THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

PBI - Q4 2017 Pitney Bowes Inc Earnings Call

EVENT DATE/TIME: JANUARY 31, 2018 / 1:00PM GMT

OVERVIEW:

PBI reported 2017 revenue of $3.5b and GAAP EPS of $1.39. 4Q17 revenue was $1.05b and GAAP EPS was $0.48. Expects 2018 revenue growth (excluding currency impacts) to be 9-13% and adjusted EPS to be $1.40-1.55.

CORPORATE PARTICIPANTS

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

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

Stanley J. Sutula *Pitney Bowes Inc. - CFO and EVP*

CONFERENCE CALL PARTICIPANTS

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

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

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

PRESENTATION

Operator

Good morning, and welcome to the Pitney Bowes fourth quarter earnings conference call. (Operator Instructions) Today's call is 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 2016 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 statement 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 table 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. - CEO, President and Director*

Good morning, and thank you for joining the call. As in the past, I will provide an update on the company's strategic transformation and how our 2017 annual results played into our overall transformation. Stan will provide an overview on the full year and details around the quarter and then take you through our 2018 annual guidance. We will then open the call for your questions.

From my perspective, the headline of the quarter and the year is that the company moved to growth, admittedly slight growth excluding Newgistics, but growth nonetheless. Our growth is the result of our ongoing efforts to reposition the portfolio to growth markets. Some of these efforts have been around portfolio changes and some are the success as a function of organic efforts. The subtext is that this growth is centered broadly around shipping. When companies are trying to transform, repositioning a business that was in secular decline to a position of growth is the first step, but certainly not the last.

In large part, these new dynamics informed our decision to publicly speak about our evaluation of strategic alternatives. As a matter of practice, on an annual basis, our board has looked at strategic alternatives. But given PB is now a different company centered around different themes, the dynamics around this year's evaluation of strategic alternatives were unlike previous years. We'll have an update on our evaluation of alternatives once we have concluded the process.

As I said in November, Pitney Bowes is a different company than 5 years ago: a company that is positioned to grow. Perhaps the best example for how different we are is our new SendPro C-Series product. This new product enabled by our new cloud initiatives, our new enterprise platform and delivered through a new set of channels. None of this was even contemplated in 2012. More on our progress with this new product in a moment, but the short story is new product is exceeding our expectations on almost every dimension.

Now let me turn to progress against our strategic initiatives, beginning with the reinvention of our Mail business. Again, our new SendPro product is a digitally connected product based on an open platform that enables mailing, shipping and other third-party applications. In the fourth quarter, we have seen clients move to the new equipment faster than we expected, services and attach rates are strong and we've seen payment-to-payment increase. The SendPro product embodies our initiative to reinvent our core business. Early days for sure, but there is much to be optimistic about with this new product. Broadly, the products that we have announced in our SMB business over the last 2 years are contributing to the stabilization of our equipment sales.

It is also worth noting that our Production Mail business performed very well in the quarter and in the year. In large part, this performance was driven by new products announced and delivered over the last 24 months.

In terms of operational excellence, we continue to see progress. Our gross inventory is now about $110 million. As a reminder, in 2012, the same number was over $250 million. Additionally, our DSO has improved over that same time period.

As you all remember, we announced in November a new set of initiatives to take out an additional $200 million of gross spend. This is on top of nearly $300 million of expense we've already taken out over the last 5 years. Stan will give you the specifics, but we've made good progress here. This new initiative to become more efficient is a result of many things, but in large part, this is enabled by our enterprise business platform and our new channels.

Finally, again Stan will elaborate more, we've made very good progress stabilizing our shipping API platform and our service levels are now at industry norms. This gives us the opportunity to fuel our growth and facilitate our capture of new clients.

Turning to our third strategic initiative or grow Digital Commerce. Our Digital Commerce segment grew significantly in the year, driven by our Ecommerce business and the stabilization of our Software business. Our Software business grew slightly in the year. The new channels continued to progress well in the quarter. In 2017, most of the progress with our new channels will be characterized as channel shift. In 2018, we are working with new partners to take us to new markets and to new clients. While we made good progress with our Software business, we are still not where we need to be.

Our Global Ecommerce business grew nicely in 2017. We continued to invest in this business and added new clients. Our newest acquisition, Newgistics, performed very well, and in many ways, better than we expected in the quarter. More importantly, reaction from our clients and prospects continues to be very strong.

Again, the story of 2017 was around growth. For the year, revenue grew 4% including Newgistics. Even without Newgistics, we still grew slightly for the year. From a [going] rate perspective, we grew 2% on a pro forma basis in the fourth quarter, which gives you a feel for the momentum of the portfolio. Clearly, we have more work to do. It's been a tough road to get to this point, but most companies working to transform don't make it this far. Now we need to move to more profitable revenue growth.

With that, let me turn it over to Stan.

Stanley J. Sutula - *Pitney Bowes Inc. - CFO and EVP*

Thank you, Marc, and good morning. As Marc discussed, we made progress against our strategic objectives over the course of 2017, which included investments for our longer-term growth. In 2017, we improved our revenue performance as we continue to reposition the portfolio to growth markets. However, we realized we have more work to do.

Let me start with our full year results and then I will drill down into the details of the fourth quarter and update you on our outlook for 2018.

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 free cash flow.

Reconciliations of all non-GAAP to GAAP measures can be found in the financial statements posted within our earnings press release and on our Investor Relations website.

For the full year, based on the guidance ranges we provided during our third quarter earnings call, revenue and adjusted EPS performed within their respective ranges and free cash flow came in just above the top end of the range. Revenue was $3.5 billion, which represents growth of 4% over prior year. This included 1 quarter of incremental revenue related to the Newgistics business. On a pro forma basis, total revenue would have been slightly up over prior year.

Looking at revenue by group. Digital Commerce grew 32%, Enterprise grew 3% and SMB declined 5%.

Adjusted EPS was $1.41 and GAAP EPS was $1.39. GAAP EPS included charges of $0.21 for restructuring and asset impairments; $0.03 in transaction costs, largely related to the Newgistics acquisition; a charge of $0.01 for the early redemption of our May 2018 note; and a $0.03 gain from the sale of technology for a mining industry application to a channel partner.

GAAP EPS also included an estimated onetime noncash net benefit of about $39 million or $0.21 per share, recorded on the provision for income tax line, related to the enactment of the Tax Cuts and Jobs Act of 2017. This net benefit is comprised of a $130 million benefit related to the remeasurement of the net U.S. deferred tax liabilities arising from a lower U.S. corporate tax rate, offset by an estimated onetime tax charge of $91 million related primarily to a U.S. tax on the unremitted earnings of the company's foreign subsidiaries.

Free cash flow was $384 million and GAAP cash from operations was $496 million.

Looking at our capital allocation strategy and uses of cash for the year. For the year, we used free cash flow to pay $139 million in dividends to our common shareholders as well as paying $41 million in restructuring payments. Our capital expenditures totaled $171 million.

From a debt perspective, we issued $1.45 billion in new debt, redeemed $965 million of existing debt through the year. Total debt increased over prior year, which is attributable to the funding of our Newgistics acquisition for $475 million. At year-end, we had $1 billion in cash on our balance sheet. Of this amount, approximately 60% is overseas. I will come back to this when I provide an update on our 2018 outlook.

Let me now take you through the details of the quarter. In the fourth quarter, we delivered $1.05 billion in revenue, adjusted EPS of $0.40 and free cash flow of $145 million. Revenue grew 17% over prior year and included the incremental contribution from Newgistics. On a pro forma basis, revenue would have grown 2% this quarter.

We continued to experience a shift in our portfolio toward growth markets, which is evidenced in the overall growth this quarter with 3 out of the 6 segments growing year-over-year.

Excluding the impact of Newgistics, revenue benefited from strong double-digit growth in our Global Ecommerce segment as well as strong growth in our Production Mail and Presort Services segments. Software and SMB revenues both declined in the single-digit range.

For the quarter, adjusted EPS was $0.40, which was a decline of $0.13 from prior year. GAAP EPS was $0.48 and included restructuring charges of $0.10, transaction costs of $0.01, and a charge of $0.01 for the early redemption of our May 2018 note. GAAP EPS also included a net benefit of $0.21 related to tax legislation.

Free cash flow was $145 million this quarter, which was a reduction of $19 million from prior year, mostly due to lower net income. On a GAAP basis, we generated $165 million in cash from operations. During the quarter, we used free cash flow to pay $35 million in dividends to shareholders and $11 million for restructuring payments.

Looking at the P&L, starting with revenue performance by line item as compared to prior year. Business services grew 80%, driven by the incremental contribution from Newgistics. Excluding Newgistics, business services grew double-digit, driven by the continued growth in Global Ecommerce as well as strong growth in Presort Services. Equipment sales grew 3%, driven by growth in Production Mail. Software revenue declined 5%. We also had declines in supplies of 2%, support services of 6%, rentals of 9% and financing of 11%, all largely due to the performance of our SMB group.

Gross profit was $497 million with a margin of 47.3%. Excluding Newgistics, gross margin was about 52.6%, a decline of 380 basis points from prior year, which is largely reflective of the shifting mix of our portfolio and the decline in SMB.

SG&A was $326 million or 31.1% of revenue. Compared to prior year, SG&A was $44 million higher due to the costs related to Newgistics, which were not in prior year, as well as investments in e-commerce. This year also included partial funding of our performance-based incentive plan, which was not paid out last year. SG&A was partly offset by lower expense in the SMB business.

R&D expense was $33 million or 3.1% of revenue. Compared to prior year, R&D expense increased $1 million and improved by 50 basis points as a percent of revenue.

EBIT was $138 million and EBIT margin was 13.1%. Compared to prior year, EBIT declined $49 million and EBIT margin declined 800 basis points. The decline was driven primarily by the decrease in the company's gross profit, the Newgistics acquisition, investments for growth and the partial funding of our performance-based incentive plan.

Interest expense, including financing interest expense, was $44 million, which is $3 million higher than prior year.

The provision for taxes on adjusted earnings was $19 million and our tax rate was 19.8%, which is lower than prior year by 12 points. During the quarter, we recognized benefits associated with the resolution of certain tax examinations.

Diluted weighted shares outstanding at the end of the quarter were 188 million, which is about 2 million shares higher than prior year.

Now let me discuss the performance of each of our business segments this quarter. In the SMB Solutions group, revenue was $441 million, a decline of 7% from the prior year. EBIT was $140 million and EBIT margin was 31.8%.

In North America Mailing, revenue is $340 million, which was a decline of 7% versus prior year.

Equipment sales grew this quarter, driven by good performance with our new SendPro C-Series. As we discussed last quarter, there has been some lumpiness in our equipment sales numbers throughout the quarters. On a full year basis, North America Mailing's equipment sales grew slightly, which is an improvement from where they had been in prior years, which points to the future stabilization and is a positive indicator for future revenue streams. The decline in recurring revenue streams, mostly around financing, rental and services, contributed to the lower revenue performance this quarter. As Marc pointed out, in the fourth quarter, we have seen clients move to the new equipment faster than expected, services and attach rates are very strong and we have seen payment-to-payment increases.

EBIT was $128 million and EBIT margin was 37.7%, which is a decline of 180 basis points from prior year due to the decline in recurring streams, however, an improvement from the last 2 quarters.

In International Mailing, revenue was $102 million, which was a decline of 7% from prior year. Equipment sales declined, largely driven by weakness in the U.K. and Nordics, and was partially offset by growth in Australia and Japan. Recurring revenue streams also contributed to the overall decline.

EBIT was $12 million and EBIT margin was 12%, which was a slight improvement of 30 basis points over prior year.

In the Enterprise Business Solutions Group, revenue was $256 million, which was growth of 8% over prior year. EBIT was $47 million, which was growth of $2 million from prior year, and EBIT margin was 18.4%, which was a decline of 70 basis points from prior year.

In Production Mail, revenue was $128 million, which was growth of 8% over prior year. Equipment sales grew double digits this quarter on strong printer and sortation equipment placements.

Support services and supplies revenue were also up from prior year.

EBIT was $19 million and EBIT margin was 14.8%, which was a decline of 140 basis points over prior year, mostly due to the mix of products within equipment sales where we sold a higher percent of printers and sorters, which are lower margin than our inserters.

In Presort Services, revenue was $128 million, which was growth of 8% over prior year and driven by improved revenue per piece, along with higher First Class, flats and parcel volumes processed. Revenue was partially offset by lower Standard Class mail volumes processed.

EBIT was $28 million and EBIT margin was 22%, which was relatively flat to prior year.

In the Digital Commerce Solutions Group, revenue was $352 million, which was growth of 84% over prior year and included the incremental revenue from Newgistics. Excluding the incremental revenue contribution from Newgistics, revenue grew double digit over prior year.

EBIT for the group was $10 million and EBIT margin was 3%, a decline from prior year of about $7 million or 650 basis points, respectively. This quarter's EBIT included $4 million in incremental amortization of intangibles related to Newgistics along with the continued investments in e-commerce.

In Software Solutions, revenue was $88 million, which was a decline of 5% from prior year. Revenue declined due to lower license and services revenues. The decline in license revenues primarily in Location Intelligence and Customer Information Management, but partially offset by growth in Customer Engagement Solutions. The indirect channel continued to show growth this quarter. Data and SaaS revenues also grew this quarter.

EBIT was $10 million and EBIT margin was 11.8%, which was a decline of $2 million and 170 basis points, respectively, driven by the lower revenue.

In Global Ecommerce, revenue was $263 million, which was growth of 168% over prior year and included incremental revenue from Newgistics. Newgistics volumes processed in the quarter exceeded original expectations and revenue delivered strong growth over prior year results. Clients are recognizing the value proposition we bring to the table, which presents a great opportunity for us going forward. Excluding Newgistics, Global Ecommerce revenue grew at similar levels as previous quarters. This sustained double-digit revenue growth was driven by strong performance in both cross-border retail and marketplace volumes, along with domestic shipping. The domestic shipping increase is driven by Complete Delivery, which is our end-to-end carrier service enabled by our shipping APIs.

Through the quarter, our shipping API platform maintained stability and was at industry norms. We also moved new clients onto our platform, including V-Technologies, a leading provider of integrated shipping software solutions with over 500 e-commerce merchants. As we mentioned last quarter, due to the sensitivity around the holiday season, many merchants held off moving their volume to our shipping API platform as to not cause any disruption to their clients. That being said, we still saw a 60% increase in shipping label volumes in the fourth quarter over third quarter volumes.

EBIT was break-even for the quarter and largely driven by investments in market growth opportunities as well as the incremental amortization of acquisition-related intangible assets for Newgistics, which will be just over $4 million a quarter going forward.

Before we update you on our 2018 guidance, I want to inform you of a new group we formed in January called Pitney Bowes Commerce Services, which is the combination of our Presort and Global Ecommerce segments. Lila Snyder has been appointed President of this new group. In 2017, these businesses processed more than 16 billion mail pieces and enabled nearly 0.5 billion parcels in the U.S. and around the world. We reorganized these businesses in a way that best positions us to capitalize on the synergies and growth opportunities we have identified. We will report the financials for this new group starting with our first quarter 2018 earnings and will provide a further update at our Analyst Day in March.

Now let me update you on our 2018 annual guidance. Overall, the company expects annual revenue, excluding the impacts of currency, to grow in the range of 9% to 13% when compared to 2017. We expect adjusted earnings per share to be in the range of $1.40 to $1.55 and free cash flow to be in the range of $350 million to $400 million.

Let me double-click on each of these areas as there are several drivers and factors to take into consideration. First on revenue. Our revenue growth guidance of 9% to 13% includes a full year impact of Newgistics. As we have discussed previously, our portfolio is shifting to growth as a result of our work around shipping becoming a larger contribution to overall revenue. Excluding the incremental revenue for Newgistics, we would still expect overall revenue to grow in 2018, driven by the continued double-digit revenue growth in Global Ecommerce, largely through growth in our domestic shipping APIs and carrier services offerings as well as continued cross-border expansion. We also expect Presort to continue to perform around market ranges. We expect our Software business to continue to improve its performance, driven by the indirect channel. Within our Production Mail business, we expect revenue to continue to perform roughly in line with the market ranges. We expect SMB to continue to decline, but we are beginning to see the early signs of stabilization in equipment sales, which were down less than 1% on a global basis in 2017. The new SendPro products are expected to continue to drive equipment sales performance in North America Mailing, and while we expect the recurring revenue streams to moderate, it will take time for the streams to fully stabilize.

Let me take you through how we are looking at our adjusted EPS for 2018. There are several headwinds and tailwinds that need to be taken into consideration, the first being the shift in mix of our portfolio that I just described as I went through each of the segment's revenue expectations. The portfolio mix is shifting to the higher revenue growth areas, but lower-margin businesses, and therefore, while we expect 2018 revenue to grow, we also expect contraction to our overall gross profit margins driven by the changing mix of the portfolio.

Last quarter, we announced a $200 million gross spend reduction program that will take place over the next 2 years. Our business model is changing and we must change how we operate as a company. Of the $200 million spend reduction, we expect to recognize approximately 60% of the savings over the course of 2018, and of that amount, about 60% will be people-related and the rest will come from a reduction in programs, third-party spend and all other areas.

We have called this a gross spending reduction program because some of these savings will be reinvested in the business. In 2018, we plan on continuing to invest in growth opportunities for competitive advantage and market leadership, along with reinstating our variable compensation, which remains pay-for-performance. Therefore, excluding the expense associated with Newgistics, we'd expect about 50% of the 2018 gross savings to impact our bottom line.

It is important to note that we also have 3 quarters of incremental spend, along with the incremental amortization of intangibles in 2018 related to Newgistics, which was not in our 2017 results.

In regard to Newgistics, we expect to recognize revenue synergies through cross-sell opportunities in our Global Ecommerce and Presort businesses as well as cost synergies once fully integrated. That being said, we expect Newgistics to be accretive in 2018. Also, we will benefit from tax legislation. We expect our 2018 tax rate on adjusted earnings to be in a range of 23% to 27%. This is lower than our historical average tax rate, but relatively flat to our 2017 full year adjusted rate due to the resolution of certain tax examinations during 2017. We plan to use some of the savings enabled by the lower tax rate to raise wages for the majority of our U.S. hourly employees and to provide additional financing offerings to our SMB client base.

Looking at free cash flow, as we've communicated, we expect it to be earnings-driven as we have done significant work around inventory and working capital requirements over the last few years. We therefore expect free cash flow to be in the range of $350 million to $400 million in 2018, which is similar to 2017. At this time, we have not factored in any significant increase to our financed receivables resulting from the additional financing offerings to our SMB clients.

In regard to tax legislation and repatriation. As I mentioned earlier, we have $1 billion in cash on our balance sheet. Of this amount, approximately 60% is overseas. As part of tax reform, we intend to repatriate overseas cash. We will keep adequate balances for our businesses that operate in other countries, but would expect to bring about $0.5 billion back to the U.S. We have earmarked that cash to be used to pay down future debt maturities in order to delever our balance sheet. While interest expense will benefit from this paydown, we still expect higher interest expense over prior year, primarily as a result of the additional debt used to fund the Newgistics acquisition and the timing of issuances in 2017.

Let me also address the timing of some of these items in 2018. We expect the cost savings, tax benefits and Newgistics revenue and cost synergies, along with the seasonality of our growth businesses, to ramp up throughout the year. We also expect interest expense to be higher earlier in the year due to the timing of our expected debt paydown. As such, we would expect our first quarter attainment of our full year EPS to be at the low end of our historical attainment over the last 5 years.

We recognize there is more work to do. We are confident in our ability to continue to transform the portfolio, simplify our operating model and deliver on our commitments. We look forward to talking to you more at our Analyst Day on March 6.

With that, operator, please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Kartik Mehta, Northcoast Research.

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

Stan, I know you talked about the North American Mailing business and the drivers to what's happening with EBIT, and I'm wondering if you could just walk through maybe timing of when you anticipate that to stabilize and possibly reverse.

Stanley J. Sutula - *Pitney Bowes Inc. - CFO and EVP*

Sure. Thanks, Kartik. So talk about North America Mailing, if we start with the gross margin in 4Q, it was 72.4%. That was a decline of just over 200 basis points from our prior year and most of that was driven by lower stream revenue. But I think it's important to note that there's been some stability in that margin, and that margin's relatively flat to 2Q and 3Q. In terms of when do we expect that to start to turn, we've been fairly consistent here that, with the new product, we're going to need an elongated period of equipment sales to rebuild those finance receivables. Now we started on that journey, so we had growth in the fourth quarter, we had growth for the full year on equipment sales in North America, but it will take a longer period. This lease stream, if you will, the average life is over 4 years. So it will take a period of time to see that moderate through time. Now started with equipment sales and we need to keep that going, then obviously we're going to continue to work the other gross profit margin efficiencies in North America Mailing.

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

And then, Marc, I realize you guys are thinking about bringing about $500 million of cash back and paying down debt. But this year, you will generate close to $375 million in free cash flow. What is the use of that cash at this point? Will you continue to pay down debt or build the cash on the balance sheet until the strategic review is completed?

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

Yes. Listen, in terms of our capital allocation priorities, they haven't changed. Right now, we've committed ourselves to investment-grade ratios, that continues to be true, so the money from overseas will be a step forward, although more work to do. We've continued to be committed to a competitive dividend. That continues to be true. And then, broadly, Kartik, I would say, to your point, I mean, we look at creating strategic flexibility for any cash. But as we've said all along, our view is that we wouldn't -- that we would not let cash accrue on the balance sheet for an extended period of time. We'll put it to use.

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

And then just one last question, Marc, just the progress on your shipping APIs. I know in the fourth quarter, it was difficult just because of what retailers might have wanted to do. But as we've started the first quarter, maybe progress. I don't know if you can give some metrics that would help to show the progress you're making in that part of the business.

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

Yes, so I would say our stability in the fourth quarter was good. If you look at our stability from Black Friday to the end of the year, it was at industry norms, so that's basically 4 9. So think of that as one important metric. As you look at the pipeline, to your point, that was deferred in the fourth quarter. Pipeline is good and now we're kind of working our way through that pipeline.

Stanley J. Sutula - *Pitney Bowes Inc. - CFO and EVP*

And I'd add that the volumes in fourth quarter were actually up 60% over third quarter.

Operator

Our next question comes from the line of Allen Klee, Sidoti.

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

For Newgistics, can you talk a little about where you stand on going -- what the plans are in '18 for the integration and the potential benefits?

Stanley J. Sutula - *Pitney Bowes Inc. - CFO and EVP*

Sure, Allen. So first is, we're very pleased with the start of Newgistics. They had a terrific fourth quarter, exceeded our expectations. And actually, while we said we were going to leave them isolated, we saw some early signs of the potential synergies and I'll give you an example of that. As their peak went through in fourth quarter, we actually used some borrowed labor from our Presort businesses to help supplement that peak. I think it's a really good example of where we can trade off labor between the 2 organizations. So now, as we head into 2018, the teams are already well integrated, working through determining the right place to handle all the parcels because, as you recall, we were driving some parcel volume in our Presort business, so we're going to move that and centralize that through Newgistics. We're already going through the leases on both organizations, looking at the transportation routes. We put teams in place to deal with all of that. We're delighted to have them onboard. They had a terrific start. I think it's going to be a great addition to the Pitney Bowes family. And as we look forward, those synergies, we're also seeing it on the revenue side. The cross-sell opportunity with clients now to offer them end-to-end, everything from helping them do the demand gen on a cross-border side, to fulfillment, to shipping and now to returns and the ability to finance all that, we remain really excited about the potential and the synergies here that we'll achieve in '18.

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

Okay. And then just, finally, 2 things on Digital Commerce Solutions. One, software was down sequentially, and maybe just talk about what's going on there and the outlook. And then I heard you guys say that part of your transition is now to move to profitable growth, and I was wondering if that applies to Global Ecommerce for '18 or how you think about that.

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

I'll do them in reverse order. So the answer to your second question is yes. We expect Global Ecommerce to be at profitable revenue growth for 2018, albeit I would say moderate profit as we continue to invest in that business. Investments, we'll continue to invest, although lower than the 2017 levels. As it relates to software, as we said in the third quarter, there was a single large software deal in the third quarter that certainly affected the overall results. I would say, conversely, we really had no large deals of any significance in the fourth quarter so the quarter-to-quarter difference was principally around that. We've got more work to do here. I'm not -- I mean, the business grew last year so that's an improvement from where we were. The channel -- the indirect channel continues to mature. I would say most of last year they spent kind of selling on our installed base together. As we move into 2018 and they gain confidence in our products and, candidly, become more adept at the sales motion that's required to sell our products, that should expand. So as we contemplate software going forward, we continue to believe it's part of our growth as we move forward.

Operator

(Operator Instructions) We have a question from the line of Glenn Mattson, Ladenburg Thalmann.

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

On SMB, can you guys talk about just the process of stabilization as we move through the year? And then what the outlook is long term as far as long-term growth rates as you guys see it currently?

Stanley J. Sutula - *Pitney Bowes Inc. - CFO and EVP*

Sure, Glenn. If you take a look at SMB, I mean, we talked about this a little bit earlier with the question earlier on stabilization, it starts with equipment sales, but we don't see the market changing here. I'd ask you to join us on March 6 for Analyst Day and Jason Dies will take you more at a -- broader on the SMB strategy, but we still expect that market to be in decline of 2% to 4%. And while we're looking at that market, we're realistic on that expectation. And so what we're trying to do is bring efficiency and productivity into the SMB business. We're going to expand some of our offerings to try to bring in new revenue and profit streams. And I think the innovation that we brought here in 2017 is a good example with the SendPro C-Series. With that, it's not just the traditional mail meter. You open up an opportunity for a new revenue stream with multi-carrier shipping, with the printers that attach to it, the scales that attach to it as well as the supplies that go with printing labels. We also, because it's on an open platform, open up the opportunity to bring new apps to our clients, new capabilities, new financing. So we're looking to expand the offerings to that clientele. And that clientele we know really well. We know their credit history, we know what they do, and I think the opportunity to bring more value into that remains an opportunity for us to improve the overall performance. But in terms of looking at 2018, we do not expect SMB to return to growth. We expect the market to continue to be down 2% to 4%. What we are looking to do is to inject some new offerings into the platform, bring more efficiency into it, and I think you've seen the margin here over the last 3 quarters has been relatively flat.

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

Let me go up a level, if I might. So if you think about it in very simplistic terms, the streams are a function of what's happened the last 4 years. So if you lose a meter, 3 years ago, that continues to roll through the [I&E]. So you need several years of equipment sales at flat in order to counterbalance what's happened over the last several years. We kind of glanced through it fairly quickly. If you think about the equipment sales being flat in a market that's down 3% or 4% when we've got a significant chunk of the market, that's a fairly substantial accomplishment. So Stan said it right, as we contemplate the mail meter itself, we don't see that market changing. The option of this new product is that the new applications give clients a new reason, shipping being the first, but certainly not the last, to hold on to that asset and to stabilize that stream. So that's kind of the way that the dynamic works out. So we need a couple more years of equipment sales kind of at flat or so and the streams will follow, and then we're watching closely how the third-party apps perform and our own apps with shipping as well. That creates the ultimate counterbalance.

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

That's helpful, Marc. Would you expect that, in order to get back to those industry decline rates of 2% to 4%, that would take, as you've mentioned, a couple of years of better performance like you've had? Or would you get back to market rates faster than that?

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

I think we'll get back to market rates faster than that.

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

Okay. And then I imagine you're not going to speak broadly on strategic alternatives today, but can you make a significant case for why this should still all be one company? I mean, I think originally it was hopefully to rebuild the sales channel and then hopefully sell -- cross-sell a lot of products into the SMB base. I don't know if that has played out well or if that's still part of the long-term strategic plan, or if these are really 2 separate entities that could be better suited to be independent.

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

We'll go deep on this at Analyst Day, but I'll give you the high-level answer now. So if you think about what I just said as it relates to the SMB business and shipping being the principal application, that gives us the opportunity to first stabilize then ultimately sell more into that installed base. On the other side of the ledger, if you think about our commerce services segment, that, too, is all around shipping. When you look at the technologies that underpin that, the API technologies, the global carrier services, the Pitney Bowes Commerce Cloud, those technologies are all shared. Interestingly enough, the assets from many of those technologies come from our Software business. So we will go deeper on that, but that is, in short, the case is that we are very focused on leveraging economies of scale and economies of experience across our portfolio to ensure that the breadth of the portfolio remains coherent, but shipping is kind of the theme across the business.

Operator

We have a follow-up question from the line of Allen Klee, Sidoti.

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

I appreciate the challenges of managing a business through a transition and all the actions you've taken. Given this, can you point to any actions that you think can -- that have improved your ability on forecasting this year versus last?

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

Yes, I would say the move to new systems was disruptive in many different ways, but it's certainly created a degree of cloudiness in terms of our ability to look at the future, and particularly around streams. So as we exited 2016, in particular, I mean, we were -- the systems were still new, point one. Two, we were still learning the systems, point two. And I think the combination of those things created less visibility into the business than we had hoped. So I would say the first point is that as the system stabilizes, we understand how to use the systems better, that helps. Secondly, there is -- once you have the kind of information base that we're creating, and I'll speak to our pipeline in particular, that helps. So we've got a global CRM system that allows us to look at pipeline. We're now putting metrics around those pipelines that allows us to evaluate the pipeline. Early days, for sure. I mean, as I look at other companies, and I think they're perhaps a little bit ahead of us, but we're making up ground quickly. What won't change, Allen, is that as you think about how we think about the trade-offs in the business, we will always trade short-term performance for long-term value, so that's not going to change. So there's degrees of visibility that I think will get and I think are getting better, for sure, but our preference and our bias towards long-term value remains the same.

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

I had one other follow-up. Can you just remind me what you said about how to think about first quarter '18? And also should we be thinking about any changes in sales and marketing spend that could have a material impact in any of the quarters in '18 like we saw in some of the quarters in '17?

Stanley J. Sutula - *Pitney Bowes Inc. - CFO and EVP*

So why don't I start with the 1Q skew. So as we said in the prepared remarks, Allen, that there are number of things as we head in. One, the actions on the $200 million will have a skew. As we bring back cash to pay down debt, that has a timing effect, so we'll have higher interest expense in the beginning of the year. And as you look at some of those items and we look at the overall performance, we expect that the first quarter, when you take it as a percent of the full year, will be at the lower end of the 5-year history, and I think that will give you a feel for how to position that within the year. In terms of -- you asked about marketing expense and go forward, we continue to look at sales and marketing holistically across. I don't see an increase to that related to that effort. As a matter of fact, we should get synergies out of driving, looking at that across units. And for example, as we look at our new segment now with Presort and Global Ecommerce and Newgistics all combined, that allows us to go to market in a more consistent dynamic and that should help us significantly in that approach. So don't expect a material change.

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

So if you're asking about some of the brand expense that we have incurred over the last couple of years around advertising, right now, as we sit, we don't plan any material advertising initiatives from a TV perspective in 2018. We'll continue to invest in our brand, but it'd be much more in digital and social than a big buy or something that would cause lumpiness.

Stanley J. Sutula - *Pitney Bowes Inc. - CFO and EVP*

And that would be a benefit to us.

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

Yes. On the other side of it as it relates to the sales channels, we continue to move to a broader array of channels, digital channels, tele-channels, indirect channels, and we'll continue to move that. And we think that not only gets us to new markets, but is also more efficient.

Operator

And at this time, there are no other questions in queue. Mr. Lautenbach, do you have any additional remarks?

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

I do, and thank you, again, everyone, for joining us this morning. Listen, as I said at the outset, the headline is simple, and that is we have moved this company to growth and you don't need to look far to understand how unusual that is in today's world. The portfolio is substantially moved and we think that is the first step, but certainly not the last step as we move forward. As we continue to move forward in those businesses, we'll for sure make investments, but as they scale, they will create profit. And to the question that was asked about the synergies across the portfolio, we believe that gives us important leverage, that as we add revenue, it will be profitable revenue growth. So more to say in March when we we're together at Analyst Day, but that's where we are for today. Thank you for joining us.

Operator

Ladies and gentlemen, that concludes our conference for today. Thank you for your participation and for using AT&T Executive TeleConference Service. You may now disconnect.
