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PBI - Q3 2016 Pitney Bowes Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 revenue of $839m and GAAP EPS of $0.35. Expects full-year 2016 revenue, on a constant currency basis, to be in the range of 1% decline to 3% decline vs. 2015, and adjusted EPS to be $1.75-1.82.

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CORPORATE PARTICIPANTS

Adam David *Pitney Bowes Inc - VP of IR*

Marc Lautenbach *Pitney Bowes Inc - President & CEO*

Michael Monahan *Pitney Bowes Inc - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Kartik Mehta *Northcoast Research - Analyst*

Ananda Baruah *Brean Capital, LLC - Analyst*

Shannon Cross *Cross Research - Analyst*

George Tong *Piper Jaffray - Analyst*

Glenn Mattson *Ladenburg Thalmann & Company Inc. - Analyst*

Allen Klee *Sidoti & Company - Analyst*

PRESENTATION

Operator

Good morning, and welcome to the Pitney Bowes third quarter 2016 results conference call.

(Operator Instructions)

Today's call is also being recorded. If you have any objections, please disconnect your line at this time. I would now like to introduce your speakers for today's call, Mr. Marc Lautenbach, President and Chief Executive Officer, Mr. Michael Monahan, Executive Vice President, Chief Operating Officer, and Chief Financial Officer, and Mr. Adam David, Vice President, Investor Relations. Mr. David will now begin the call with a 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 2015 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 most 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 Lautenbach - *Pitney Bowes Inc - President & CEO*

Good morning. Thank you for joining our third quarter conference call. Similar to last quarter, there were several moving parts and puts and takes during the third quarter that affected our performance and our financial results. While we continued to make progress against our strategic initiatives

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to unlock value and transform our Company, we have more work to do. That said, we are confident that the actions we have put in place this year will continue to yield improved results in the fourth quarter and throughout 2017.

On the positive side of the ledger, our new enterprise business platform which was deployed in the second quarter continues to provide operational benefits. Our new products and solutions introduced in the second and third quarter, and tied to the Pitney Bowes Commerce Cloud are resonating well with our clients and gaining traction, and our go-to-market strategy is yielding solid results.

Turning to the third quarter results. Global ecommerce posted another strong performance and our production mail business grew and delivered impressive equipment sales results. Overall, equipment sales grew 6% this quarter. While we continue to make progress on building out our partner channel in our software business, license revenue in the third quarter fell short of our expectations.

Clearly, we are not satisfied with our software performance, and have taken a number of actions around improving our sales channel efforts, and continuing to focus on growing the pipeline for license revenue deals. We are making progress, but there's much more to do. In our small and medium business, equipment sales rebounded after the initial deployment of our enterprise business platform in the second quarter. While there are lingering issues, we continue to enhance the platform and expect to see improvements in the end of the year, and into the first half of 2017.

Now let me update you on the progress we are making on our strategic initiatives, the reinvention of our mail business, operational excellence, and growing our digital commerce business by leveraging our client base. First, reinvention of our mail business. We introduced the notion of reinventing our mail business back in September of 2015.

We understand that today's SMB clients require the reliability, security, and predictability of our traditional mailing systems, as well as the need to simplify the increasing volumes of shipping parcels, but we also know that clients want the ease-of-use and rich features that our digital capabilities provide. For Pitney Bowes, reinventing mail is all about combining the strength of both physical mail and shipping, with our digital capabilities to deliver more value for our small and medium business clients.

In the past six months, we have doubled down our efforts to deliver new and innovative products that leverage our considerable digital capabilities. We have delivered the Pitney Bowes Commerce Cloud, added a new online webstore capabilities making it easier for clients to do business with us, provided clients with video capability through our EngageOne solutions, developed shipping APIs that provide new ways to monetize our software assets, and introduced into the market several software-as-a-service based products and solutions, including SendPro and SmartLink. In fact, we have more than 15,000 clients enrolled to use our SendPro solutions, and we have shipped over 25,000 SmartLink devices since they were first introduced.

In early October, we announced SendPro 300, an example of what we mean when we talk about reinventing our mail. The SendPro 300 streamlines multi carrier office shipping and mailing for SMBs, allowing clients to manage their mail and shipping with USPS, FedEx, and UPS while reducing costs. When connected to the Pitney Bowes Commerce Cloud, the SendPro 300 links business and shipping vendors with analytics and APIs, and provides automatic postal updates, low ink alerts, service warnings and diagnostic notifications.

Next, operational excellence. Driving operational excellence in our business remains a significant ongoing focus for our Company each and every day. A critical component for driving operational excellence is our new enterprise business platform which was deployed in the US in the second quarter. While we have not yet realized the full operational benefits from the platform, we know what needs our focus and attention, and expect to see increasing improvements in the platform and the benefits through the remainder of the year and throughout 2017.

As a reminder, this is not just an ERP implementation. The new platform touches every part of our business, including how sales opportunities are managed, products are configured, enabled and tracked, financials produced, customer service delivered, and client satisfaction managed. As I mentioned last quarter, and it's worth repeating, our new enterprise platform is an essential component to our overall transformation. The substantial long-term benefits we derived from this platform outweigh any short-term challenges that we may face.

In the third quarter, SG&A improved 3%. In terms of servicing our debt, we issued $600 million of five year notes. The transaction was oversubscribed, which is an indication of the continued interest in confidence by the capital markets in our transformation story.

Finally, growing our digital commerce business by leveraging our client base. Global e-commerce business continued to perform very well, growing its retail and marketplace organic revenue 17% excluding the impacts of currency. During the quarter, we continued to add new store fronts, including Soludos, Evolue, and the New York Times Store. Additionally, our Global ecommerce segment had an 11% EBITDA margin this quarter, driven by revenue growth and synergy savings.

Last quarter, I mentioned that demand for our cross-border capabilities was one of the most impressive things I've seen. To that end in the quarter, we announced we expanded our business in Australia to provide Global ecommerce solutions to retailers looking to sell their goods across international borders.

With the Pitney Bowes' Borderfree retail solution, Australian retailers will reach consumers in 220 countries and territories. Since launch, we have brought three Australian retailers onto our platform and signed more than 10 store fronts. We are also working on expanding opportunities for our US retailers in key consumer markets like China and India.

For example, eBags recently announced that Pitney Bowes is helping them launch their products on Tmall in China. We're in the early stages, but are pleased about this opportunity. Also during the quarter, we announced that our shipping APIs for USPS postage are now part of the multi channel order platform offered by Ordoro, a multi-channel e-commerce order and management solution provider.

Now, let me briefly discuss our software business. As I mentioned earlier, license revenue in our software business was disappointing; however, during the quarter we signed a number of new partners including regional systems integrators and location Intelligence partners. The response from our partners, regional systems integrators, and global systems integrators has been very positive, and we are encouraged by the progress we are making attracting world class partners to help sell our products and solutions.

Importantly, more than 200 partner sales and technical resources have been trained so far, and we are now shifting our focus from recruitment of partners to enablement and pipeline building to drive the sales results we are looking for. We are making good progress in all areas, and expect revenue from partners to be a strong contributor in 2017.

I said at the outset of my prepared remarks, there are a lot of puts and takes during the third quarter, but I like where we are in this phase of our transformation, and I am confident that the actions we have put in place this year will continue to yield improved results in the fourth quarter and throughout 2017. With that, let me turn the call over to Mike who will take you through our third quarter results. Mike?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Thank you, and good morning. As Marc discussed, we continued to make progress against our long-term strategy, and achieve some additional milestones during the quarter, but we recognize we have more work to do. Let me provide an overview of the quarter, and drill down into some of the details. I'll then give an update on our expectation for the remainder of the year.

For the third quarter, there are some significant highlights worth noting. ecommerce marketplace and retail grew revenue organically 17%, excluding the impacts of currency this quarter. As a reminder, this is the first quarter of reporting Borderfree fully in both periods, and now represents a clean comparison.

This cross-border revenue growth is particularly encouraging because it reflects both a stronger US dollar versus the prior year, as well as some temporary disruption on demand for parcel shipments from the US to Canada prior to the resolution of a Canada Post labor dispute. Additionally, our global ecommerce segment had an 11% EBITDA margin this quarter, driven by revenue growth in synergies savings from the Borderfree integration.

The enterprise business solutions group in total continues to perform within the long-term market rates for both revenue and EBIT margin. Production mail grew revenue this quarter by 5%, driven by 27% growth in equipment sales. Excluding the impact of currency and market exits, revenue grew 11% in production mail. As we have noted in the past, equipment sales is subject to fluctuations from the impacts of big installations.

For SMB, equipment sales declined 1% both globally and in North America mailing. The North America mailing segment improved its overall revenue performance from last quarter, but we are not yet fully back to the stream revenue run rate established prior to the implementation of our new enterprise business platform. Also in the third quarter, we continue to address and focus our efforts on areas that need to improve. While software solutions did not see improvement in year-over-year license revenue in the quarter, the business continues to make progress in its indirect channel strategy.

As Marc mentioned, we continued to sign new regional systems integrators and location intelligence partners. Although it will take time to ramp up the indirect pipeline and see a positive impact to our results from the new agreements we've signed, we are pleased with the progress we have made in building out this new channel. In the meantime, the Company is focused on improving its direct sales channel efforts, and growing the license revenue pipeline.

In SMB, recurring revenue streams declined at a greater rate than recent periods, largely due to lower financing and supplies revenue. In North American mailing, our financing-related fees were not fully normalized due to proactively waving some fees to allow clients to adjust to new billing formats, and based on the timing of when some invoices were sent. Additionally supplies revenue declined on lower demand and supply sales resource mix during the quarter.

Given the high margin nature of these recurring revenue streams, EBIT margin was impacted this quarter. We expect stream revenue, particularly financing revenue to continue to improve from current levels, as a result of financing fees normalizing and supply sales productivity. Presort revenue growth was muted by the rate change earlier in the year, and some lower margin deals signed recently.

Let me now take you through the third quarter overall financial results. Please note that a reconciliation of GAAP to non-GAAP financial measures can be found in the financial schedules appended to our earnings press release and earnings slides, which are posted on the PitneyBowes.com website under the Investor Relations section.

Turning to the results, revenue for the third quarter totaled $839 million which was a decline of 2% on a constant currency basis adjusted for market exits, and a decline of 2.5% constant currency, and 3.5% on a reported basis. Revenue in our SMB segment group declined 6% on a constant currency basis adjusted for market exits, and declined 7% on a reported basis. Revenue in our enterprise business solutions group grew 4% on constant currency basis adjusted for market exits, and grew 2% on a constant currency, and 1% on a reported basis. Digital commerce solutions revenue grew 2% on a constant currency basis, and declined 1% on a reported basis.

Adjusted earnings per share from continuing operations were $0.44. Adjusted earnings per share results include a positive tax adjustment of $0.07 per share, principally driven by the resolution of tax examinations. GAAP earnings per share were $0.35, which includes a $0.06 per share of restructuring charges, and a $0.03 per share charge from the announced redemption of the preferred stock of our Pitney Bowes International Holdings or PBIH subsidiary.

Free cash flow was $119 million, and we generated $137 million in cash from operations on a GAAP basis. In comparison to prior year, free cash flow was lower mostly due to the timing of accounts payable. During the quarter, the Company used its cash to pay $35 million in dividends to common shareholders, $25 million for the Maponics acquisition, and $17 million for restructuring payments. From a debt perspective, the Company issued new five year 3 3/8% notes for $600 million. This will be a debt-neutral transaction, as a portion was used to pay down our commercial paper balance during the quarter, and the remaining $300 million is being used to redeem our PBIH preferred securities.

Turning to the income statement, as a reminder this information is on an adjusted basis, and a reconciliation of GAAP to non-GAAP financial measures can be found in the financial schedules appended to our earnings press release and earnings slides which are posted on the PitneyBowes.com website under the Investor Relations section. Adjusted earnings before interest and taxes or adjusted EBIT was $146 million this quarter, which was $27 million lower than the prior year as a result of reduced revenue, particularly in North American mailing and software.

Adjusted EBIT margin was 17.4%. Adding back depreciation and amortization, adjusted EBITDA was $197 million for the quarter. SG&A for the quarter was $300 million, which was $9 million or 3% lower than the prior year. As a percent of revenue, SG&A was 35.8%, which was 20 basis points higher than the prior year. SG&A declined in absolute terms when compared to the prior year, primarily driven by lower employee-related costs.

In support of our savings objectives around operational excellence, we recorded a pretax restructuring charge of $16 million at the end of the quarter for actions taken to improve operational efficiency and productivity across our business portfolio. Net interest expense which includes financing interest was $35 million, a decline of $2 million when compared to the prior year.

Average outstanding borrowings during the quarter were $246 million higher than the prior year. The average interest rate this quarter was 4.45%, which was about 77 basis points lower than the prior year. The effective tax rate on adjusted earnings for the quarter was 21.9%. The lower tax rate this quarter is principally related to the favorable resolution of tax examinations.

You may recall, that we had a higher tax rate in both the first and second quarters of this year. On a year-to-date basis, and including this quarter's tax benefits, our tax rate on adjusted earnings is 31.5%. We therefore expect our annual tax rate to be at the low end of our stated range of 33% to 35%.

Now I'd like to discuss the third quarter results for each of our business segments. This information can also be found in our earnings press release, and the slides that we posted to the PitneyBowes.com website under the Investor Relations section. In North American mailing, revenue was $330 million and EBIT was $139 million. The revenue decline rate this quarter was an improvement from second quarter, which was impacted by the new enterprise business platform cutover.

Equipment sales declined 1% compared to prior year, returning to levels similar to pre-go live of the new platform. As Marc noted earlier, in October we added the SendPro 300 to the growing family of connected mailing and shipping devices and apps. As I mentioned earlier, recurring revenue streams declined at a high single-digit rate, largely driven by lower financing-related fees and supplies revenues.

The level of financing-related fees were not fully normalized due to proactively waiving some fees to allow clients to adjust to new billing formats, and based on the timing of when some invoices were sent. Additionally, supplies revenue declined on lower demand and supplies sales resource mix during the quarter. We expect stream revenue, particularly financing revenue to continue to improve from current levels, as a result of financing fees normalizing and supply sales productivity. EBIT margin was 42%, which was 310 basis points lower than prior year and mostly the result of the decline in high margin recurring revenue streams.

In international mailing, revenue was $96 [million] and EBIT was $10 million. Excluding the effects of currency movements and market exits, revenue declined 3.5% compared to prior year, and equipment sales were flat. Equipment sales benefited from growth, most notably in France, Italy, and Japan but were mostly offset by a decline in the UK. Recurring revenue streams declined, driven by lower supplies and rental revenues. EBIT margin was 10.2%, which was relatively flat to prior year, as the decline in high margin recurring revenue streams was offset by lower operating expenses.

Turning to enterprise business solutions. Overall the segment group's revenue grew 2% on a constant currency basis, which is in line with our long-term expectations. Revenue grew 4% when adjusting for currency and production mail market exits. In production mail, revenue was $106 million and EBIT was $16 million.

Equipment sales grew 27% over prior year due to higher sorter, inserter, and print equipment placements, as a result of a number of large client installations in the quarter. Support services revenue declined as a result of a continuing shift from in-house mail production to third-party service bureaus who tend to self-service, as well as reduced service revenue associated with the market exits. EBIT margin was 14.8%, which was an improvement of 260 basis points from prior year due to service delivery cost management initiatives, and lower sales and marketing costs.

In presort services, revenue was $114 million and EBIT was $19 million. Revenue and EBIT margin were impacted this quarter by a decline in the average revenue per piece of mail processed as a result of the rate change earlier in the year, and some recently signed lower margin deals. EBIT margin was 16.8% which was a decline of about 560 basis points versus prior year, primarily due to the revenue decline and increased labor costs.

For the digital commerce solutions group, in software solutions, revenue was $89 million and EBIT was $10 million. Revenue declined from prior year due to lower customer information management and location intelligence licensing revenues, but benefited from growth in customer engagement software licenses. As Marc outlined, and I noted earlier, we are actively signing up new system integrators and other partners as part of our continued focus on expanding the indirect channel.

And while we continue to make good progress in expanding the indirect channel and training partner sales and technical resources, it will take time before results reflect substantial revenue from partner-led deals. The business also continues to improve its direct sales efficiency to grow the pipeline of license deals. EBIT margin was 11.6% which was a decline of 340 basis points versus prior year mostly due to the lower licensing revenue.

In global ecommerce, revenue was $104 million and EBIT was $4 million. As I mentioned earlier, this quarter included a full quarter of Borderfree results in both periods. Excluding the impacts of currency, our marketplace and retail revenues grew 17% from prior year on strong growth in the UK outbound shipments. US outbound marketplace grew despite a stronger US dollar versus prior year, as well as some temporary disruption on demand for parcel shipments from the US to Canada, prior to the resolution of the Canada Post labor dispute.

Domestic office shipping revenue declined from prior year, which reduced overall revenue growth for the global ecommerce segment this quarter. EBIT margin was 4.2%, which was an increase of 550 basis points versus the prior year; however, as I noted earlier, the global ecommerce segment had an 11% EBITDA margin this quarter. This better reflects the profit and cash improvements post the Borderfree acquisition. The EBITDA margin improvement is due to the revenue growth, as well as the synergy savings from the Borderfree integration, which more than offset continued investment in the business.

That concludes my comments on our financial performance for the quarter. Now I'd like to discuss our annual guidance. The Company expects improving trends in the business in the fourth quarter as a result of actions taken to achieve its long-term strategic initiatives. These initiatives include the initial benefits of the implementation of our enterprise business platform, new product introductions, and continued enhancements of our channel strategy which will benefit the fourth quarter with increasing contribution into 2017.

For 2016, the Company expects to be at the low end of its annual guidance range for revenue and adjusted earnings per share. For the full year 2016, we expect revenue on a constant currency basis to be in the range of a 1% decline to 3% decline when compared to 2015, adjusted earnings per share of $1.75 to $1.82. Adjusted earnings per share guidance excludes the year-to-date charges of $0.22 per share, primarily related to restructuring and asset impairments. We expect free cash flow to be in the range of $400 million to $450 million.

Also as a reminder, the Company is hosting its annual Analyst Day on December 6 in New York City, at which time we'll provide an update on our strategy. Please visit our Investor Relations website for further details on registering to attend, or viewing the webcast online for this event. Operator, that concludes my remarks. Please open the line for questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Your first question comes from the line of Kartik Mehta from Northcoast Research.

Kartik Mehta - *Northcoast Research - Analyst*

Hey, good morning, Marc and Mike. As you look at the North American mailing business and the lower financing and supplies revenue, how much of that is market share loss versus how much of that do you think is the change in go-to-market strategy for you?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

In terms of those two line items, I would say supplies has a couple of factors to it. We did do some resource mix shift during the quarter, that probably cost us a little bit.

What I mean by that is, we had more resources or focused on digital access and digital selling for supplies, versus direct selling or inside sales selling supplies. We also had a small impact related to the cutover because of some resources supporting other customer activities other than supplies. In particular, the sale of our SmartLink product which is -- accrues to equipment, but is a new product we had to offer.

With respect to financing income, there was about $4 million that we would relate to fees that we forwent in the quarter, in the interest of getting our clients up to speed, in the new invoicing and those types of things. So if you were to adjust for those fees, we would have been down more in the mid single-digits, more around 7% on the financing line, which is not out of line with where we've seen that line item over the last several quarters. So I think it's less a market share issue, more sort of some of these transitional issues around both the implementation of our ERP program, as well as in the case of supplies, a combination of resource shift and some lower demand that we did see in the quarter.

Kartik Mehta - *Northcoast Research - Analyst*

Marc, from a bigger picture standpoint, as you're restructuring Pitney Bowes, and you kind of -- as a journey you've taken on, and we're into 2016, as you look forward and where you are, how much of some of the missteps -- and I'm not sure if that's right word -- that have happened, would you say are execution? Or how much of it is just that the marketplace has changed, and whether it be FX or demand for certain products?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Yes, I'm sure it's drives us a slightly different way. I would tell you, as we're making the changes to our business, whether it be the go-to-market in the SMB, or changing the geographic footprint, or changing the go-to-market in software, or the introduction of our new business platform, there were disruptions across all of those things. So I don't see those as operational missteps. I see those as short-term sacrifices, as we do the right things to optimize the business for the long-term.

Kartik Mehta - *Northcoast Research - Analyst*

And then, just a last question, Mike, maybe, can you just talk a little bit about 2017 in terms of the cost savings you're anticipating still from the operational efficiency changes you're making this year, and how that will impact 2017?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Sure. As we said before, we expect the benefits to really start to begin to accrue in the fourth quarter this year, with the largest share of those benefits coming next year. I would say, we still remain on track for that as we've described. We'll obviously at our Analyst day give a more detailed update on that, but we believe we're still in good shape for getting those savings.

Kartik Mehta - *Northcoast Research - Analyst*

Thanks, Mike.

Operator

Your next question comes from the line of Ananda Baruah from Brean Capital.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Hey, guys. Good morning, thanks for taking the questions. Can you hear me okay?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

We can, thanks.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Okay, great. Just a couple if I could. The first is, Mike, if you could I guess, just bridge for us getting to the low end of the full year guide, given that it seems just sort of simple math, the step-up in December Q EPS, which I believe is $0.14 from September Q, is a little bit, a tad above the higher range of what you guys have done in the past. And so, I know that the sort of expectation is that you have sort of more progress in the few of the initiatives that you've been going through this year. But I would just love to get context around that? And then, I have a follow-up, thanks a lot.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Sure. So good question. In terms of the fourth quarter versus third quarter, I think as you appreciate, fourth quarter is generally our biggest quarter. A number of our businesses have seasonality around that, it's usually our biggest equipment quarter in SMB.

Obviously, ecommerce has a holiday season benefit and opportunity to it. And then, the other big piece that creates a change between the third and fourth quarter is, beginning to see the benefits associated with our enterprise business platform benefits begin to kick in as well. So it's a combination of seasonality, I would say further productivity in our new ERP system, and then the cost savings associated with that.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I would also say that, this is a case where past does not prologue. If you look at what's gone over the last several years, we have been as I said, dealing with these short-term disruptions, as we make the steps to improve the business in the long term. So I'm not sure you can look at what has been historical step-ups, as we contemplate the third to fourth quarter.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Yes. And Marc, I can totally get that as well. And I guess, in that context, do you guys feel that you have, do you feel like you have a good grasp on the visibility right now? I mean, I guess we're almost kind of approaching kind of -- we're half way through the quarter, so do you feel like we're approaching that? So do you feel like you have a grasp on the visibility, because of the things that you control, so that you feel good about the low end of the range at this point? And then, so I guess, I'm wondering -- ?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I think, as I outlined there's a number of factors that would drive the fourth quarter. Obviously, as we sit here today, we believe we have the right processes and people in place to make those things happen, particularly on the SG&A and cost savings side, those things are obviously part of our longer term plan to generate those benefits, and we're now six months in. So we start to see those come through.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Got it. And then, the second one is just on the equipment sales growth, can you -- the dynamics behind that -- my hunch is that some of it is sort of the initiatives you've been doing the last few years obviously, plus some benefit from your new enterprise initiatives -- and well not enterprise initiatives, but the sort of your enterprise software system. So is there any way to tell how much of it is from that, or at least what your gut feeling is? And then, I know I've asked this question a couple of times about, sort of the new normal on equipment sales, kind of run rate whether it be sales or a more mitigated decline? But are you thinking any differently about that now that you had some nice quarters of growth put in? And then just in the context of the number you put up in US mailing, so sort of with the transitions you're going through, how are you thinking, how would you like for us to think about that interplay playing out ultimately, the really strong -- what the really strong [quoted] sales growth? Thanks.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I would say, there's three dynamics in equipment sales. I would say in production mail as Mike pointed out, we had good performance, but we also benefited from large deals. So I would not want to leave you with the expectation, that 27% of equipment sales is the new normal for D&T. It is a lumpy business. We've been on both sides of that curve since I've been here. That said, as we look at how we're positioned for the fourth quarter between backlog and written business, we're encouraged, I'll say it that way.

The second dynamic is that I think some of the new product stuff is starting to make a positive difference. This will be a slow ramp, because these are businesses that have a big base and they're annuity based, so it's going to take awhile for them to have a meaningful impact on the bottom line. But it's clear that the new products are making a difference.

And then, the third dynamic is as we get through the business platform implementation, we're starting to see sales productivity back to normal levels. If you would unlayer the United States from Canada, we saw what I would say is, more what we would have expected productivity in the United States, six months into the deployment of the platform. And on the other side of it, Canada, where we're a year in, we've seen improved productivity, which is a very pleasant benefit. It wasn't part of our business case when we contemplated the new business platform. So we would expect to see those same dynamics in the United States and the rest of world over time.

How do we add all that up? I'm not sure I'm smart enough to give you advice on how to add all that up. But I would say, that as we think about equipment sales in SMB, I think flattish is kind of my interpretation of what stabilization looks like. As it relates to D&T, D&T is going to continue to be lumpy, and then you average those dynamics. So I'll turn to Mike to see if he wants to add anything to that.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

No, I think that's fair. I think the minus 1% in SMB is a good indication of getting back on track. And as Marc said, we've launched a number of products -- I would say they are very early in the cycle, in terms of having the impact on revenue. So we'll see how that influences that, as we go forward in terms of equipment sale.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Thanks a lot guys. Appreciate it.

Operator

Your next question comes from the line of Shannon Cross from Cross Research.

Shannon Cross - *Cross Research - Analyst*

Thank you very much for making my questions. I'm curious, when you reported last quarter, you'd indicated that the ERP system had been cut over and salesforce was working well, and things were picking back up. So I guess, I'm curious as to what sort of changed during this quarter, or was it just a continued sort of rollout of the ERP system, and working through all of the contracts that led to the miss, and then from a North America standpoint? And then how are you feeling into fourth quarter, I just want a little more clarity on that? Thank you.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Let's pick three time stamps, as it relates to the deployment of the business platform. So starting in April, I would say what we said in the last call, was that April and May were affected negatively, as we implemented the new system. And as we got into June and July, those dynamics normalized, and what you saw through the balance of the quarter was that dynamic continuing. So I think there's three different kind of time stamps, as you unlayer that question, Shannon. I think you have to look at April/May which is one set, and then June through now is the next, and then finally how we go forward.

As it relates to the issues that we had in the third quarter, and I hesitate to call them issues, the customers we're seeing build in a fundamentally different way. That caused a lot of questions understandably, so out of an abundance of caution as it relates to client satisfaction, we made some adjustments in terms of when we sent out bills, and also how we thought about fees as related to late charges. So I would tell, it's kind of normal stuff, and there's different layers as we move forward. I would, as Mike said, as we got into late in the third quarter and into the fourth quarter, the billing stuff normalizes. So we expect that, as we had indicated to get back to normal levels in the fourth quarter.

Shannon Cross - *Cross Research - Analyst*

Okay, great.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes, and I would just reemphasize, I think the sales performance is in line with what we saw pre-implementation, so that piece of the business I think is certainly back on track. And what Marc is really describing is some of the back office stuff associated with settling down the implementation.

Shannon Cross - *Cross Research - Analyst*

And the production mail strength, was that any specific area or vertical that drove it? Just I'm trying to think about how that sort of -- had the boost -- and I know you cautioned not to think it's necessarily going to be continuing, but I'm just curious, because that was a nice boost.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes, I would say there's sort of a run rate of business where we'll replace a machine or two in a given client, and that's the bulk of the business, and then occasionally we will do a bigger build out for particular clients. I think as we've talked in the past, our main verticals we serve are financial services, insurance and the like. And where we tend to have big in-house customers, when they will refit a large facility or multiple facilities, that can cause some bigger deals and bigger installations. That can happen with Post as well. So the third quarter did include a couple of big deals where we had more a build-out of a bigger facility, on top of our normal run rate of replacement equipment for the vast majority of our customers.

Shannon Cross - *Cross Research - Analyst*

Okay. And then, when we think about ecommerce going into the holiday season, can you talk about currency in terms of some of the moves you've seen? Obviously, the pound has moved significantly, the Aussie dollar I think, has strengthened a little bit I haven't looked in last week, things move so quickly. But just as we think about how you should benefit from obviously the holiday season and selling increase there, but then how do we think about that maybe, either dampened or supported -- I'm not sure at this point -- by currency?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I think if we look at the third quarter as a sort of indicator. If I look at the US dollar to pound relationship, we did see growth in our US outbound on a global basis. That was probably muted somewhat by the stronger US dollar. On the flip side, given the weaker pound, the UK outbound has grown very nicely. And I would say the direct relationship between US and UK was kind of a net neutral, because the growth in demand from the US for UK products pretty much offset the reverse of that.

So as we look forward to the fourth quarter, we still have a US dollar that's a bit stronger than last year. But what we've seen is, as the currency sort of normalized year to year, we don't see rapid or significant movements during the periods, then we tend to see some of that buying come back. The others, we've expanded the number of markets outbound from the UK by another [six]. And as you know we've added Australia, although that we're very early innings in Australia, have about seven store fronts open in Australia at this point.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I would say this carefully, and stipulate that this business will continue to be susceptible to currency fluctuations. That said, what you're starting to see is the breadth of the business organically has the ability to absorb some nominal amount of currency movements in a way, that candidly just couldn't when it was a smaller scale a year ago.

Shannon Cross - *Cross Research - Analyst*

Great. Thank you very much.

Operator

Your next question comes from the line of George Tong from Piper Jaffrey.

George Tong - *Piper Jaffray - Analyst*

Hi, thanks, good morning. Can you elaborate on some of the factors that may have contributed to software licensing revenues falling short of expectations in the quarter, and the timing of when you might expect your new channel partnerships to become productive?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

So I would attribute the third quarter miss, we started with a better pipeline as I indicated in the second half. We had hoped to realize a better yield on that pipe in the third quarter. We lost about a dozen deals at the end. We didn't lose any of -- we didn't lose but one or two to competition, most of them were timing from a client perspective, so we still think that pipeline is good for the second half.

I appreciate your question on the new channel, because it's important that we're clear about this. So if you look at the life cycle of bringing on a new channel, there's inevitably a dance up front, in terms of how I'd characterize dating, starting to get to know each other, a few deals here and there. And then you move into a more substantial relationship, where they actually train their people. And I want to just double click on that, because it's perhaps not as obvious how important that is. So I made the comment that we trained 200 individuals from these principally regional systems integrators and global systems integrators. As you all know, those businesses run on an hourly meter.

So the fact they are taking people away from billable work and dedicating them to building their skills tells you a lot. So it's one of the reasons why we continue to think we've got good prospects for that business. But all that being said, you get the relationships, you train the people, and then you start selling. So that takes quarters, not weeks or months. So I would say in the short-term, we continue to be dependent on what our direct salesforce can do. As you all know that's performed I would say, unevenly over the last couple of years, but we believe we've got better line of sight in the fourth quarter. I think the new channels will begin to come on earnest. I think you'll see a little bit in the fourth quarter, and then it will continue to build into 2017.

George Tong - *Piper Jaffray - Analyst*

Got it, very helpful. Turning quickly to presort, the revenues there dipped for the first time in several years. Can you discuss whether you believe that the decline is structural in nature, or if there are catalysts that can help drive growth again?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes, in terms of presort business we did -- volumes actually were pretty much level year to year. We did see some lower price deals in the quarter, and we had some -- a bit higher labor costs. In terms of as we look forward, if we look at the 2017 proposed rate case, what the postal service is really doing is incentivizing mailers to drive more efficiency in the network, through higher density in mail. And given the investments we've made in our network and all, we think there's an opportunity for us to help more mailers qualify more of their mail at the highest discount. And so, we see that as a positive opportunity for us as we go forward in the presort business. So we see opportunity for continued growth there as we go out into 2017.

George Tong - *Piper Jaffray - Analyst*

Got it. And then lastly, understanding, you'll provide more details at the upcoming Analyst day, can you share preliminarily what your ERP savings are on track for this year in 2017 and in 2018, particularly compared to your prior Analyst Day figures?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes, we haven't really changed our outlook with respect to the benefits we should get. I would say thus far in 2016, we're ahead of -- I believe we outlined $15 million to $20 million. We're more than $20 million, in terms of our outlook for the full year of 2016. That's in part offsetting some higher costs, but lower capital spend in the year.

As we looked out to 2017, I believe in the Analyst Day, and Adam will keep me honest here we had $65 million to $80 million. We believe we're still on track for numbers in that range, and we'll refine that more at the Analyst Day. And then obviously, there will be additional benefits in 2018, as we annualize the benefits we get in 2017. So as I said, we'll give more color on that as we go forward, but that's the order of magnitude we're looking at.

George Tong - *Piper Jaffray - Analyst*

Very helpful. Thank you.

Operator

Your next question comes from the line of Glenn Mattson from Ladenburg Thalmann.

Glenn Mattson - *Ladenburg Thalmann & Company Inc. - Analyst*

Hi, good morning. I guess it was a year ago in Q4, when software first took another little leg down. I think at the time, it was mostly related -- you guys blamed it on a few large deals slipping, maybe the pipeline being mischaracterized at the time. So I guess, going forward, currently are you -- can you talk about some of those deals from last year? Are they maturing at this point? And then just what your expectation is for big -- large software deals in Q4 of 2016?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Sure. I would say, many of the large deals that we had planned in the fourth quarter of last year, we've gotten this year, and I think what we're seeing is demand slipping to the right. And I think that's basically consistent with the overall business investment environment.

I had hoped at one point because we had such small share, that we would be able to move out of our existing markets with our direct salesforce, and to some extent inoculate ourselves against what's been rather sluggish business investment in capital spending. That's not turned out to be the case.

As we look into 2016 in the fourth quarter, as you always have the software business, you have a couple of large lumpy deals, and they will be binary. So we think we've got a good bead on them. We think we've assessed them in a prudent way, but that is the nature of software business, these things flow one way or the other. So we'll know more and we'll tell you more as we get through the quarter and Analyst Day is -- be a handy time to update you on some of these things.

Glenn Mattson - *Ladenburg Thalmann & Company Inc. - Analyst*

Given the newly trained channel salesforce, what would be your expectation for 2017, as far as what would constitute success along that path? Would it be a better rate of decline, or growth in software, or what are you looking for next year?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

For software to increase next year.

Glenn Mattson - *Ladenburg Thalmann & Company Inc. - Analyst*

Okay. Great. Thanks.

Operator

Next question comes from the line of Allen Klee from Sidoti & Company.

Allen Klee - *Sidoti & Company - Analyst*

Good morning. For ecommerce, with the -- because you had mentioned this is the first quarter of good apples-to-apples year-over-year, in terms of the integration with Borderfree and some of the benefits you're hoping to get from that, where would you say you stand on that?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Well, I would say we think of benefits in two categories. On the cost side, I would say we're pretty far along on that. An important piece of that is the integration of the logistics back end, and we think we're well down that path. So I'd say we have the majority of the benefits on the cost side today.

Obviously, the other side is on the revenue side, and that's where we're, I think beginning to see the contribution of revenue, the leverage of the Borderfree system with our fully landed cost engine, and that's giving us additional revenue opportunities. So we think the integration is pretty much done at this point, in terms of bringing the two businesses and the two teams together, and really now focused on growth in the ecommerce business.

Allen Klee - *Sidoti & Company - Analyst*

Okay, great. And then with your Commerce Cloud products, and could you just give a little update of where they stand, and also your multi carrier solution and digital stamps of how that's all doing?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes, in terms of Commerce Cloud, and we talked about a number of new products from the SendPro, which is the multi carrier shipping system for small businesses. Since that is a subscription type solution, it's early days for that. Marc talked about some of the numbers early on, in terms of beginning to get placements of that product, that will build a recurring stream over time. So early days, but good feedback on the product. Other important products in the Commerce Cloud that we talked about include our shipping APIs, and we're beginning to embed those into a shipper's infrastructure, and that allows us to provide them an engine for generating USPS labels. So again, early days on that, but we're beginning to, as we announced with Ordero, get some wins around incorporating that in. So we see a number of opportunities around Commerce Cloud. It will be a stream revenue type of portfolio over time. So early days, but we're pleased with the initial activities we've had.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I just want to tie two questions together, if I might. So understandably, people think about our software business as a standalone entity. And I get that, it's how we report the segment, and it's understandable at one level. That said, if you look at what is going on in our SMB business, as it relates to Commerce Cloud and SmartLink and SendPro, none of that happens without the digital capabilities that we have inside this Company. I'd make the same comment about the strength that you're seeing in our ecommerce business. So while there's an understandable focus on our software business -- and make no mistake I'm not pleased with where we are, to a degree the success that we're beginning to enjoy in our other business are because we had those software assets and capabilities.

Allen Klee - *Sidoti & Company - Analyst*

Okay, great. And then just wanted to confirm that did you buy back any stock during the quarter?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Very minimally. We bought back $2 million worth of stock, which is -- equates to 145,000 shares.

Allen Klee - *Sidoti & Company - Analyst*

Okay. Thank you very much.

Operator

Your next question comes from the line of Shannon Cross from Cross Research.

Shannon Cross - *Cross Research - Analyst*

Just a really quick follow-up. I noticed your -- on the cost of rentals the margin -- or sorry on rentals, the margin was sort of a change from prior quarters. Is there anything going on there, or how do I think about that?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

No, no material change there. That's principally due to the cost of meters, so the rentals are principally meters in the US and in France are the primary places. I think we did have some D&T rentals. We generally have a small amount, that generally we would have a lower margin. So that might have a little bit of an impact, but I think we've continued to see lower costs associated with meters and therefore, improved margins on rentals.

Shannon Cross - *Cross Research - Analyst*

Okay. So something we should consider as an ongoing benefit, as opposed to one-timer?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I'm sorry, Shannon, you faded out a little bit there.

Shannon Cross - *Cross Research - Analyst*

Oh, actually you did too on my side, that's interesting. No, I was just saying, it's sort of an ongoing -- the level we've seen in the prior quarters is sort of where we should be?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes.

Shannon Cross - *Cross Research - Analyst*

On an ongoing basis? Okay, thank you very much.

Operator

And at this time, there are no further questions. Mr. Lautenbach, I'll turn the call back over to you.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Thank you, operator. I'd like to close with three points. First, we know exactly what is required to finish the year strong, and we remain confident in our ability to meet our financial commitments. The cumulative actions we have put in place are improving our business performance, and we have a good line of sight to incrementally take out more cost and expense, and become even more efficient without sacrificing our long-term objectives.

Second, and I understand this, it is easy to get lost in the numbers, and lose sight of how far we have come, in order to improve our ability to create value in this business, especially as is the case of software when we fall short of our expectations. It's only when you step back, and look at all of the things we've done, that you get to the point, you begin to realize how much has been accomplished, and how much value we're poised to create.

If you think about it in terms of our strategic initiatives, the stabilization of mail, our go-to-market initiatives are yielding improved results and equipment sales are stabilizing. We're reinventing mail by delivering new products and solutions like shipping APIs, SendPro, SmartLink and SendPro 300 that are linked to Pitney Bowes' Commerce Cloud, and leverage our digital assets and capabilities to drive incremental value.

Operational excellence. We've made substantial improvements in our expense structure, and are far more productive today, than we were a few short years ago. We've improved our balance sheet, and we cut our inventory nearly in half. Critical to our transformation, we're continuing to see operational benefits from our new enterprise business platform, which now covers 80% of our business. We expect to realize increased operational benefits from this platform in the fourth quarter and throughout 2017.

Finally growing digital commerce. In the third quarter, global ecommerce grew 17% organically, excluding the impacts of currency, and margins improved. Four years ago, this was a fledgling business. Today this business is on track to become a substantial part of our portfolio, and is growing significantly in the years ahead. The opportunities in this space are significant, and we're just getting started.

In our software business, we've introduced a number of world-class products in the marketplace, and world-class clients, and we're building are robust partner channel that includes global systems integrators, regional systems integrators, and location intelligence partners. We've trained more than 200 partner sales and technical resources that will help drive our business. We have much more work to do in software, but we've made significant improvements already this year.

And finally, that [clear water] that I described last quarter, we'll begin to see the investments we've made over the years. We spent the last three and a half years building a strong foundation. I would argue in many ways, the hard part of the work is behind us.

We've invested in areas to secure our future growth and taken the necessary steps to acquire unlocked value. We have the right vision, the right strategy, and the right products and solutions. As with everything, it's now coming down to execution, and that's on us. With that, I'm looking forward to speaking with you again at Analyst day in New York City on December 6. Thank you.

Operator

Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation, and for using AT&T executive teleconference. You may now disconnect.
