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PBI - Q1 2018 Pitney Bowes Inc Earnings Call

EVENT DATE/TIME: MAY 02, 2018 / 12:00PM GMT

OVERVIEW:

Co. reported 1Q18 revenues of $983m, gross profit of $460m, and GAAP EPS (included charges totaling $0.01 for transaction costs, largely related to announced divestiture) of $0.28. Expects 2018 revenue growth vs. 2017 (excluding impacts of currency) to be 11-15% and adjusted EPS to be $1.15-1.30.

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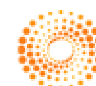

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PRESENTATION

Operator

Good morning, and welcome to the Pitney Bowes First Quarter Earnings Conference Call. (Operator Instructions) Today's call is also being recorded. If you have any objections, please disconnect your lines at this time. I would now like to introduce participants on today's conference, Mr. Marc Lautenbach, President and Chief Executive Officer; Mr. Michael Monahan, Executive Vice President, Chief Operating Officer; Mr. Stan Sutula, Executive Vice President, Chief Financial Officer; and Mr. Adam David, Vice President, Investor Relations. Mr. David will now begin the call with the safe harbor overview.

Adam David - *Pitney Bowes Inc. - VP of IR*

Good morning. Included in this presentation are forward-looking statements about our expected future business and financial performance. Forward-looking statements involve risks and uncertainties that could cause actual results to be materially different from our projections. More information about these risks and uncertainties can be found in our earnings press release, our 2017 Form 10-K annual report and other reports filed with the SEC that are located on our website at www.pb.com and by clicking on Investor Relations. Please keep in mind that we do not undertake any obligation to update any forward-looking statements as a result of new information or developments.

Also for non-GAAP measures used in the press release or discussed in this presentation, you can find reconciliations to the appropriate GAAP measures in the tables attached to our press release and also on our Investor Relations website.

Additionally, we have provided slides that summarize many of the points we will discuss during the call. These slides can also be found on our Investor Relations website.

Now our President and Chief Executive Officer, Marc Lautenbach, will start with a few opening remarks. Marc?

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Good morning, and thank you for joining the call. The headline for the quarter as the company continues to move to growth and our strategy is delivering results. As is always the case, there are positives and negatives to the quarter. We had positive top line performance in our e-commerce business, and Newgistics, our recent acquisition, performed very well. And we had an outstanding performance in our Production Mail business. On the other side of the ledger, our SMB business got off to a slow start, performing below our expectations and revenue was below the long-term

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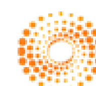

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model. Also, our software business had no large deals in the quarter. That said, both businesses are off to solid starts, and we expect these businesses to improve in the second quarter.

The first quarter epitomizes what we've been saying and seeing as we transform the company. The business continues to shift to higher growth markets, as witnessed through our revenue growth. Our first quarter results demonstrate that we are making progress against our strategy and set us up to deliver on our financial commitments for the year. Stan will take you through the financial details and I will have more on that in a moment.

First, let me update you on our recent announcement around the portfolio and then also talk about the strategic pillars by which we now measure ourselves.

Earlier this week, we announced the sale of Production Mail and its supporting software to Platinum Equity. The Production Mail business is a leader in this industry. Our strategic review validate that this business is more viable outside our company. I've said many times in the past that we will do what is right by our shareholders to create long-term value for our company. This is a prime example. This business performs well and is a market leader but does not have a strong tie to our shipping and addressing focus as our other businesses. We have and will continue to look at a broad range of alternatives as it relates to the portfolio and the resulting capital allocation decisions that go along with it.

That being said, we plan to use a majority of the net proceeds from the portfolio sale to further strengthen our balance sheet by reducing debt. As we think about the company's strategy, we see our core mailing business continue to be an important foundation. This business is not only highly profitable and generates a good portion of our earnings and cash flow, but also provides us with one of our greatest assets, our clients.

Building from that foundation, we talked about 3 pillars to our strategy at Analyst Day. Today and going forward, we'll focus on reducing the complexity of shipping for our clients; we'll continue to focus on our operational excellence; and we'll also look into leverage economies of scale and experience across our company. Let me double-click on each of the strategies.

In terms of reducing the complexity of shipping for our clients, shipping is a logical adjacency for us in a market that is growing. When you think about what Pitney Bowes has done over the course of the last nearly 100 years, we took something that was fairly complex, sending billions of pieces of mail and made it easier for our clients. For us, we like complexity because we have the products and tools that reduce it so that our clients can do business with their clients and the complexity provides the opportunity to drive long-term margins.

Today, we are applying that same dynamic to shipping with new offerings like our SendPro C-Series product line. Since launching the product, we've shipped nearly 30,000 units through the end of the first quarter and continue to see clients sign up for longer lease terms as they see the value proposition of this offering.

In commerce services, we're helping retailers, marketplace and shippers reduce the complexity of their domestic and cross-border shipping needs. In 2017, our commerce services businesses helped our clients with nearly 0.5 billion of their parcels, physically and digitally, and these numbers continue to grow. In the first quarter, compared to prior year, we saw total parcel volume grow nearly 15% with Newgistics included on a pro forma basis, in part due to over 2,000 new domestic shippers using our APIs as well as additional cross-border volumes on our platform.

Also in the first quarter, we saw volumes through our shipping APIs increase more than 20% from the fourth quarter, which is typically the largest quarter given the holiday season. One important item to note is that we recently renewed our long-term partnership with eBay. This is a multiyear contract for our U.S. Global Shipping Program, which is significant in supporting our long-term strategy, particularly as we help reduce the complexity of cross-border shipping for our clients. We also recently announced the strategic relationship with ChannelAdvisor, a leading provider of cloud-based e-commerce and shipping management solutions. ChannelAdvisor will leverage our shipping APIs for the new shipping management suite. These are solid indicators that our value proposition is resonating with clients.

In regard to operational excellence, we have already done a tremendous amount of work in this area over the last several years, taking out nearly $300 million in expense since the end of 2012. While investing, in our brand, platform, processes, products and talent. We will continue to drive efficiency in our network and with our platforms, both in how we operate as a business with our clients and partners and how we operate internally.

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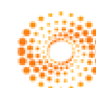

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We'll continue to look at optimizing our expense structure and have committed to taking out another $200 million of gross spend over the next 2 years, which we are on track to achieve based on our first quarter results. We will continue to remain disciplined when it comes to the quality of our balance sheet as evidenced in the first quarter. As we previously mentioned, we are in the process of repatriating back approximately $500 million in non-U.S. cash. We have already used a portion of the cash to repay our March notes, and we used the remaining balance to reduce near term debt.

In addition, we used a majority of the net proceeds from the sale of Production Mail and its supporting software to further reduce our near term debt.

Turning to leveraging economies of scale and experience. Our APIs are a great example of how we are leveraging our technology and data, where businesses are using APIs that we developed in-house. Today, we have standardized and created over 100 internal and external APIs within shipping, payments, Location Intelligence and Customer Information Management. Within the Commerce Cloud, we are improving how we serve our clients, enabling increased efficiencies across our portfolio, creating value and improving our product competitiveness, all on a contemporary platform. A good example of this is the Pitney Bowes Software and Data Marketplace, which allows modern discovery and delivery of data products to our clients. And as I mentioned earlier, one of the most important assets that Pitney Bowes has is our clients. We have hundreds of thousands of clients that we have been doing business with, often for decades. We are providing value to these clients through our shared technologies, creating a new digital relationship and very different experience from what we had done for nearly a century. In addition, we have started to expand our financial services to fund the shipping needs for clients by using excess bank capacity to fund throughput volumes in the first quarter. Early days still, that the extension of our financial service offerings to our client base is an area that we expect to ramp up through the year.

Turning to our results. We saw a very strong revenue growth largely due to incremental contribution from Newgistics, which also delivered growth as we made progress integrating it with our Presort and Global Ecommerce businesses. Our revenue growth is a significant proof point of the work we have done over the last few years. We have transformed our portfolio through strategic acquisitions and logical adjacencies in growing end markets, in addition to investing organically in our capabilities, technology and talent, which has also contributed to this growth.

We continue to make progress against our strategic agenda, which is important as we set out to achieve our annual and long-term objectives.

With that, let me turn the it over to Stan to take you through the financial details of the quarter and update you on guidance. Stan?

Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

Thank you, Marc, and good morning. As Marc mentioned, as always there were pluses and minuses throughout the business. However, our overall financial results leaves us well positioned for the year. In the first quarter, we continue to see the portfolio shift to higher growth markets, with our commerce services business comprising 39% of revenue and shipping-related offerings contributing over 25% to total revenue.

Let me first talk about the recently announced change to our portfolio. Earlier this week, we announced that we entered into a definitive agreement to sell Production Mail and its supporting software to Platinum Equity for $361 million. We expect net proceeds from this sale to be approximately $270 million. These numbers are subject to adjustment upon finalizing the deal. We also announced that we plan to use a majority of the net proceeds to pay down debt.

As Marc mentioned, our Production Mail business performs well but does not have a stronger tie to our shipping and addresses as our other businesses. From a financial perspective, we are reaffirming our annual guidance and have updated solely to reflect the impact of this announced sale. I will take you through the details after I go through our first quarter results.

There are few items that are important to note before I discuss our results. The divestitures reported in our first quarter results. Beginning in the second quarter, Production Mail and its supporting software will be reported as discontinued operations. We expect to close on this deal late in the second quarter or early in the third quarter. Also, and as mentioned at Analyst Day, starting this quarter we are now showing Commerce Services as a reporting group. This group is comprised of our Presort and Global Ecommerce segment. Logistics rolls up into Global Ecommerce segment,

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our SMB group segment remains unchanged. The software and Production Mail segments will be shown separately. Additionally, our quarterly results include incremental Newgistics revenue, cost and expenses.

Lastly, you will notice that we have added EBITDA by segment to our press release and financial statements, while we segment EBIT as the primary measure of profit and operational performance for each segment, we believe EBITDA is a useful secondary measure and an additional way we look at the economics of our businesses, especially in the light of our more recent, larger acquisitions.

Turning to our results. As in the past, unless otherwise noted, my statements going forward will be on a constant currency basis when talking about revenue comparisons, and on an adjusted basis when talking about earnings-related items including cash flow. Reconciliations of all non-GAAP to GAAP measures can be found in the financial statements posted with our earnings press release and on our Investor Relations website.

For the first quarter, revenue totaled $983 million, or growth of 15% over prior year. Looking at revenue by group, Commerce Services grew 71%; SMB declined 8%; software grew 1%; and Production Mail grew 6%. Adjusted EPS was $0.30 for the quarter. GAAP EPS was $0.28. GAAP EPS included charges totaling $0.01 for the transaction cost, largely related to the announced divestiture. Free cash flow was $65 million and GAAP cash from operations was $83 million. Compared to prior year, free cash flow declined $46 million, largely due to the timing of working capital, primarily in our Presort Services business and predominantly within accounts receivable. In addition, we made a prepayment to one of our larger outsourced vendors, in order to capture a deep discount which normalizes within the year.

Looking at our capital allocation strategy. For the quarter, we used free cash flow to pay $35 million in dividend to our common shareholders and we paid $16 million in restructuring payments. Capital expenditures totaled $43 million. From a debt perspective, we reduced our debt level from year-end by repaying our March 2018 note for $250 million, where we repaid $5 million in principle on our 2020 term loan using cash that we repatriated. At the end of the quarter, our total debt was $292 million higher than prior year, mostly as a result of the debt we issued in the third quarter last year to fund the Newgistics acquisition, but partially offset by the first quarter pay downs.

At the end of the quarter, we had $775 million in cash and short-term investments on our balance sheet. During the quarter, we repatriated about $370 million of non-U.S. cash, which through the end of April is now just over $400 million. As we mentioned previously, the remaining repatriated cash will be used to pay down near term debt maturities and we also plan to use a majority of the net proceeds from the recently announced divestiture to further reduce near term debt.

Looking at the P&L, starting with revenue performance by line item as compared to prior year. Business services grew 71%, which is largely attributable to the incremental contribution for Newgistics. On a pro forma basis, Business services revenue grew 12%, driven by the continued growth in Global Ecommerce. Software revenue grew 2%; support services declined 4%. We also had declines in supplies of 6%; rentals of 6%; and financing of 8%, all largely due to the performance in our SMB group. Equipment sales declined 8% driven by a decline in SMB, but partially offset by growth in Production Mail.

Gross profit was $460 million, with a margin of 46.8%. This is a decline of 10 points from the prior year, of which half of the decline is driven by the addition of Newgistics to our portfolio, which was not in our results last year. The other half of the decline is largely reflective of the shifting mix of our portfolio and the decline in SMB. SG&A was $310 million, or 31.5% of revenue, which was an improvement of 5 points from prior year. Compared to prior year, SG&A was $5 million higher due to Newgistics, which is not the prior year, and investments in e-commerce, but partially offset by lower expenses in SMB and corporate. We are off to a good start and on track to deliver on our gross savings commitment of $200 million over the next 2 years.

Remember that this is incremental to the nearly $300 million in SG&A that we have already taken out over the last several years.

R&D expense was $33 million or 3.3% of revenue. Compared to prior year, R&D expense increased $1 million and improved by less than 1 point as a percent of revenue. As our portfolio shifts to growth markets, we also continue to shift our R&D spend to take advantage of these opportunities.

EBIT was $120 million and EBIT margin was 12.2%. Compared to prior year, EBIT declined $17 million and EBIT margin declined by about 4 points, driven primarily by the gross profit decline.

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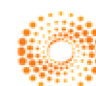

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Interest expense, including financing interest expense, was $43 million, which was $4 million higher than prior year due to the timing of new debt issuances and redemptions over the last year.

The provision for taxes on adjusted earnings is $21 million and our tax rate was 26.7%, which was lower than the prior year by about 6 points, mostly attributable to the recent tax legislation changes within our guidance for the year.

Diluted weighted shares outstanding at the end of the quarter were 188 million, which was about 1 million shares higher than the prior year.

Let me now discuss the performance of each of our business segments this quarter. Within the commerce services group, revenue was $381 million, which is growth of 71% over prior year. On a pro forma basis, revenue grew over 10% over prior year. EBIT for the group was $19 million, and EBIT margin was 5.1%. EBITDA was $40 million and EBITDA margin was 10.5%. In Global Ecommerce, revenue was $247 million, which was growth of 177% over prior year and included a full quarter of incremental revenue from Newgistics. Newgistics, on a pro forma basis, delivered 9% revenue growth and benefited from a strong performance in both its parcel and fulfillment volumes. Excluding Newgistics, Global Ecommerce revenue grew 29%, which was driven by strong performance in both domestic shipping and cross border volumes. Our shipping APIs continued to perform well through the first quarter and our platform stability operated at the industry norms. As Marc mentioned, our first quarter API volumes increased over 20% as compared to the fourth quarter, which is typically our largest quarter for volume given the holiday season. EBIT was a loss of $8 million, and EBIT margin was a negative 3.1%, which was driven primarily by investments in market growth opportunities and operational excellence initiatives in the areas of automation, network optimization, simplification and technology upgrades. These operational excellence initiatives will drive long-term profitability.

EBIT also included incremental amortization of intangible assets related to the Newgistics acquisition. EBITDA was $7 million and more than doubled than the prior year on the strong revenue growth. EBITDA margin was 2.7%.

Within Presort Services, revenue was $134 million, which was growth of 1% over prior year and driven by improved revenue per piece, along with higher volumes of First Class mail and flats processed, but partially offset by lower standard class mail volumes processed. EBIT was $27 million and EBIT margin was 20.1%. The margin decline from prior year was largely driven by higher labor and transportation cost. EBITDA was $33 million and EBITDA margin was 24.7%.

Within the SMB Group, revenue was $423 million, which was a decline of 8% from prior year. EBIT for the group was $135 million and EBIT margin was 32%, which was within our long-term market range. EBITDA was $157 million and EBITDA margin was 37%.

North America Mailing, revenue was $325 million, which was a decline of 9% from prior year. Equipment sales declined largely due to lower sales in top-of-the-line products and a lower level of client lease extensions. We also had a tougher compare where prior year equipment sales grew 5% partially due to a higher amount of large deals that closed last year. In addition, we experienced a lower level of inside sales staffing during the quarter, which is being remedied throughout the second quarter.

Throughout the quarter, we continued to make progress with our SendPro C-Series offering, with good printer attach rates, longer lease terms and higher average payments relative to our legacy products. Recurring revenue streams declined, largely around financing rentals and service revenues. EBIT was $119 million and EBIT margin was 36.7%. The margin decline from prior year was largely due to low recurring revenue streams in mix of equipment sales, which was partially offset by lower expenses. EBITDA was $136 million and EBITDA margin was 41.9%.

In International Mailing, revenue was $98 million, which was a decline of 6% from prior year. Equipment sales declined largely driven by weakness in the U.K., but partially offset by growth in Germany and France. Recurring revenue streams also contributed to the overall decline. EBIT was $16 million and EBIT margin was 16.2%. The margin improved from prior year driven by lower expenses. EBITDA was $20 million and EBITDA margin was 20.9%.

In Software Solutions, revenue was $82 million, which was growth of 1% over prior year. Results reflect the implementation of the new revenue recognition standard, or ASC 606. Revenue in EBIT were favorably impacted in the quarter by $11 million and $9 million, respectively as a result of the timing of revenue recognition. It is important to note that while the company benefited from the timing of recognized revenue this quarter,

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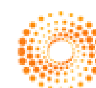

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we do not expect the full year impact of ASC 606 to be material. Excluding this impact, revenue declined from prior year driven by a lower level of large deals in the quarter.

Software's revenue was also impacted by a lower level of upfront license revenue deals this quarter partially offset by growth in SaaS deals. The indirect channel continues to make progress and contributed over 30% to the overall software pipeline in the first quarter. EBIT was $5 million and EBIT margin was 5.9%. The margin improvement from prior year was driven by the higher revenue. EBITDA was $7 million and EBITDA margin was 8.9%.

In Production Mail, revenue was $97 million, which was growth of 6% over prior year. Equipment sales grew double-digits and benefited from higher inserter and printer placements. EBIT was $10 million and EBIT margin was 9.9%. The margin was relatively flat to the prior year, driven by the higher revenue performance but partially offset by the mix of products within equipment sales. EBITDA was $10 million and EBITDA margin was 10.6%.

Let me now update you on our annual guidance. As I mentioned earlier, we are reaffirming our annual guidance and updating it solely to reflect the sale of Production Mail and its supporting software. In 2017, these 2 pieces of our portfolio generated $427 million in revenue and $58 million of EBIT annually. We expect all the revenues in directs costs and expense associated with our Production Mail business as well as its supporting software, which is recorded in our software segment, to transfer with the sale. Also, about $1 million of the financing business will remain within our existing portfolio. It's important to note that there is a portion of shared services cost, which are currently allocated to Production Mail that will remain with Pitney Bowes in order to continue to support other areas of the portfolio. However, we expect to offset a portion of those costs with our transition service agreement, or TSA, with Platinum Equity.

From a timing perspective, we expected Production Mail second quarter profit to perform better than the first quarter given the ending backlog along with recent announcement of the businesses expanded relationship with CSG. In addition, that expectation is that the revenue and earnings related to the supporting software is part of the sale that would be spread evenly by quarter. Also, note that the TSA commences after the deal is closed. As mentioned briefly, we plan to use a majority of the net proceeds to further reduce near term debt maturities and we'll provide additional details upon the finalization of the transaction.

Looking at each of our guidance measures and taking the announced divestiture into consideration, we now expect revenue when compared to prior year and excluding the impacts of currency to be in the range of 11% to 15% growth. We expect adjusted earnings per share to now be in the range of $1.15 to $1.30, and we expect free cash flow to now be in the range of $300 million to $350 million. Our tax rate on adjusted earnings is expected to remain at the range of 23% to 27%. Again, the changes to guidance only reflect the sale of Production Mail and its supporting software. We expect to close on this transaction late in the second or early in the third quarter, subject to customary closing conditions.

With that, we'll now take your questions. Operator, please open the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question is from the line of Ananda Baruah, Loop Capital.

Ananda Prosad Baruah - *Loop Capital Markets LLC, Research Division - MD*

Hey Marc, you talked a little bit in the prepared remarks about the import of the core mailing business and sort of the client access it provides you. Could you just remind us for the remaining businesses, how you guys view the connectivity between them, the synergies between them as they exist today, operationally? And then maybe as you see the -- I'm going to say synergy opportunities, but really sort of just the overall business opportunities that could exist between the remaining business units going forward. That'll be helpful.

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Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Thanks, and I think it's an important question, one that we can't communicate often enough on. So if you think about the portfolio and a little bit of historical perspective, we were pretty much all a mailing company in 2012 in market that was going through secular decline. As we sit today, we are certainly still a mailing company. We've got a big chunk of our business in mailing that will continue to be important in SMB. But we're moving the shipping as well. So if you think about what we're doing, we're rotating the portfolio from mailing to shipping from markets that were going through secular decline to markets that are growing. So shipping will be the first synergy. And you see that in SMB with our new CSD product that has a multi-carrier shipping, which is a very unique feature. You clearly see it in commerce services. You see it in Newgistics. So you begin to see this logical coherence across the portfolio. So that gives us all kinds of opportunities to create synergies around carrier libraries, around APIs, around other like technologies. Secondly, we talked about commerce services. Many of our -- what I call broadly Software-as-a-Service function, whether it'd be an SMB software or commerce services are delivered via a common chassis commerce services. Obviously, the more volume you can put through that chassis, the more you're able to get synergies. Underneath that, we've also identified the import of addresses, and that again is obvious as it relates to mailing and shipping. But when you really begin to decompose the software portfolio and where we're doing well in Location Intelligence and SIM, addresses is a common denominator. We use the example, and it's perhaps not the most economically significant example, but it's important to our clients around -- and we had for addresses. So address technology that was developed in our software business are reapplied to commerce services when they -- customers putting in their address for a shipment, the read-ahead technology has been a technology that has allowed us to get higher -- allowed the clients to get higher conversion rates. So we see multiple different opportunities to create synergies. The one we haven't talked a lot about in-depth, which is one that I'm getting more and more excited about, are twofold. First of all, our synergies between our Presort network and Newgistics network. As you think about the world going forward and being able to offer dependable economic shipping, being able to repurpose some of the Presort assets to shipping and add it with Newgistics network is an incredible synergy, and one that we're just beginning to tap. And I would say, broadly, our know-how of moving 14 billion pieces of mail reapplied to packages is important. And I would also point out to -- point to our relationship with USPS. So it's kind of look at all of these businesses, our relationship with USPS is critical. So we've called a play here. We've specifically, within our strategy, called out economies of scale and economies of experience, which is just a fancy way of saying that we're going to be purposeful about working to ensure that these businesses are accretive to one another. So I apologize for long-winded answer, but it's a good question. And I'm sorry, the second aspect which I was going to comment on which Stan just reminded me was GFS. GFS is a great capability of financial services. We've got great relationships with hundreds of thousands of clients. We've got great credit capabilities to extend credit into the SMB market. We principally use that capability to fund meters, but more and more as we outlined in Analyst Day we see the opportunity to move that capability into other markets. So thanks for the question.

Ananda Prosad Baruah - *Loop Capital Markets LLC, Research Division - MD*

Yes. No, I appreciate all the context, and actually I was going to follow-up with a question on financial services also. So I appreciate you just sort of got to it. Yes, no, that's great. I'll stop there.

Operator

Our next question is from the line of Kartik Mehta, Northcoast Research.

Kartik Mehta - *Northcoast Research Partners, LLC - Executive MD, Director of Research, Principal & Equity Research Analyst*

Marc, you talked about using the proceeds of the Production Mail business for debt paydown. And I'm wondering, considering where the stock is, what thought was given to buying back shares and maybe how the board and you thought about that, and using the proceeds in the manner of which you're using them?

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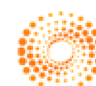

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Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

And I'm going to -- you have to indulge me for a moment as I'm going to give you rather long-winded answer. This is an important question and I want to make sure that we're complete and transparent about how we think about it. So I'm going to take you back to March 6 on Analyst Day, where we outlined our priorities for capital. We first talked about investments in the business organically and then through acquisitions that confirmed to very rigorous financial criteria. The second was deleveraging of the balance sheet and the achievement over the long term of investment-grade ratios. And the third priority was return of cash to shareholders, principally through dividends. You asked a similar question after the last earnings call, and I gave a fairly similar answer. And then finally, I'll point back to September when we were out raising money for the Newgistics acquisition. We told the market broadly and we told our debt investors in particular that it will be a priority for us to deleverage our balance sheet. Why do I run through that litany of events? Certainly not to recount history. It's to make 2 fundamental points. The first is we've been very clear about what our prioritization of capital is. I think that's important from an investor perspective to understand what you're investing in. It's also candidly important in terms of running the business. It's hard to turn out a dime in terms of capital allocation. As we think about capital allocation, we think about over 3, 5-year time period. So that's one reason. Second is at a very simple level. I think it's important to say, what you're -- to do what you say you're going to do. But the broader point is this, and that is -- I think the higher-level question is, why do you have the allocation of capital prioritization that you do? And the answer is this, as we move from a portfolio that was going through secular decline to a portfolio that's growing, so if you think about 2007 or 2009 to 2012, the portfolio was declining 6%, to where we are today which is moving towards growth. The principal around capital allocation is to create flexibility. And I'll use the Newgistics example to kind of illustrate the point. We've been looking at the Newgistics asset for a while. We were interested, we didn't think we're going to be able to get it, and then we had another opportunity. If I wouldn't have had the flexibility to go raise money to buy that asset, we would have missed an incredible opportunity. So I used that particular example to illustrate the importance of flexibility as you're transforming the company and moving to growth. So I understand all the different preferences in terms of capital allocation. This is how we look at it. And I think it's important to be transparent about it, so that you know what you're investing in. And I think that's true if you're an equity investor or a debt investor. So I get the -- with the stock price where it is, why that question comes up, but my principal objective is to transform this company, secure our future, move it to growth, shipping is a logical adjacency. And I think the evidence of success is in the results. If you think about the e-commerce business, where it started 5 years ago, it was less than $10 million, $12 million, whatever it was. It's now a several hundred million dollars business. For sure partially through acquisition, but a lot through organic growth as well. You look at Newgistics, it grew 9% or 10%. So as you think about this from an investor perspective, from a management perspective, you're betting on a company that's moving to a logical adjacent market with a team that is applying capital consistent with how they said and delivering results into growth area. So I think it's a really important point. I think it's really important that we're clear about what our motivations are so investors can make decisions about what they want to do. But I told a bunch of debt investors that we would deleverage our balance sheet in September. I think it's important to do what you're going to say, because I want to continue to have flexibility.

Kartik Mehta - *Northcoast Research Partners, LLC - Executive MD, Director of Research, Principal & Equity Research Analyst*

So maybe Marc, it's probably a broader discussion, I appreciate the thoughts. Just, are you at all worried about maybe where the debt covenants are? And is this a reflection on that? Or is this strictly a reflection on flexibility and is that flexibility because you see other opportunities be it in Global Ecommerce or Presort, or other areas where you think you could grow the revenue and EBIT?

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Stan will talk about the covenants. But I want to make a couple of broad points. We have $775 million of cash. We are not cash poor. We are -- we've got plenty of cash. Our motivation around capital allocation is precisely what I said. It is to provide flexibly so we can continue to move in the shipping market and grow. We see continued organic opportunities around building out the network. We see some technologies that we think will make sense, either to develop internally or to buy. But we are not -- we are in a strong cash position. That affords us the flexibility to do what we need to do.

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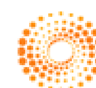

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Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

And on covenants, Kartik, it is not an issue around covenants whatsoever. It is really around maintaining strategic flexibility. It's around using that cash in the form we said we were going to repatriation and you saw that we were successful in repatriating a significant amount in first quarter. Currently we have just over $400 million of the $500 million repatriated. Combine that with the proceeds we'll be able to take debt down this year, back to roughly the slightly below the first quarter of 2017 levels. That has nothing to do with covenants, it has everything to do with financial flexibility.

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Let me make one other point. People often asked me why do you care about investment-grade ratios? We really care about investment grade ratios, because I want to have the flexibility to do what I need to do. It's not that we're bowing at the altar of some mathematical abstraction. Flexibility is important. Doing what you're saying and do is important.

Kartik Mehta - *Northcoast Research Partners, LLC - Executive MD, Director of Research, Principal & Equity Research Analyst*

I appreciate Marc. Just you know my perspective would be great for you to -- it seems like the best investment right now for Pitney is Pitney itself. And to take some of the proceeds in buy back shares would be very accretive. So maybe you know it's a longer conversation for us to have at another time, but thank you.

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Let me just respond to that. I agree with you to the extent that we have a great set of businesses to invest in. So as I look at our opportunities to deploy capital, we certainly look at a broad ramping, but the most persuasive investment that I see and that's not to say that the stock isn't at this level a persuasive investment, I think it is. I would -- I think it's a great buy at this level. But the most compelling thing that we can do as we move to growth is invest in the capabilities that we need to secure our future. And that's going to be best for our long-term shareholders and best for the enterprise.

Operator

Next question is from the line of Shannon Cross, Cross Research.

Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal & Analyst*

I have a couple of cash questions as well. Stan, how much was the prepayment for services, how much did that impact the cash flow this quarter? Just trying to get a magnitude of sort of the one time items.

Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

Sure, so Shannon, it's a good question. So on flow free cash flow, if we take a look, we're down about $45 million year-to-year. And if you take a look at that, about 2/3 of it was driven by the timing issues, predominantly in Presort. And remember, this is areas where clients either go into deficit position short-term on postage, which we cover or an AR. And as we've grown that business, we'll go after that, we view those strictly timing. On the prepay, it's about 1/3 of the year-to-year delta. And look, we don't normally do prepays, but this was a compelling discount that saves us money and that obviously, normalizes out within a year. So you can think about 1/3 of that year-to-year related to the repay.

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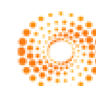

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Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal & Analyst*

Okay, And then Marc, or Stan, I don't care. In terms of the dividend, you're at a 7.5% dividend yield, I think right now. You sold the company that generated cash. Obviously, I think Marc, when you first came in, unfortunately not due to your things you had to do, but you had to cut the dividend. How are you thinking about dividend payments and as you transition, arguably, to a more of a growth company? Sometimes the capital structure shifts as well. And so I'm just curious as to your thoughts there.

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Yes. Thanks for the question. I'm going to be monotonous in my answer. We've got a similar question at Analyst Day. I'll rephrase the question because I think it's kind of similar. But the gist of the question was from an equity investment perspective, where it sounds like argumentative that you're fundamentally transform your growth business and therefore you should get multiple in the marketplace associated with the growth business. I reaffirmed the premise of that question. And my answer was as follows. We think it's very important that we have a competitive dividend. As you think about that at the next level, what informs what a competitive dividend is? The first is, you are competitive relative to your peers as your peers change, the net calculus changes. And the second to your point is the size of the company. So right now, I would say that we are in-flight in terms of becoming a growth company. We made progress over the last several quarters. But I think we'll make more progress going forward. As that becomes more apparent to the market and we put proof points on the board and as the size of the company settles out, we will inevitably relook at our capital allocation priorities. So capital allocation, to your point kind of fits the context of the time. Right now we happen to be in transition. So it's a little bit more fluid, but I appreciate the question.

Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal & Analyst*

Thank you. And I'm just curious, the last question, as you look at your all of the strategic options and all of that, and I know how things do sort of play together, but I mean, is -- do you think this is sort of a -- will be giving announcements like Presort throughout the year or are you pretty steady at this point?

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Production Mail. And just not to start any rumors on The Street, Production Mail.

Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal & Analyst*

Sorry. Production Mail, I apologize. It has been a long day.

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

I know you work awfully hard.

Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal & Analyst*

Did you see the Xerox's announcement anyway...

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

My own colleague, John Visentin. I wish some of it...

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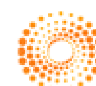

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Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal & Analyst*

Yes, yes, anyway, so but just going back to my question I apologize...

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

So I think the portfolio continues to be -- will evolve. And it will evolve because the company is evolving and will continue to evolve to where we see value in the marketplace. So we laid out pretty specific criteria in terms of how we would think about divestitures in particular, strategic coherence, leaders in the marketplace, acceptable returns. So we look at our portfolio across these 3 dimensions all the time. So I'm not going to foreshadow any particular move, but I will be transparent about how we think about it.

Operator

Next question is from the line of Glenn Mattson, Ladenburg Thalmann.

Glenn George Mattson - *Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research*

This relates to the guidance, the -- with the sale of Production Mail, you're lowering -- you're going to be a smaller company by $400 million or something. I guess I would wonder, there has been some cuts in SG&A, there's been some planned cuts in SG&A, but why wouldn't you extend or add to those cuts given that you're going to be smaller size?

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

I'll let Stan answer, but, I mean, we obviously, didn't sell Production Mail on a whim. It's been something we've been contemplating for a while. So to a degree our $200 million of gross cuts contemplated that divestiture. We'll work -- we continue to work at that number to make sure that it's appropriate and that we deal with whatever stranded costs there might be. The TSA agreement it's important aspect of how we deal with that. So I understand these things kind of get processed in a different synchronization level externally and internally, but we've been working on this for a bit.

Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

Yes, the $200 million, Glen, is obviously a big number, but first quarter -- and first quarter, I think is a really important signal of the $200 million. If we were slow out of the gate, it's incredibly hard to recover. But we actually performed very well with the units in first quarter. We're right on track for what we have to do. That total number is at least $200 million over that time. And we think there's opportunity here as we look -- continue to look at our processes, leverage the investment and our systems, which I think still has a lot of opportunity. And obviously, as we've done this and looked out when we're looking at Production Mail, we know we have to take care of those stranded costs as well. So what this is bringing is, is better insight into our business as we go through. We're not just out there with a straight target where everybody can down x, we're evolving into looking how to improve our processes that better serve our clients and extend our speed and urgency of how we deal with the market and how we deal with competition. So we're confident in the $200 million. We're off to a very good start, the attainment if we look at that, leaves us very well positioned for the year. And $200 million is a pretty big number as well. But candidly, if we can get more, we will get more.

Glenn George Mattson - *Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research*

Okay, you guys mentioned that on the inside sales on the SMB business you had some lower levels of staffing on the inside sales. Can you further expand on that please?

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Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Sure, I mean, I think if you read the newspapers we all see that United States now is very low on unemployment, labor markets are tightening, we experienced a dose of that in our SMB business particularly in our Spokane facility. We've got ourselves a little bit under headcount. They've staffed backed up. And as we look at April in particular, they're back on the horse.

Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

There will be new leadership there as well in that particular piece.

Glenn George Mattson - *Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research*

And was that one of the driving factors behind the SMB continued little weaker than expected? Or is there -- what else could you do to get that business stable?

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

So the answer to your question is, yes. That was a important contributing factor to the decline of the SMB business. We think the combination of getting that staffing right as well as the new product is the right combination. We continue to kind of fine-tune our strategy on pricing and offers to ensure that we have the highest possible conversion rates. But we think we've got the right basic tools and just kind of fine-tuning the staff with the product, with the pricing that is the right recipe going forward.

Glenn George Mattson - *Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research*

Okay, and then moving over to software. I think one thing that stood out when you just mentioned that the indirect channel contributed to 30% of the pipeline or 30% of the pipeline growth, I wasn't sure on that. But pipeline is always nice. But can you talk about conversion rates and I guess the quality of the pipeline and just some background around that?

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

So the comment was relative to pipeline. Stan, sitting next to me, will correct me if I am wrong. So to your point, our pipeline is interesting, but in the end what we all care about is dollars. So as we think about the indirect channel, it's not just dollars but dollars that we wouldn't have gotten without that pipeline -- without those partners. So we have very specific measures of how we not only think that channel should produce, in total, but what is incremental. So that's point 1. Point 2, in terms of the quality of the pipeline, this is more of a macro statement than anything to do with a particular channel. The quality of the pipeline in the second quarter is very high because we have a lot of renewals. We have unusual amount of renewals which for those who are not familiar with software business means that the license agreement that the clients have is expiring. So there is an impending event, which is a salesman's dream. So we're very optimistic about the quality of the pipeline, particularly in the second quarter. But I would say more broadly in the remainder of the year. But all that being said, this is still a work in process. We still need to prove that this channel can deliver the way I think it can. So we've got more work to do.

Glenn George Mattson - *Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research*

Thanks for that. And then I guess last question just on the overall strategic outlook, the sale of this business. Was this part of one of the recommendations from the study that you did, the Lazard study? And was this the extent of the recommendation? Or I guess would you share what maybe the investing public at some point more in-depth about what they recommended? And how you guys decided on which of those recommendations to pursue and which to not ignore -- I guess ignore so...

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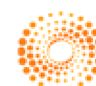

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Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

I mean. I'll be little circumspect about how I answer your question. But the sale of Production Mail isn't something that we just thought about over the last 6 months. Candidly it's been something that we've been thinking about for several years. And it had to do with the end user growth of the overall market and how that market is evolving. So that's a market that's, as we describe it, flattish with margins that are acceptable but under pressure as the buyers of that technology begins to consolidate. That being said, we like that business. We think that business has got great opportunities. But it's not ever going to get capital inside of our business given the end user dynamics of the particular marketplace. So I would say as we went through the conversation with the board about strategic alternatives, this is when that we decided the timing was right both internally and externally. We think we've got a really good and fair price for the asset. I think this is a great company and we'll do really well going forward. I just think it's going to do better outside of the portfolio than in. Beyond that I'm not going to talk about any specific recommendations from Lazard. I will say that we -- we clearly didn't ignore any recommendations as we thought about the strategic alternatives.

Operator

Next question from the line of Allen Klee, Sidoti.

Allen R Klee - *Sidoti & Company, LLC - Senior Equity Research Analyst*

For North American SMB, can you provide any granularity in terms of what you're seeing, when postal meter rentals are coming due in terms of the buckets it's going in, of them declining to renew or going to SendPro? Or just renewing with postal meters? How to think about? And if that's kind of going with your expectations?

Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

Yes. So on renewals as they come in, I would say the trends haven't changed materially through time. In terms of when clients come towards the end, renewal comes up, you get a mix of what happens. So ideally, they would trade up, and we demonstrate the -- our new product and we certainly have shared that we've had success there. We sold over 30,000 of the C-Series, or the extender existing lease, which is a profitable transaction, gives the client what they need over time. And then we've also extended our portfolio, that if the client doesn't need the meter anymore there are online SaaS options for the client to take advantage of and then there are cancels. So I would say we haven't seen that change materially. And we talked a little bit about equipment sales. I'll just remind us that the equipment sales are lumpy through time. They don't follow a consistent pattern. If we looked at last year going through the quarters in North America, plus 5, plus 24, minus 16, plus 1, and we grew through the year. So when we take a look at first quarter, and we look at some of the contributing factors with the lower staffing here, we think this temporary and that will be back in better shape. And as Marc said, we're off to a solid start here in 2Q.

Allen R Klee - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Okay, thank you. I had 2 modeling-related questions. One was based on the sale of Production Mail and repatriated cash. How much additional debt do you expect to pay down going forward for the rest of this year?

Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

So if we take a look at that, Allen thanks for the question. Marc said we had $775 million in cash and short-term investments. So we're going to yield approximately $270 million from the sale of Production Mail. If you recall, we said we're going to repatriate $500 million. We've done just over $400 million. We already paid down the March redemption here for $250 million. And if you look at free cash flow generate $235 million to $285 million of incremental cash flow for the year and, of course, we have the remaining dividends. When you put that altogether, we'll use approximately $425 million to $475 million of that cash to pay down near term debt. That would take our debt levels down to just below where we were at first

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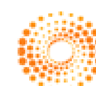

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quarter 2017 and leave us with a similar level of cash that we have now around year-end. So lots of moving parts in there. But that deleverages our balance sheet, leaves us with lots of strategic flexibility and certainly in a position to handle any of the near-term needs. It also help reduce our need to be out in the market anytime in the near future.

Allen R Klee - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Okay, great. And how much CapEx is associated with Production Mail?

Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

There's not an enormous amount of CapEx in the Production Mail. You know, it's, I think, single-digit millions, so the bigger combinations of CapEx are in our other businesses.

Allen R Klee - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Okay, great. And then with your APIs, it was encouraging to hear how it's grown sequentially off a tough off of the biggest 4Q quarter. Could you tell us a little more about maybe ChannelAdvisor and your other partners and kind of maybe what ChannelAdvisor does and kind of the growth outlook you see?

Stanley J. Sutula - *Pitney Bowes Inc. - Executive VP & CFO*

So first let's talk a little bit on a high level of shipping API. So we continue to make progress here. We took you through the journey of last year, growing 20% over fourth quarter volumes, which is a peak, I think, gives you an indication that we continue to gain momentum in this business. In fact, if you look at the volumes on a year-to-year basis, we're up almost 13x. So a significant improvement in that trajectory. And that's really coming off of heavy investments in the platform, that's both from an offering as well as stability. And as you know, we haven't talked about any stability issues here since last summer. And again, we performed we think at industry norms. We're excited about the announcement with ChannelAdvisor and candidly our other partners. Obviously, we print a lot of labels with eBay. This brings experience, it extends our reach. But with ChannelAdvisor, as they deal with all their clients, we think we bring an attractive price, very good capability, a stable platform plus the ability to offer other types of services, whether it's tracking, shipping, returns or Newgistics. I think it's a really exciting opportunity for us to extend the model here.

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

I would just add, if you look at where Stan is tremendously excited about, not just ChannelAdvisor but broadly the reception in the market place. ChannelAdvisor is a great partnership because they have access to lots of packages. They have a different business model than others in the industry. They don't charge a subscription fee, so they're economically advantaged versus competitors and it's at transaction levels. They charge at transaction level. So we think they have a great access to the market. They have an advantaged business model. They're a great company. And I think their access to the market, their access to packages, their business model in combination with our APIs is an incredibly important initiative and one that is competitive differentiated versus others in the industry. Hard to underestimate the importance of that announcement.

Allen R Klee - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Okay, great. My last question is regarding the hire of Cliff Rucker. And you guys had mentioned that this can potentially create some new e-commerce related ideas. Is there anything you can expand on that?

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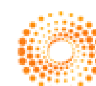

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Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Listen, Cliff's a tremendous executive. He comes with a wealth of experience from the USPS and I would say the industry as a whole. So he brings relationships, he brings knowledge as a further plus point of our relationship with USPS. So we're excited. So thanks for pointing out.

Operator

No further questions in queue. Mr. Lauterbach, Would you like to make any additional remarks?

Marc B. Lautenbach - *Pitney Bowes Inc. - President, CEO & Director*

Sure. I want to build off of the last comments and tie Kartik's question with -- the conversations we had just had. As we contemplate our opportunities to deploy capital, to Kartik's point, we're tremendously excited about investing in the business. To us that means investing in technologies like APIs. We didn't mention or didn't get a question on our relationship with eBay, which we just extended for several years. That's how we see putting our capital to work. In summary, it would be expedient for me to put a lot of money behind share buybacks right now. It will probably optimize our executives earnings this year, but that's not what we're about, we're about creating long-term value. So if we think about capital, we're going to continue to invest in our business. I've seen too many companies in growth markets that got themselves hamstrung with buying back shares and not providing the kind of flexibility they need to grow their business. So first quarter was an important proof point. It goes along with others as it relates to the new markets that we're moving to. And it's positive whereas to first quarter, I'm more positive about the balance of the year. So thank you, and we'll talk to you in 90 days.

Operator

Thank you. Ladies and gentlemen, that does conclude your conference and we do thank you for joining and using AT&T Executive TeleConference. You may now disconnect.

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