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Unisys Corp. (UIS)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Unisys Corporation Fourth Quarter and Full-Year 2021 Earnings Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

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

Courtney Holben

Vice President-Investor Relations, Unisys Corp.

Thank you, operator. Good morning, everyone. This is Courtney Holben, Vice President of Investor Relations. Thank you for joining us. Yesterday afternoon, Unisys released its fourth quarter and full-year 2021 financial results. I'm joined this morning to discuss those results by Peter Altabef, our Chair and CEO; and Mike Thomson, our CFO.

Before we begin, I'd like to cover a few details. First, today's conference call and the Q&A session are being webcast via the Unisys investor website. Second, you can find the earnings press release and the presentation slides that we will be using this morning to guide our discussion, as well as other information relating to our fourth quarter and full-year performance on our investor website, which we encourage you to visit. Third, today's presentation, which is complementary to the earnings press release, includes some non-GAAP financial measures.

The non-GAAP measures have been reconciled to the related GAAP measures, and we've provided reconciliations within the presentation. Although appropriate under generally accepted accounting principles, the

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company's results reflect charges that the company believes are not indicative of its ongoing operations and that can make its profitability and liquidity results difficult compared to prior periods, anticipated future periods or to its competitors' results. These items consist of post-retirement, debt exchange and extinguishment, and cost reduction and other expense.

Management believes each of these items can distort visibility of trends associated with the company's ongoing performance. Management also believes that the evaluation of the company's financial performance can be enhanced by use of supplemental presentation of its results that exclude the impact of these items in order to enhance consistency and comparativeness with prior or future period results.

Following measures are often provided and utilized by the company's management, analysts, and investors to enhance comparability of year-over-year results, as well as to compare results to other companies in our industry, non-GAAP operating profit, non-GAAP diluted earnings per share, free cash flow and adjusted free cash flow, EBITDA and adjusted EBITDA, and constant currency. For more information regarding these metrics and related adjustments, please see our earnings release and our Form 10-K.

From time-to-time, Unisys may provide specific guidance or color regarding its expected future financial performance. Such information is effective only on the date given. Unisys generally will not update or reaffirm, or otherwise comment on any such information except as Unisys deems necessary, and then only in a manner that complies with Regulation FD.

And finally, I'd like to remind you that all forward-looking statements made during this conference call are subject to various risks and uncertainties that could cause the actual results to differ materially from our expectation. These factors are discussed more fully in the earnings release and in the company's SEC filings. Copies of those SEC reports are available from the SEC and along with the other materials I mentioned earlier on the Unisys Investor website.

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

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Good morning, everyone, and thank you for joining us to discuss our fourth quarter and full year 2021 results. 2021 was a very active and exciting year for Unisys. We made advances on revenue, profit and cash flow. And our investments in solutions, go-to-market and workforce management planning have positioned us to advance our momentum in 2022. Mike will provide detail on our financial performance and accomplishments, but first, I will give some insight into the business.

Starting with Digital Workplace Solutions, or DWS, we made significant progress in 2021 on our goal to transform to higher growth and higher margin user experience based solution. As of year-end, we have established our base offering portfolio to compete effectively in additional markets, and we are seeing traction with recent new contract wins. We are focused to continuously improve our solutions to involve with and lead the market. We are integrating our solutions with capabilities added through acquisitions to enhance our full suite of DWS solutions.

As we noted on the last call, industry analysts such as Gartner, IDC, Everest, ISG and HfS are recognizing our improved and expanded capabilities. During the fourth quarter, we were designated a leader in advanced digital workplace services in NelsonHall's NEAT Assessment. During the fourth quarter, we accelerated our unified endpoint management, or UEM, capabilities, one of our targeted solution sets with the acquisition of Mobinergy.

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We are already seeing cross-fertilization opportunities across both client bases and key strategic partners of Mobinergy and Unisys, which now includes the clients from our Unify Square acquisition of earlier in the year.

Mobinergy has strong relationships with many telecom carriers, which are valuable prospective partners to the Unify Square business, as they can embed PowerSuite, which focuses on [ph] new CaaS (00:06:07). During the fourth quarter, we signed a contract with a new banking client in Europe to provide an upgraded user experience with Digital Workplace Solutions, including device lifecycle management, unified endpoint management and field services.

Moving to Cloud and Infrastructure solutions, or C&I, our strategy of growing cloud in our targeted markets resulted in C&I being our fastest-growing segment in 2021. Cloud revenue specifically grew 22% year-over-year for the full year. In the fourth quarter, we further advanced our cloud migration and management capability. We improved our single pane of glass services management to drive actionable insights across infrastructure-as-a-service, cloud native applications and data capture. We enhanced our multi-cloud management capabilities across hyperscalers and added plug-in accelerators for container-based application management services.

We expanded our capabilities in Google Cloud platform, Microsoft Azure and AWS, including upskilling talent with training and professional level certifications across each of these platforms. Through our Unisys University Program, we increased our cloud infrastructure-as-a-service and microservices certifications. We achieved an 80% increase in expert level accreditations in cloud computing for the year. During 2022, we are focusing our capability development efforts on enhanced cloud-native application development, cloud security and AI, machine learning operations.

Our new cloud capabilities also received additional recognition from industry analysts, as we were recently named a major player globally in managed multi-cloud services by IDC. We were also named a leader in the US, the UK and Brazil in ISG's Provider Lens on public cloud solutions and services. In the fourth quarter, we acquired CompuGain, deepening our cloud offerings with CompuGain's significant application modernization, cloud-native agile application development, and cloud and hybrid cloud data management expertise and capabilities, including designation as an Amazon Web Services Advanced Consulting Partner.

CompuGain has a strong presence in the financial services sector, which has added to our established position in that sector, and we expect cross-selling opportunities with CompuGain and Unisys clients. We recently signed a new scope contract with a leader in the US housing finance system to develop and implement cloud-native data pipeline solutions to increase agility and reduce time to market for data workloads in a highly controlled environment.

Turning to Enterprise Computing Solutions, or ECS, our goal has been to grow revenue through expanding the ECS ecosystem, while maintaining license revenue stability. We broadened our approach to key industry solutions to encompass the diverse workflow-centric demands of our clients. In travel and transportation, we are extending capabilities into retail channels in the airline industry. We are also augmenting our cargo solution with a robust data analytics capability.

With respect to our financial services industry solution, we have signed a partnership agreement to augment our capabilities around payment processing. During the fourth quarter, we signed a renewal and expansion with a major US-based global airline for our SaaS-based cargo solutions product suite to support airfreight management, sales, operations, load planning, cargo handling, customs and mail handling, along with the interfaces to e-commerce, mobile devices, revenue management and accounting.

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Turning to our broader go-to-market efforts, throughout 2021, we invested in our sales force, solution architects and marketing initiatives leading to our strongest TCV and ACV of the year in the fourth quarter, year-over-year growth in total company pipeline and expected continued improvement in go-to-market metrics during 2022.

Full year ACV was up 11% year-over-year. ACV grew 54% sequentially in the fourth quarter. TCV grew 29% sequentially in the fourth quarter. Full year TCV was down 11% year-over-year, but noting average contract length is declining as the market evolves, and the average contract length been consistent year-over-year, TCV would have been flat. Notwithstanding, we expect to have an absolute increase in TCV in 2022. And finally, our pipeline grew 5% year-over-year.

We are pricing new contracts to offset anticipated cost increases related to the competitive labor market and the weighted average expected gross margin associated with contract signed in 2021 was higher than that in 2020.

Turning to marketing initiatives, we are investing in our brand and have brought in world-class agencies to support us in these branding efforts, and we look forward to updating you on these activities in the near future. We have partnered with Landor & Fitch to enhance the Unisys brand, including positioning, visual identity and messaging. In addition, we have brought in TBWA Worldwide to advance our advertising, and we have hired Golin as our public relations firm to help us better connect to clients and prospects through media coverage and thought leadership.

With respect to workforce management, the market for talent is highly competitive. We adapted quickly during the year with targeted talent attraction and retention initiatives, resulting in voluntary attrition for 2021 of 17.1%, which was lower than the pre-pandemic level of 17.9% for 2019. Initiatives such as internal mobility and upskilling programs have increased opportunities for our associates, which resulted in a 33% internal fulfillment rate for 2021, which is itself up from 24% in 2019.

With respect to wage inflation, we're actively reviewing our workforce and also focusing our compensation adjustments on the capabilities and roles that have been identified as critical to achieving our short and long-term strategic goals. We're also leveraging referral based hiring, which increased to 21% in 2021 from 19% in 2020 and 16% in 2019. These overall efforts allowed us to avoid any material disruption of service to our clients and kept us on track to drive growth while improving margins. They also position us to continue executing against our operational and financial goals in 2022.

Turning to ESG and DEI, at the end of 2021, we published new sustainability and DEI reports on our website, which we encourage you to review. A few highlights of our recent ESG program includes joining the UN Global Compact in the fourth quarter and driving 75% of our key suppliers to disclose their ESG actions and commitments. We expect to reach our 2026 goal for reduced Scope 1 & 2 GHG emissions in 2022.

A few highlights of our recent DEI progress include launching a new leadership development program for associates from underrepresented groups and a new inclusive leadership workshop, which is underway and which nearly 90% of our leaders have already completed. We also expanded our associate impact groups that facilitated more than 50 programs during 2021 and increased our women and underrepresented ethnic group representation by three points each within director and above levels.

In conclusion, we made significant progress executing our strategy in 2021. I would like to thank our associates for their hard work and commitment.

With that, I'll turn the call over to Mike to discuss our financial results. Mike?

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Michael M. Thomson

Executive Vice President & Chief Financial Officer, Unisys Corp.

Thank you, Peter, and good morning, everyone. In my discussion today, I'll refer to both GAAP and non-GAAP results. As a reminder, reconciliations of these metrics are available in our earnings materials. As Peter highlighted, we're pleased with the progress we made during 2021 on our key operational and financial objectives. The progress resulted in year-over-year growth in full-year revenue, profitability and free cash flow. It also resulted in us being free cash flow positive for the first time since 2016, supported by year-over-year gross profit and gross margin increases in each of our three segments. We also achieved all of our full-year guidance metrics. We believe that the investments we made during the year in enhancing our solutions, our go-to-market strategy and the proactive approach to workforce management positions us well to advance our momentum in 2022. We're expecting accelerated revenue growth and additional profitability improvement, which I'll highlight when I cover our 2022 guidance shortly.

First, let me review the results for 2021, full-year revenue growth of 1.4% year-over-year, which is above the midpoint of our guidance range of 0% to 2% growth. Our ongoing enhancements to our cloud capabilities and efforts to increase awareness with industry analysts and clients resulted in C&I being the fastest-growing segment for the year, with full-year 2021 revenue growing at 6.7% year-over-year to $496.5 million, now representing approximately a quarter of total company revenue. This was supported by full-year cloud revenue growth within the segment of 22% year-over-year.

As we noted on our last call, we expected C&I revenue to be down year-over-year in the fourth quarter due to a one-time revenue pickup we received in the prior year period from a public sector client. Ultimately, C&I's fourth quarter revenue came in a little stronger than expectations.

ECS full-year 2021 revenue grew 2.7% year-over-year. This annual growth was above our internal expectations, primarily as a result of several contracts which were renewed earlier than planned, we continued to see strong demand for our ClearPath Forward solutions and our large client renewal rate remains above 95%.

As we've previously noted, we expected ECS license revenue to be split approximately 55% and 45% between the first and second half of the year based on our anticipated software renewal cadence. As a reminder, the 2020 first half, second half license split was 40% and 60% with 40% of the full year license revenue coming in the fourth quarter. As a result, fourth quarter ECS revenue was down 13.3% year-over-year, though was better than expected and pushed the first half, second half license revenue split to 50-50.

With respect to DWS, as Peter mentioned, we now have our base portfolio of integrated experience offerings established, and we're moving into the next phase of our transformation of this segment with an emphasis on continued enrichment of our solutions, implementing our go-to-market strategy and ultimately increasing wallet share for new logo expansion.

Peter noted some of the examples of recent client wins showing traction with our enhanced offerings. As we remarked on our last call, we've also transitioned away from some heritage contracts that were not core to our future growth and not part of our client experience roadmap. The exclusion of these contracts resulted in DWS revenue being down 5.6% year-over-year in the fourth quarter and 3.6% for the full year. We renewed all material contracts scheduled to be renewed in the fourth quarter. And as I'll get to you shortly, gross profit for the segment was up in both periods even with lower revenue, which in part illustrates the low margin nature of the work we exited.

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Overall, as I noted, our 2021 revenue results were in line with our guidance. We expect accelerated revenue growth in 2022 and are providing revenue growth guidance of 5% to 7% for the full year of 2022, with 1% to 3% of that growth coming from organic operations.

This guidance implies even higher growth rate for the rest of the business when considering that we expect ECS revenue to be down high-single digits or low-double digits year-over-year due to the 2022 ClearPath Forward anticipated license renewal schedule. As a reminder, this means that we expect fewer contracts to be up for renewal in 2022, not that we're expecting lower renewal rates. Our first-half, second half ECS license revenue split is expected to be approximately 35% and 65% in the front half and back half of 2022.

Total company backlog was flat sequentially at $3 billion. As a reminder, the ramp up of our go-to-market strategy and the hiring of additional direct sellers, as well as the emphasis on channel sales and the addition of advisory capabilities, was all happening in the back half of 2021. We're expecting backlog to increase throughout 2022 and into 2023. We're also expecting a 5% to 10% increase in backlog for the full year 2022.

As we discussed, the type of solutions that we're shifting towards are less capital intensive and have a shorter implementation timeframe, which we believe will lead us to quicker conversion of backlog to revenue than we've seen in the past. This is supported by year-over-year increases in ACV that Peter mentioned. Of the $3 billion in backlog, we expect approximately $365 million will convert into revenue in the first quarter of 2022. We expect first quarter total company revenue to be down low double digits year-over-year due to the timing of the ECS ClearPath Forward license revenue schedule that I mentioned previously.

Moving to profitability, full year 2021 total company gross profit was up 18.4% year-over-year and gross profit margin was up 400 basis points year-over-year. These results were supported by year-over-year improvements in full year gross profit and gross profit margin for each of our three segments.

Fourth quarter DWS gross margin increased to 160 basis points, and as a result, gross profit was up 6.9% year-over-year, even with lower revenue. Additionally, full year DWS gross profit was up 38% year-over-year. And full year DWS gross profit margin was up 410 basis points year-over-year, based on the improvements to efficiencies made throughout 2021, the exiting of some low margin contracts, as well as our focus on our higher margin experience solutions.

Full year 2021 C&I gross profit increased 144% year-over-year to $56.6 million, with fourth quarter C&I gross profit up 24.7% year-over-year. Full year, C&I gross margin improved 640 basis points to 11.4%, with fourth quarter C&I gross profit margin up 310 basis points to 15.2%. These increases were driven by improvements to margin in both cloud solutions and traditional infrastructure work.

Although fourth quarter ECS gross profit was down 13.4%, due to the revenue timing I mentioned, gross margin was flat year-over-year. Full year ECS gross profit increased 14.1% year-over-year to $428.6 million and full year gross margin increased 620 basis points to 63.1%. As a reminder, our targeted growth in ECS segment is through the expansion of our services offerings, which is expected to put modest pressure on ECS margins in the future, but would be a benefit to gross profit dollars and overall company margins.

We also saw a significant improvement year-over-year in our full year non-GAAP operating profit, which was up 25.6% to $192.8 million, and in our full year non-GAAP operating profit margin, which was up 180 basis points to 9.4%, a little stronger than we had anticipated going into the fourth quarter. Non-GAAP operating profit margin was down 230 basis points in the fourth quarter due to the revenue and profitability items I mentioned, but again a bit stronger than we expected entering the quarter.

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As we've previously discussed, we're anticipating a slight drag on operating profit as we continue investing in our go-to-market strategy required to support our continued growth, as well as investing to retain and attract top talent within the context of a highly competitive labor market. The ClearPath Forward renewal schedule will also impact margins in 2022.

In spite of all these factors, we expect anticipated benefits from our continued efficiency improvement efforts and the benefit of the shift to higher margin solutions through our development efforts and successful integration of the acquisitions we made in 2021 to absorb the pressures on margin. And we're setting our non-GAAP operating profit margin guidance for 2022 at 9.5% to 10.5%, still showing advancement even at the floor of our range.

As we've noted in our calls throughout 2021, we've undertaken significant efforts to continue to de-risk our balance sheet, including removing $1.2 billion of gross pension liabilities during the year, in addition to the $300 million of liabilities removed in the fourth quarter of 2020. These successful de-risking efforts resulted in approximately $500 million or $6.77 per diluted share of required non-cash pre-tax settlement charges during 2021, versus approximately $140 million or $2.25 per diluted share of such charges in 2020. As a result, our net loss from continuing operations for the full year 2021 was $448.5 million or $6.75 per diluted share, versus $317.7 million or $5.05 per diluted share in the prior year period.

Full year, non-GAAP net income was $117.5 million versus $75.4 million in 2020, and full year non-GAAP EPS was $1.75 per diluted share versus $1.13 per diluted share in 2020, representing a 55% increase in non-GAAP diluted EPS. As with revenue and non-GAAP operating profit, we saw significant improvement in our full year adjusted EBITDA results. Full year adjusted EBITDA increased to 15.3% year-over-year to $369.9 million relative to $320.8 million in 2020, and full year adjusted EBITDA margin increased 220 basis points year-over-year to 18% versus 15.8% in 2020, based on similar drivers as non-GAAP operating profit and margin. This was all above the midpoint of our guidance range, which was 17.25% to 18.25%. For 2022, we expect similar improvement in adjusted EBITDA margin, as we noted, with respect to non-GAAP operating profit margin, and as a result, our 2022 guidance for this metric is 18% to 19%.

We continue to employ our capital-light strategy and our focus on integrating best-in-class offerings to enhance our solutions and optimize development costs. Our full-year 2021 capital expenditures declined approximately $30 million year-over-year to $100 million. However, in 2022, we expect to increase and be between $125 million and $150 million to support our recent anticipated new logo contract wins.

We're also excited to report a significant improvement in full-year cash flow, including being free cash flow positive for the first time since 2016. Full-year 2021 free cash flow was up $843.6 million year-over-year to $32.3 million in line with our internal expectations and full-year adjusted free cash flow was up $129.6 million to $172.2 million. While we don't provide guidance on free cash flow, we expect to see significant improvement in this metric in 2022, given our anticipated ongoing margin improvements, the modest remaining cash charges associated with the optimization program we completed in 2021 and the removal of the required pension contributions for our US qualified pension plan.

We're expecting cash taxes to be between $50 million and $55 million, working capital is expected to decline to a use of $10 million to $20 million, cash interest is expected to be approximately $35 million, and lastly we expect approximately $10 million to $15 million in remaining cash payments associated with the actions in the optimization program that we completed in 2021.

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As of the end of 2021 our global pension deficit decreased by $283 million relative to our position as of year-end 2020 to approximately $750 million. Additionally based on the calculations and actuarial assumptions as of December 31, 2021, no future cash contributions are required for our US qualified defined benefit pension plans for at least the next 10 years.

Our other plans at this point require approximately $40 million of contributions in 2022 stepping down to approximately $35 million per year from 2023 to 2026. Our net leverage also remains low, and we have a healthy cash balance, excluding the deficit for our US qualified defined benefit pension plan, our net leverage is 0.6 times and our cash balance is $553 million as of the end of 2021, more than double our working capital needs.

To wrap up, we're energized to see the efforts across the company and see our strategy translating into significant improvement in our financial performance.

We look forward to continue executing against our medium-term goals and achieving our 2022 guidance in the year ahead. With that, I'll turn the call back over to Peter. Peter?

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thank you, Mike. With that, operator, can we please open the call for questions?

QUESTION AND ANSWER SECTION

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

Rod Bourgeois

Head of Research, DeepDive Equity Research, LLC

Q

[audio gap] (00:31:46) talk for a second about your progress in building your growth capabilities. If I look at what's happened over the last year, you made some leadership changes in your three segments in the first half of last year. And then it seemed in the second half, you started ramping your sales and branding effort investments, which was kind of a new thing, given the pension overhang in prior years, you're now kind of moved into more of an investment mode on the growth front it seems. So my question with that as the background is, are you now seeing the expected results from these sales and branding efforts coming through in your deal flow? Or is most of the benefits from that several months down the road as you look out over the next couple of years? I guess I'm just trying to get a sense on the magnitude and timing of the returns that you're getting from the particularly the sales and branding efforts? Thanks.

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

A

Yeah, Rod, this is Peter. That's a great question, and thanks for making it. And thanks also for your observations. So if we take a little bit of a bigger picture and look at how the company is transforming, 2020 was really the year that we dramatically improved our balance sheet. And with that balance sheet, we were able to lay out a more powerful strategy going forward and an organization to execute on that. We did that in 2020, as you noted in 2021, actually in January of 2021, we [indiscernible] (00:33:27) to execute on that new strategy and that required changing our organization to create the business units that we talk about now, it looked inside and outside the

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organization to get the best leaders for those business units, the majority of those came from outside the organization, and it also meant executing on both the go-to-market and the cost savings.

What you saw in 2021 in terms of our margin expansion was a lot of margin expansion resulting to the cost savings part of that equation. The go-to-market effort really started with new leadership in the April and May context and then fleshing out the team throughout the rest of the year. So what you saw in the fourth quarter was really the beginning of the results of that.

You saw a dramatic increase in ACV, a dramatic increase in TCV, you saw a lot of signings of our new, more higher margin capabilities. So what you're – so to answer your question, last year, most of the savings or rather most of the margin improvement came from those savings. What you can expect in the next three years is continued margin improvement from the savings, and by savings, I mean, things like automation and AI, not just simply kind of old fashioned labor savings, but savings because of new technologies, about half of the margin improvement will come from that. About half of the margin improvement will come from the fact that we're signing kind of next generation higher margin work.

The pipeline is picking up, every one of our indices that looks to our effective go-to-market is picking up. The last element in this multi-year strategy is actually marketing and communications, we really didn't want to start that until we had everything else in place. We didn't want to start to market until we knew we have the capability to deliver. With the changes we made in the fourth quarter of last year, we hired all of those three very significant outside firms to help us on marketing, communication, advertising. That is well underway now. And that's really the final piece, and that's really going in, in the first six months of this year. I hope that helps, Rod?

Rod Bourgeois
Head of Research, DeepDive Equity Research, LLC

Very helpful. And then, on a somewhat sort of related line of thinking, if I kind of go back to where we were three months ago, your Q3 had what seemed to be temporary headwinds, the supply chain disruptions and contract exits and even some lag effect in getting the pricing ramped up, maybe even some challenges in getting sales and branding efforts in place. Can you just give us an update on those headwinds where you were wrestling with headwinds three months ago, where you are today, and what you're assuming in your outlook for 2022 on those headwind fronts? Thanks.

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

Yeah. So, Rod, that's also a great question. Let's split up the headwinds into a couple of different categories. On the supply chain, in general, I would say that we have – we are not seeing the supply chain issues that we were seeing in the third quarter and that we thought might last longer, we're just not seeing them. So I think supply chain in the broad sense is not having a material effect. None of the headwinds that you listed are really having a material effect on us at this point. I think all of that has been eliminated, the exception to that rule is really related to the cost of labor.

So you are still seeing, and we all know it, there's an increase in demand for IT services labor, which is a good thing for our industry, but that's coming with an increase in labor cost. And as we said, we're managing that through a variety of factors, not just increasing compensation, although we're doing that, but also increasing entry level recruiting, increasing the amount of people we get as a company from referrals and also keeping our overall turnover below where we think the IT services market is in general. So we think we're being effective in that. So if I wanted to say there was one headwind remaining for us, it really is, we have to manage the cost of labor very carefully. With respect to our numbers for this year, the obvious headwind that Mike talked about is, this is not as

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strong a year for our ECS licensing revenue as last year. And so that affects not only revenue, but it affects profit. The good news is that the other two segments, DWS and C&I, are expected to really rise to the occasion and make up for that.

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Yeah, and Peter, if I could just add to that, Rod as well, just on that ECS comment, the expectation as we get into 2023 and 2024 is that ECS license revenue and services revenue starts to come back in line with things that we've seen in earlier years, like 2020 and 2021. So that is temporary in nature, Rod, in the sense of, as you well know, it's just the schedule in which those licenses get renewed. I mentioned in my prepared remarks that the renewal rates remain to be pretty high in that business and I think, maybe two or four components of headwind, Peter picked on the staffing piece, I think, he is 100% right there, but we've been happy, at least that the pricing side of the coin has held pretty steady, people are certainly aware that the cost are rising and we seem to be able to bring that forward as well.

So I think that's been pretty solid and we're looking forward, clearly, the go-to-market investments that we've made already and we'll continue to make through certainly the front half of 2022 and beyond to start seeing that pipeline increase, I mentioned, we're targeting about a 10% increase in backlog year-over-year.

So we're really to your earlier point focused in on all of the investments and heavy lifting that we've done over the last 18 months to really shift that focus to growth, but still increasing the operating margin along the way as well, right? So maybe not as dramatically as the almost 200 basis points or 180 basis points this year, but still moving up [indiscernible] (00:40:37) as well. So I feel pretty good about the work we've done to-date and where we're going.

Operator: Our next question comes from Matt Galinko from Maxim. Please go ahead.

Matthew Galinko
Analyst, Maxim Group LLC

Q

Hey, good morning, congrats on a good end to a year. Maybe the first question is, it sounds like the bulk of revenue growth is expected to be inorganic in 2022 vis-à-vis your guidance. To what extent do you put cross-selling in the inorganic versus organic bucket? And I guess secondarily, are you – you talked about feeling pretty complete with the platform, are you done with M&A for the year? Or do you still see some opportunities to add to that what you're doing there? Thanks.

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

A

Yeah. Thanks, Matt. I think, one thing to keep in mind on the inorganic versus organic is that the largest acquisition we did by revenue was CompuGain, a very important acquisition for us, that was not closed until December, so that changes – so there simply wasn't much revenue from CompuGain in 2021.

With respect to future acquisitions, we closed three acquisitions in 2021, which were the first acquisitions we had done in over a decade, and that was largely because we had made the balance sheet changes we did in 2020. That acquisition program remains active and we are continuing to look for good opportunities. Those opportunities tend to be in the DWS and in the C&I space, and we're focusing on those two areas with respect to acquisitions.

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With respect to the cross-selling, and exactly where that revenue is taken up, our approach is pretty clear, those acquisitions came with a certain amount of revenue and we're treating all of the revenue that those acquisitions came with as inorganic. Then the question is what do we build on top of that, that revenue is considered organic, because it is requiring the company to support the way we're moving forward. Mike, any clarification of that or further thoughts on it?

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

No, perfectly stated Peter, I wouldn't change a thing.

Matthew Galinko
Analyst, Maxim Group LLC

Q

All right, great. And maybe just one follow-up, I think you mentioned wanting to get closer to maybe industry standard levels of turnover in your workforce. I think you mentioned something on those lines. What are you using as the benchmark, and how far do you feel you have to go to get there?

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

A

Yeah, so Matt, I think that was in response to my answer to Rod earlier, and I may have confused the answer. What I intended to say was that we are already, we believe, below the average involuntary turnover rate. So we think we're better than the industry right now. It's hard to tell. And to some extent, it doesn't really matter, because what matters is how you manage the turnover yourself. But our turnover effective for the full year of 2021 was 17.1%, that we believe, based off what we have seen in other reporting, is slightly lower than the involuntary turnover average for our IT services competitors.

Importantly for us, it's also lower than our turnover rate in 2019. So we're still operating at below the turnover rate that we saw pre-pandemic. So I think we all expect that the rate might increase some in 2022, we're doing a whole lot of activity, as I outlined, to keep that under control. But at this point, we don't see that turnover rate as affecting operations or our ability to grow.

Matthew Galinko
Analyst, Maxim Group LLC

Q

Thanks. If I could sneak just one quick last one in there. I think you've referenced a metric 80% increase in cloud credentials in your workforce, I thought that sounded like a pretty nice increase. And I'm curious if that was – how much of that was M&A versus organic workforce development, and just how does that translate into an ability to execute on your current pipeline.

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

A

Yeah, Mike may have the split of how much of that was M&A versus organic, but I would tell you from the work that we did at what we call Unisys University, which is part of our HR team, we entered the year in 2021 with a very significant goal for certifications organically, and we exceeded that significant goal. So I'm going to guess that the vast majority of that, if not all of it we're counting, was organic. But Mike, do you have any more data on that?

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Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Yeah, I don't have anything more specific, but based on the fact that the acquisitions that we brought in were obviously very late. I would agree [audio gap] (00:45:54) we've seen trends happen throughout the year as far as our improvement in those certifications. And Matt, that's something, as you know, when we talked about the investments that we've been making, it was not only in our [indiscernible] (00:46:09) obviously, it was in our people as well, and that certification process.

And we've talked a little bit about some of the other reporting, and Peter mentioned it in his prepared remarks around some of the DE&I stuff. Outside of that piece of it and the leadership development, it's also about the upskilling aspect and just making Unisys a better place to work. And I think those are good KPIs or metrics that we track to continue to provide opportunity [ph] for the associate base here (00:46:44).

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

A

Yeah, just picking up on what Mike said, Matt, one of the indications of how effective that certification process has been for us is the amount of open positions that are filled internally. Those are almost exclusively people who are moving from one job to another job because the new job is better. It's more next generation, it pays better, it has more opportunities and it's growth. So getting certifications and one of the reasons that we exceeded even our aggressive role on certifications is people are seeing that correctly as a way to really advance.

So if we look at the last three years, in 2019, 24% as I mentioned, of our openings came from internal fills, that jumped to 30% in 2020, and 33% in 2021. So those certifications are working. And I think, as Mike pointed out, that's one of the reasons we've kept attrition down, because people are seeing their ability to advance inside the company.

Operator: Our next question comes from Jon Tanwanteng from CJS Securities. Please go ahead.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Hey, guys. Thank you for taking my question and [ph] I echo and (00:48:07) congrats on the strong performance ending the year. My first one is just a little more color on the ECS license renewals, both in Q4 and heading to next year, if you could. I was wondering, did you pull in any from 2022 or was that just simply a bigger renewal than you expected, first of all? And then second, do you still expect services revenue within ECS to grow even while the license renewals decline?

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Sure, Jon. So, yeah, so in my prepared remarks, I talked a little bit about the ECS. I hesitate to say pull-in because, as you know, it's really typically client generated that they want [indiscernible] (00:48:50) earlier than thought. There was some ECS pull forward, I'll say, in regards to those early renewals in 2021, but regardless of that particular value, the 2022 and, to some extent, 2023 were just both lower renewal years in general in regards to when those contracts were due. And then if I look out the 2024 that renewal schedule jumps back up to 2021 level. So it's really the cadence in which those contracts were signed and the length of those contracts, as I know you're aware as well. Sometimes a three-year contract turns into a five. I think in earlier this year we had one that was a five-year contract [indiscernible] (00:49:41) signed at a seven year contract.

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So, clearly the desire for that product is there and we continue to kind of grow that base in regards to both volume as well as what you've mentioned in the second part of your comment, services is definitely still a focus of growth in the segment in total. In fact, when we're calling for growth for the total [indiscernible] (00:50:09) 2022 and 2023, it's about the services expansion. And that services expansion, as you know, comes in a couple different flavors. Some of it is services expansion from a managed services perspective for the clients that are running the ClearPath Forward operating system. But everything above that operating system, when you look at it through the lens of application development, apps modernization and migration are other areas of services that we're addressing within that, also security related services above that operating system layer are also areas of services growth expansion.

So still very keenly focused on growing that services component of that particular segment, but as Peter mentioned and I did earlier, having a lower renewal cycle has not only impact on the top line, but as you know, the ECS margins are north of 60%, so it also has a little bit of pressure on the margin profile. But if you look at the total company overall, we're still feeling margin growth in spite of that. So it gives you a sense of how those other two segments are growing [indiscernible] (00:51:21) [ph] augments on that. (00:51:24) So hopefully, Jon, that captured both your components.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

It does, thank you, it actually leads pretty well into my next question which is what is the implied improvement in total services margins given that renewables are just going to be weaker this year?

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

You know what, Jon, I'll have to I'll have to go back and look at that and maybe get back to you offline on that, I don't have that right in front of me, but I can certainly get to it and maybe we will put something out on the website as well so we can make sure it's Reg FD cleared.

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

A

Yeah. And Jon, this is following up, one of the reasons that Mike doesn't have that in hand, because Mike has everything in hand is that with the changes we made, we really don't segregate between services revenue and tech revenue, that – I mean, which doesn't mean that you shouldn't, and it doesn't mean it's not important to you or to anybody else.

But just as the way we operate the company, we're really operating the company now based off these three segments. And so all of the revenue in the three segments is fair game for us in terms of, what we're looking to those segments to produce. So we've gone more to a segment approach than a services and tech approach, that's just the way that we're if you will, leading and an operating the company, it doesn't mean that that number is not relevant and we'll get it to you.

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Yeah. And look, I'm able to dig it up while we're chatting here. So roughly Jon, about 7% increase from the services side of the house is what we're expecting in that segment.

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Operator: Our next question comes from Joseph Vafi from Canaccord. Please go ahead.

Joseph Vafi
Analyst, Canaccord Genuity LLC

Q

Hey, guys. Great progress in 2021, congrats on that. I was wondering if we could just talk about growth. We've been talking a lot about labor, how linear is growth now for you to growth in head count? And maybe if you could break that down, like especially maybe in DWS and C&I, I think, does head count have to grow in line with revenue there, or is there leverage now? And a quick follow-up.

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

A

Yeah, so, Joe, I'll take that at first and let Mike follow-up. One of the things that has been an active focus of our efforts has really been to decrease the cost of labor as a percent of revenue. And so what you saw, if you go back to FY 2020, or two years ago, the cost of labor as a percent of revenue was about 55.6%. And then if you look at the last year, the cost of labor decreased to 54.2%. So more than about 1.4% less. That's really one of the ways we're measuring, if you will, the tide and it is our goal to continue to drive that down. And we think we'll continue to drive that down in 2022.

If we think about the different segments, whether it's DWS or C&I or ECS, really, we're separating, if you will, the direct correlation between cost of labor and revenue in all three of those. In DWS, that comes largely from automation and AI; in C&I as well; and then in ECS, it's a little trickier, because although we are getting more efficiency in our software development efforts, because services is becoming a larger percentage of that, and services is more dependent on labor as just kind of a general principle than software is, there's going to be a little bit of a countercyclical affect in ECS, just by the nature of that work. But I would say in the real areas of revenue growth of C&I and DWS, we're using AI and automation to really take away some of that direct link between cost of labor and revenue. Mike, follow-up on that?

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Yeah. No, look, I think you've got all the components right, Peter, both by segment and otherwise. So, Joe, all I would say is that we look at our revenue growth in 2022 and beyond. Clearly the head count is not moving nearly in the same manner for all the reasons that Peter just mentioned. So I do think there is leverage happening and will continue to happen. We're not where we want to be fully from an automation perspective, and that's the reason why you're seeing gross margin improvement continue in both DWS and C&I, and that's really exactly what you're speaking to. So we'll continue to see some benefits as leverage model, and so I don't think it's certainly not linear and as Peter mentioned that the total cost of workforce in comparison will be flat and/or declining over those periods, which tells you that the head count is to be levered even more so from a linear perspective.

Joseph Vafi
Analyst, Canaccord Genuity LLC

Q

Sure. Got it. That's great. And then is there any – are there any heritage contracts that may roll off this year? I mean, maybe at this point, there's a chance they could still renew or not, but is there anything built in the guidance on that at this point? Thanks a lot.

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

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Yeah, yeah. No, look, we've mentioned in Q3 of last year that there was only one or two other contracts that we had in our guidance that were being renewed, that we had any concerns with and one of those is actually already signed. So I don't think there are any that we're concerned about as far as the renewals are concerned. As I mentioned in Q3, the handful that we exited were kind of oilfield service related and then frankly, kind of white label or POS type work. So we really don't have a ton of that in the pipe here as far as renewals are concerned. And we feel pretty good that the renewal base not only it's healthy, but the renewal base is what we expect to be on our client experience journey and can really show value to those clients. So we feel pretty good about that on a go-forward basis.

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

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Hi, thank you for taking my questions and congratulations on the good performance in 2021. So just had a follow-up first on the – you were talking about the M&A. You are expected to continue to be active in that. What are you seeing in terms of the valuations there, given how the public market has come down? What are you see seeing in the private market and what you're looking at?

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

A

Yeah. So Anja, this is Peter, that's a great question. And we're seeing kind of a continuation of the relative valuations we saw last year, but we are seeing a decrease in the valuations almost across the board. So what I mean by relative valuations is the closer you get to cloud, the more expensive the acquisition is in terms of the kinds of deals we're looking at, the closer you get to DWS, the less expensive. And that's in part an indication of the DWS market in general is growing more slowly than cloud and is a little less profitable.

From our standpoint that works great for us, because DWS is an area where we believe that we have now a really powerful solution set, especially with the acquisitions we made last year, and we could look forward to more scale acquisitions as we go forward if we find that opportunity at the right price. And we do think that that prices is again lower than a comparable cloud company.

With respect to cloud acquisitions, we have to be careful, because historically in the last 18 months, they have been expensive and although the price is down a little bit, they're still expensive in terms of our analysis. That said, the CompuGain acquisition we made in December was exactly the one we needed to make. We had been looking for an acquisition like that ever since we've started the program up after changing the balance sheet in 2020.

All of that CompuGain revenue and talent is in cloud work and application development work, and as I think all of you know the applications and an AI portion of cloud is where a lot of the growth is. And although we had some capability in that particular area before the acquisition of CompuGain, it's a whole new world for us now. It's a dramatic increase in capability. So that was a little more expensive because it was cloud related, but it exactly filled our needs and we're very enthusiastic about the ability of that organization to grow. So that's kind of what we're looking at, Anja, little long winded answer, but I hope that's helpful.

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Yeah. And Peter if I could...

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

A

And Mike if you could – yeah, please.

Michael M. Thomson
Executive Vice President & Chief Financial Officer, Unisys Corp.

A

Yeah. Yeah, I just wanted to one slide add on, some of the things that we're looking for are more skill based and solutions based in some of that in regards to M&A and the solutions based IP is what drives a lot of those valuations really high. So, when we're talking about CompuGain being a great example where we really enhanced our skillset in regards to apps development and things like that, although cloud oriented you still don't have quite as bad as some of the multiples that you've seen in preceding transactions where it's really IP that you're after. We feel pretty good about our portfolio, both in cloud and in DWS about the solution itself, right. So it's really more about the analysts and the engineers and the development team, which is a little more full than some of the other elements that you see.

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

A

Yeah, Mike, that's exactly right. Anja, any follow-up on that or did it hopefully answer your question?

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

No. That answers my question. Thank you. That was all for me.

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

A

Thank you.

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

Peter A. Altabef

Chair & Chief Executive Officer, Unisys Corp.

Thanks very much. I want to thank everyone for attending the call this morning. As I think we, Mike and I answered the very, very first question that came from Rod, this is a company that it might be a little different than your average bear. We have a very – we believe to be a very strong multi-year strategy and we're marching to it and the changes we made in 2020, the execution in 2021, the performance in 2022 is really all based on a very deliberate approach. We're very pleased that we made all of our guided metrics in 2021, that's been a habit with us and we hope that habit continues and we're continuing to march down our pathway. And we're very excited about that pathway.

With respect to the people on this call and the investor analysts, I really want to personally thank you for following us, for being part of this journey and for really kind of taking the time to understand us. And I thank you for doing that. We remain available to you, we'll have one-on-ones and calls, our investor website continues to strengthen and – but absent all of that, we look forward to hearing from you and talking to you next quarter.

With that, operator we'll end the call.

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

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