, what is the question about 2025 and 2026?

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

You were talking about the outlook, you expect that revenue to be higher for 2026 and 2025 for L&S. Can you just speak to what magnitude?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yes. So, if you look at what we have previously guided to, we have previously guided to revenue of about $370 million on average for 2024, 2025 and 2026. We had already guided to $375 million for 2024, which implied a slightly lower average than $370 million for 2025 and 2026. So, what we're doing today, obviously, our 2024 number has now gone above that $375 million, but we're also increasing the 2025 and 2026 only average to $370 million. It was below $370 million before, because all three numbers were average at $370 million. So, we've categorized it as a slight increase. And the real reason for that is, because we do have a slight increase. And we also want to highlight the fact that the increase this year is not expected to decrease our expectations for 2025 and 2026. Those expectations have slightly increased.

Deb, any further color on that?

Debra McCann
Executive Vice President & Chief Financial Officer, Unisys Corp. A

No, no, I think that is exactly right, the math you went through. So good. Thank you.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp. A

Anja, I don't know if that answers the question or not.

Anja Soderstrom
Analyst, Sidoti & Co. LLC Q

Yes, it did. Thank you. That was helpful. And then, I'm just curious about the goodwill impairment for DWS, so what's that for?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp. A

Deb, do you...

Debra McCann
Executive Vice President & Chief Financial Officer, Unisys Corp. A

Right. Hi. Thank you. Peter, do you want me to take that?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp. A

Please.

Debra McCann
Executive Vice President & Chief Financial Officer, Unisys Corp. A

Okay. So, yes, it was a non-cash impairment we took in the third quarter and really it was triggered by economic and industry dynamics that overall – and you probably hear it on several calls – are impacting the pace of client signings. And so, when we kind of apply that market lens to our forecast, resulted in an impairment. So, I think, many large competitors in the market are facing significant challenges in the DWS solutions, which we have to take into consideration as we do our valuation testing.

We're still, as we've talked about, really enthusiastic about the DWS space. We're looking for Unisys to take share. And as we've talked about, 46% year-over-year growth in our new business TCV. So, we're seeing a lot of really good indicators and ongoing demand for our solutions. But when we take that market lens, kind of apply it to our forecast, that's really what resulted in the impairment. So, it is non-cash. So, it impacts our EPS. And as I mentioned on the call, without that as well as with the tax deferral, we would have been a lot higher with our EPS. But that's the result of that. So, did that answer your question?

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Yes, that was helpful. And then, I'm just curious about the margin expansion in the Ex-L&S. You see good expansion there as well and you forecasted for this year, but where are you in the innings with efficiencies there and how should we think about that margin expanding next year, will that be driven by continued efficiencies or more by scale?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

So, when we think about margin expansion, we're really thinking about it three ways, Anja. One way is we're selling more value-added solutions. So, we think the pricing that we're getting for our newer solutions will be at a higher margin than the previous solutions that we offered. And that's really true kind of across the board. There's obviously competitive pressure, but we think we're adding more value to our clients than we had before. So, the pricing we expect inherently to have more margin.

The second part of that is the delivery efficiencies within the things we are providing to our clients. So, delivery efficiencies. And the third is really our SG&A. So, our SG&A, we have a very specific plan to reduce SG&A over time. So, all three of those really will affect our profit margins going forward. And, Deb, if you want to give color on any of those three, please go ahead.

Debra McCann
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

No, I think, Peter, you covered everything. I think the efficiencies we laid out when we talked at our Investor Day, that improvement in gross margin that we expect each year. And I think we're achieving those and will continue to, as we laid out. So...

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Okay. Thank you. That was all for me.

Operator: The next question comes from Arun Seshadri with BNP Paribas. Please go ahead.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Hello, everyone. Thanks for squeezing me in. Just wanted to ask on the Ex-L&S side. It sounds like your – it's good to see the new business pipeline was up sequentially pretty nicely. If you could unpack that and also maybe talk a little bit about I think the Ex-L&S revenue has been flattish ex-foreign currency for the last couple of quarters. But the new business pipeline, it sounds like the outlook overall there is improving for growth to trend back, I guess maybe to the middle or hopefully the higher end of your [ph] 1.5% to 5% (00:53:51) range. But just if you could sort of address that specifically, I know you've discussed it in the context of DWS, but just would love to hear a sort of a broader look on the Ex-L&S side?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. Arun, thanks very much. Obviously, we are very pleased to see the pipeline increasing sequentially, 9% and 10% for that Ex-L&S pipeline increasing. We're also very enthusiastic about the backlog increases. Mike, any further color on either of those that you want to add?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Look, Arun, thanks for the question, and I'm glad you pointed it out. I do have a couple of things I'd like to add there. So, we talked a little bit about the softness in discretionary spend in general in the sector. But what we also talked about is this increase in pipeline and the increase in backlog. And based on the increase in backlog and our renewal schedule, I think the way that you've characterized your question even is really great in the sense that it gives us a tremendous amount of confidence that the growth trajectory that we have put forth for that business is starting to be underpinned in our backlog, right? So, really the strength of that business and starting to see some of that softening and the contracts we already signed for that business in the year is really giving us that high degree of confidence.

And I would almost tie it into Anja's question a little bit, we've seen the margin improvement in that Ex-L&S business to the tune of, as Deb indicated, about almost 300 basis points of improvement across the board, I think, when we look at the overall kind of Ex-L&S space. And to Peter's point, a lot of the future is coming from increased revenue. So, we've been able to prove the dynamics of our delivery, drive that margin benefit and do that on a fairly flat revenue base to indicate it. And now, we're seeing the backlog really support revenue growth, which will help expand those margins in the future.

I think Deb talked about 150 basis points to 200 basis points improvement over the next two years and add Ex-L&S space. To Peter's point, some of that's from top line growth that we feel like is embedded in our backlog, and then some continual delivery. So that's the reason why we feel very strongly about that market in general. I think we got our strategy right. I think that the kind of external efforts that Peter mentioned around our selling and our go-to-market are starting to really resonate. Peter talked about the analyst component of that, so that the visibility, the introduction to our fees are also building up our pipeline and our backlog, and then ultimately translating that to wins. So, again, feeling pretty comfortable and strong about returning to that growth on the top line and having that enhance the profit that we've already seen.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Thank you for that, Mike. That was helpful. And then, just one other quick thing. Is there – as your outlook for L&S has improved, is there any – can you talk about the attach of Ex-L&S to L&S revenue at a high level? Has that changed in any way or do you see that changing in any way? That's all I had. Thanks.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. Mike already – well, I think, Mike, if you – as you talk about that, there's really two questions. One is a fundamental effort, Arun, that we've had companywide and I mentioned it in comments to attach even at the time of signing of a new client more than one segment. And so, that would be DWS, CA&I or ECS. And we've been very effective with that. Now, your question is very specific. It's when as we saw in L&S business, we've been able to attach DWS or CA&I business to L&S. So, Mike, do you have any specifics on that element of the overall strategy?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Yeah. Arun, again, thanks for the question. I would say that the closest and easiest attachment that we see is really around apps modernization. We talked briefly around that user experience and it really sits around the core. So, we've actually had some pretty good success on the apps modernization side attached to specifically ClearPath Forward clients and ClearPath Forward ecosystem. I mean, we have clients that have hundreds of applications that are kind of custom apps that sit on top of our ClearPath Forward operating system, right. So, who better to help modernize that and that's the attachment either to CA&I or SS&C, which is the kind of next-gen component of our ECS practice. There's a really definitive attachment there. That is a market we target explicitly, and it's a market that we've seen real good take-up rates, and also growth – not only growth we've already seen in SS&C for that apps modernization, but growth in the pipeline to continue to modernize around the operating system to get the benefits of some cloud type activity on top of the current operating system. And it also help us direct that consumption to maintain that base. So, there's a lot of real benefits for us to do that, and it's probably much more akin to attachment to CA&I as well as the other components of ECS.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Excellent. Thanks, Arun.

Arun Seshadri
Analyst, BNP Paribas Securities Corp.

Q

Very helpful. Thank you.

Operator: The next question comes from [indiscernible] (01:00:10) with Jefferies. Please go ahead.

Q

Hey, guys. Thank you for squeezing me in. And congrats on the strong quarter and the raise to the outlook here. Just one question from my end. Obviously, the new logo signings very strong in the pipeline growth sequentially. Can you just parse out maybe a bit more specifically where you're seeing success with new customers across capabilities or geographies or end markets, just so we have a sense of where that new activity is coming from?

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Yeah. Thanks very much. And one of the things that is interesting about this company is, from a geography standpoint, we have a lot of diversity. We have about 44% of our revenue in the US, so about 56% outside the US, 28% in EMEA and about 16% and 12%, respectively, in Asia Pacific and Latin America. And the result of that diversification means we really are not overly dependent on any one country or any one region. And as different countries and region experience different growth rates, we can kind of migrate a bit our emphasis to those areas where we think there's bigger growth. Mike, any specifics on that question?

Michael M. Thomson
President & Chief Operating Officer, Unisys Corp.

A

Look, I would say, [indiscernible] (01:01:32), first, thanks for the question. I think the diversity, not only from a geography perspective, but also from a sector or segment perspective, it's true we are seeing our solutions and frankly, our strategy is our solutions, although geared to a specific industry, when we have dialogue on how it applies, are homogeneously applied, right? So, I don't think that there's any kind of one sector or region that dominate that spend, which is great, right? We want to have solutions that are universally applied. They always have a very specific industry slant or sector slant or even region slant when we tailor it to our clients.

But in general, I would say we're seeing a much more combined offering when we go to market and the success that we had, I mentioned on one of the other comments earlier here, most of the new logos and the new business that we're signing are either adding a component to an existing base that gives us that cross-sell component to it or the business itself when it signs a new logo has both our DWS and CA&I component pieces in it.

So, one of the beauties of our strategy, I think, is that regardless of the starting point, there's a connection to the other solutions that we do. And it really depends on the scope of the client, RFP or RFI that comes our way and we can pivot our messaging to be tailored to that specific ask. So, I guess the macro view is pretty diverse, both regionally and by industry, and can be tailored to those. So, our solutions in general are resonating. And I think there that you could look at that how it resonates both from the industry analyst perspective, and the things that Peter mentioned around how we sit in those various quadrants, and then into solutions that we've had success in penetrating this soft market with.

Q

Okay, great. That's very helpful. Thank you for the time today.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

A

Thank you.

Operator: The question-and-answer session has now ended. I would like to turn the conference back over for closing remarks.

Peter A. Altabef
Chair & Chief Executive Officer, Unisys Corp.

Thank you, operator. And I really want to thank everyone for your indulgence in keeping you a little longer for this. There was a lot to cover. There is still more on our website, which is actively updated, and I encourage you to kind of take a look at it as you go about your other efforts. We're frankly very, very excited about what we announced this quarter, the increased profitability guidance of the increased expectation on free cash flow, the increase in new business signings year to date up 32% and 50% for the quarter, which we think that ultimately that will expand our recurring Ex-L&S revenue as well as obviously the good news on L&S that you heard today. So, thank you again for following us, and we look forward to the next call.

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