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PBI - Q1 2014 Pitney Bowes Inc. Earnings Conference Call

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OVERVIEW:

Co. announced 1Q14 revenue of $937m, resulting in GAAP diluted EPS from continuing operations of $0.21. Guidance was given for 2014 revenue (excluding impacts of currency) of 1% decline to 2% growth vs. 2013, and GAAP diluted EPS from continuing operations of $1.53-1.68.

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PRESENTATION

Operator

Good morning and welcome to the Pitney Bowes first quarter 2014 results conference call.

(Operator Instructions)

Today's call is also being recorded. If you have any objections please disconnect your lines at this time. I would now like to introduce your speakers for today's conference call, Mr. Marc Lautenbach, President and Chief Executive Officer; Mr. Michael Monahan, Executive Vice President and Chief Financial Officer; and Mr. Charles McBride, Vice President, Investor Relations. Mr. McBride will now begin the call with the Safe Harbor overview.

Charles McBride - *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 2013 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*

Thank you, Charlie and good morning, everyone. Thank you for joining our first quarter 2014 earnings conference call.

By now, hopefully you have had the chance to review our first quarter financial earnings press release which we distributed this morning. Mike and I will provide additional information on our first quarter results and answer any questions that you may have at the end of our prepared remarks.

We have a lot to cover this morning so let's begin. For those of you who regularly participate on our quarterly conference calls, you know that I tend to focus primarily on providing an update on the progress we are making to transform Pitney Bowes against the three strategic initiatives.

Stabilizing our mail business, driving operational excellence, and growing our overall business especially through our participation and investment in digital commerce. While I will continue to offer my perspective against these strategic initiatives, given our performance in the first quarter I thought I would first provide some additional context and color around our results and why we are even more confident about our strategy going forward.

To my way of thinking our first quarter performance was remarkable in four ways. First, we delivered a very strong quarter the old-fashioned way. By growing revenue, and expanding margins.

Secondly, typically during the quarter you will see some businesses meet expectations or over perform while other businesses will under perform. In our first quarter every one of our businesses performed. And we accomplished this in what is generally thought to be a challenging quarter.

Third, as a result of our actions over the last 12 months we are ahead of schedule in our multi-year plan to transform the company and unlock the inherent value within Pitney Bowes. And finally, our results are consistent with the long-term economic model we laid out 12 months ago.

Our first quarter, and for that matter the last two quarters, is further evidence of the viability of our long-term strategy. Clearly the decisions we have made and the actions we have taken over the past 15 months are paying off.

In terms of our first quarter financial results, revenue grew year-over-year and adjusted EBIT, EBIT margin and adjusted EBITDA also grew year-over-year. Free cash flow also improved on a year-to-year basis.

All of these key metrics are important indicators of our performance in the quarter and going forward. And while we have much more to do, we remain focused on driving efficiencies throughout our company and maximizing growth opportunities within our existing businesses.

Mike will provide additional color on the quarter, but once again I am very pleased with our ability to execute against our strategic initiatives and our first quarter financial results. As I said at the outset, our first quarter performance was a significant both in terms of the progress we've made against the three strategic initiatives and our overall financial performance.

Beginning with the stabilization of our mailing business once again, we saw continued improvement. Last quarter we told you that the aggregate of our physical mail businesses, small and medium business, presort, and production mail businesses declined less than 1% in constant currency.

This quarter in aggregate, these businesses declined again less than 1% both on a constant currency basis and as reported basis. In the first quarter the rate of decline in SMB solutions group continued to moderate, declining just 1% in constant currency.

Our new go to market strategy which we started start rolling out last year had a positive impact during the quarter both in terms of revenue and EBIT margin. And once again US equipment sales, which are an important indicator of our performance in our mailing business, increased in the first quarter.

Turning to our second strategic initiative, driving operational excellence, we also saw improvement despite investing in our infrastructure such as an initial investment in an ERP system and several investments in our growth initiatives including digital commerce. Despite this, SG&A as a percent of revenue declined 120 basis points in the first quarter while EBIT and EBIT margins improved in each one of our three segment groups.

As a reminder, back in May, we committed to a savings run rate of $100 million to $125 million as we exit 2014. We are continuing to pursue additional efficiencies throughout the remainder of the year, but as I mentioned earlier, we are ahead of schedule.

Additionally, we continue to strengthen the balance sheet and make our debt structure more manageable. We issued $500 million of debt and used the proceeds to reduce debt scheduled to mature in future years. Most recently in April we redeemed $100 million in bank term loans scheduled to mature in 2016.

Now let me address the third chapter of our strategic initiative. Growing our overall business. Especially through our participation and investments in digital commerce.

In the first quarter, our digital commerce solutions business grew revenue 23% and today represents almost 20% of Pitney Bowes' total revenue. As a reminder, digital commerce grew 16% in the fourth quarter and 8% in the third quarter. So you can see we are starting to put some points on the board.

Revenue growth in digital commerce continued to benefit from continued strong growth in our e-commerce solutions business as well as growth in software license and marketing services. Importantly, revenue in our e-commerce solutions improved quarter-over-quarter despite the fact that the fourth quarter is usually the busiest time for shipping.

Finally, in the first quarter, we renewed several existing partnerships with existing clients, as well as signed new partnership agreements including deals with IBM and INRIX. These partnerships are important in their own right but they also speak volumes when you have the most sophisticated technology companies in the world wanting to work with you.

Before I hand over to Mike, let me again remind everyone that while we feel very good about the progress we have made, we are still in the early stages of a multi-year journey on our way to transform Pitney Bowes. And that transformation will take time and are necessarily uneven.

As I told you during our fourth quarter conference call, our fourth quarter results provided further evidence that our strategy was working and that we were on the right track to transform Pitney Bowes. I also said that we were heading into the new year with good momentum and better positioned to capitalize on the incredible market opportunities. In light of our first quarter results all of that remains true.

Finally, as a standalone quarter, our results were very good. But I'm most pleased about what the quarter suggests for the viability of our strategy, and most importantly, our ability to execute against that strategy.

With that let me now turn it over to Mike, who will take you through the first quarter results. Mike?

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

Thank you, Marc and good morning. Our positive results this quarter reflect our balanced approach to implementing our long-term strategy and further demonstrate the company's commitment to create incremental value for its clients and shareholders.

We saw solid revenue growth in the quarter, flat SG&A expenses and improved EBIT margins despite our investment in growth initiatives and infrastructure. During the quarter we took additional steps toward our strategic goal of achieving operational excellence.

We continued to implement our go to market strategy in our global core mailing and software businesses. We began to invest in our new ERP system and we continue to implement additional cost savings initiatives throughout the organization through the expansion of global shared services. We also took steps to improve our capital structure.

During the quarter we issued $500 million in 10-year bonds with a very competitive coupon of 4.625% and used the proceeds to retire $500 million in debt. This will provide us with a more manageable debt structure in future years and flexibility with our balance sheet.

Additionally earlier this month we announced the sale of the DIS business in Canada. The sale of this business is consistent with our strategy to align our business portfolio to provide focus on our core businesses and areas with the greatest growth potential.

Using principally the net after-tax proceeds from the sale of the DIS business and related finance receivables, we reduced our bank term loans due in 2016 by $100 million. The DIS business has been reclassified as a discontinued operation in the current quarter and prior periods and we have posted reclassified financial statements for the quarters of 2012 and 2013 on our PB.com website under the Investor Relations section.

Also as we indicated previously we have shifted the reporting of our shipping solutions from our SMB mailing group to digital commerce solutions. We made this change to align how we manage the business. Our shipping solutions, which are increasingly software-based, are more closely aligned with our parcel management strategy that includes e-commerce.

As Marc noted we are very pleased with our first quarter results and have confirmed our outlook for the year. However, quarter-to-quarter comparisons for the prior year will vary.

You will recall that our production mail segment had a very strong performance in the second quarter of 2013 when its revenue increased 16%. We also recorded a $0.05 tax benefit in the second quarter last year as well.

Finally, at the beginning of the second quarter this year we implemented the final wave of our account shifts in our North American SMB go-to-market channel strategy. Our overall future performance should be led by many of the same factors driving our improving comparative results over the past year.

Now let me take you through our first quarter results. Turning to our financial performance for the first quarter, revenue totaled $937 million which was an increase of 3% over the prior year on both a reported and constant currency basis.

Revenue for the quarter grew 23% in the digital commerce solutions segment and grew 1% in the enterprise business solutions group. In the SMB solutions group revenue declined just 1% on a reported and constant currency basis.

EBIT and EBIT margin increased in the SMB and enterprise reporting groups as well as the digital commerce solutions segment. Results in the first quarter reflect a continuation of the year-over-year improving trends that the company delivered throughout 2013.

Adjusted earnings per diluted share from continuing operations for the quarter were $0.42 compared to $0.37 in the prior-year, a 15% increase. GAAP earnings per diluted share from continuing operations were $0.21 which included a charge of $0.19 per share related to debt extinguishment costs associated with the debt tender in the quarter.

Results also included restructuring charges of $0.03 per share associated with our previously announced cost reduction plans. GAAP earnings per diluted share for the first quarter were $0.22 which includes income of $0.01 per share from discontinued operations.

Free cash flow during the quarter was $138 million and on a GAAP basis we generated $106 million in cash from operations. In comparison to the prior-year, free cash flow benefited from growth in adjusted net income and the timing of tax payments. During the quarter our cash flow was used to return $38 million to our common shareholders in the form of dividends and we made $19 million in restructuring payments.

Turning to the income statement, once again, all income statement related references exclude the financial results for the DIS business and results are on an adjusted basis. Adjusted earnings before interest and taxes or adjusted EBIT was $170 million this quarter or 9% higher when compared to prior year as a result of the improving EBIT in the SMB and enterprise reporting groups as well as the digital commerce solutions segment as I noted earlier.

Adjusted EBIT margin was 18.1% which was 110 basis points higher than the prior year. Adding back depreciation and amortization, adjusted EBITDA for the quarter was $213 million or $1.05 per share.

SG&A for the quarter was $351 million, relatively flat versus the prior year. However as a percentage of revenue SG&A was 37.5% which was an improvement of 120 basis points over the prior year.

This was achieved despite approximately $5 million of investment related to the new ERP implementation included in SG&A this quarter. Excluding this investment SG&A would have been 36.9% of revenue or an improvement of 180 basis points.

During the quarter we recorded a pretax restructuring charge of approximately $10 million for actions associated with our previously announced plans to reduce costs. Net interest expense, which includes financing interest, was $44 million, which was a decline of more than $4 million when compared to the prior year.

Average outstanding borrowings during the quarter were $801 million lower than the prior year. The average interest rate this quarter was 5.44%, which was 55 basis points higher than the prior year.

We incurred $62 million of debt extinguishment costs related to the bond tender completed in the quarter. That was recorded as other expense on the income statement. The effective tax rate on adjusted earnings for the quarter was 27.8% as compared to 25.8% in the first quarter last year.

Looking at the balance sheet, we had $3.3 billion of debt on the balance sheet at the end of the quarter which was $691 million less than the first quarter of last year. As I mentioned earlier during the quarter we issued $500 million of 10-year debt. We use the proceeds of these bonds to retire $500 million of debt.

Additionally in April we reduced bank term loans scheduled to mature in 2016 by $100 million. By extending our debt maturities and reducing the amount of debt that is coming due in 2016 and 2017, we have enhanced our financial flexibility.

Now I'd like to discuss the first 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 PB.com website under the Investor Relations section.

North American mailing revenue for the quarter was $381 million and EBIT was $160 million. North American mailing revenue declined 2% versus the prior year on a reported basis and by just 1% on a constant currency basis.

Equipment sales revenue grew 2% in the US but that growth was offset by lower equipment sales revenue in Canada. This was the second consecutive quarter of positive revenue growth in US equipment sales which benefited from the new go-to-market strategy.

Overall recurring revenue streams declined at a lesser rate than prior year, continuing a trend of year-over-year improvement benefiting from improvement in all revenue lines and in part from positive growth in supplies revenue. EBIT margin was 42.1% which was an improvement of 390 basis points versus the prior year as a result of the new go-to-market model and ongoing cost reduction initiatives.

International mailing revenue for the quarter was $153 million and EBIT was $25 million. Year-over-year revenue was relatively flat and benefited from growth in supplies. However, revenue growth was partially offset by a decline in rentals revenue, particularly in France.

EBIT margin was 16.2% which was an improvement of 480 basis points versus the prior year. The improvement in EBIT margin was due to the mix of products sold as well as the new go-to-market strategy that began to be implemented in Europe during the quarter.

Turning to the enterprise business solutions group, production mail revenue for the quarter was $105 million, and EBIT was $8 million. Year-over-year revenue decreased by 4% due to fewer production print installations in the quarter.

Revenue benefited from increased sales of inserting and sortation equipment as well as ongoing growth in supplies as the pace of installed printers grew since the prior year. EBIT margin was 7.4%, which was an improvement of 20 basis points versus the prior year due to the greater mix of higher-margin inserting systems sold in the quarter and cost reduction initiatives.

Presort services revenue for the quarter was $116 million and EBIT was $24 million. Year-over-year revenue grew 5% versus prior year due to an increase in first-class mail volume processed as well as higher revenue related to improved qualification of presort mail for postal rate discounts.

EBIT increased on revenue growth. However, the EBIT margin of 20.5% was a decline of 70 basis points versus the prior year. The decline in margin this quarter was due in part to costs associated with the consolidation of facilities which is expected to result in future improved operating efficiencies.

Turning to the digital commerce solutions segment revenue was $181 million and EBIT was $10 million. Revenue grew 23% versus prior year driven primarily by the continued strong growth in our e-commerce solutions for cross-border package delivery. Revenue also benefited from growth in our software licenses and marketing services revenue.

EBIT margin was 5.3% which was an improvement versus the prior year. Which was nearly breakeven on a basis. The improvement in EBIT was a result of the operating leverage related to scaling of our e-commerce business as well as lower net investment quality.

EBIT margin however was again impacted by the continued investment in e-commerce technology infrastructure and investment in software channel specialization. That concludes my comments on our financial performance this quarter.

Now I'd like to update you on our 2014 guidance. Despite the sale of the DIS business which contributed $0.07 in earnings per share for the full year 2013, and $0.01 in earnings per share to discontinued operations in the first quarter of 2014 on a GAAP basis, we are reaffirming our full-year guidance for revenue growth, adjusted earnings per share and free cash flow.

2014 revenue, excluding the impacts of currency, is still expected to be in a range of a 1% decline to 2% growth when compared to 2013. Adjusted earnings per diluted share is still expected to be in the range of $1.75 to $1.90 and free cash flow in the range of $475 million to $575 million.

GAAP earnings per diluted share from continuing operations has been updated to reflect the first quarter debt extinguishment costs of $0.19 per share and restructuring costs of $0.03 per share. We now expect GAAP earnings per diluted share from continuing operations to be in the range of $1.53 to $1.68.

This guidance excludes any further actions that are under consideration by the company to streamline our operations and further reduce our cost structure. That concludes my remarks. Operator, you may now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ananda Baruah, Brean Capital.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Congratulations on a really solid quarter. Just a few things if I could. Just a clarification, so the reiteration of the guidance includes I think it's the $0.07 impact from the sale of DIS. Is that correct?

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

That's correct. So the guidance ranges despite the fact the DIS business will be out in 2014.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Got it, fantastic. Thanks. And I guess the second question is as regards to cost savings and OpEx.

Marc, you commented that you're ahead of schedule and I was just wondering if you could put some context around that since you guys also commented that you've been finding additional areas to drive cost savings. Are you had the schedule with regards to, I guess both ahead of schedule with regards to the pace of driving the savings or are you, and are you also ahead of schedule in dropping savings to the bottom line incremental to what you had originally intended to do?

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

The short answer is yes and yes. Let me elaborate. So if you look at where we were through the end of last year, we had taken a little over $70 million of expense out. If you compare that to the $100 million to $125 million that we committed to I think the exact quote that we said was we were kind of at or above where we had anticipated.

Just reaffirming that that continues to be true. Importantly as we find more opportunities, to continue to optimize the structure of the business which we'll elaborate on next week.

The other dimension, candidly we're ahead of my schedule, is the growth of our digital commerce business. Candidly, if I would have envisioned a year ago when we laid out those three chapters, that 12 months later the digital commerce, I guess less than 12 months later the digital commerce business is growing at the rate that it did in the first quarter, it certainly exceeded any expectations that I may have had. And then I think when you put all that together achieving 3% growth in what is a pretty choppy economy is -- I won't say far but certainly ahead of where I anticipated we would be.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Got it. Great. And that's really helpful context. And I guess just drilling down some of the segment margin both US and international, particularly US of have found new recent highs and when I look at them on a year-over-year basis, the improvement over the last couple of quarters has been about equivalent.

Now, if, if we continue to look further out, I guess, we'd need to start setting new highs. And if I just do that back of the envelope in the model, I'd start to move towards the higher end of the range I guess.

I know you guys aren't going to update guidance on this call, you have analyst day coming up and we're still early in the year. But I guess could you give us any context around what we might expect or what you guys are expecting from the segment margins, maybe some, maybe some of the dynamics that are going on specifically through the geos would be helpful for us to continue to develop our mosaic going into the analyst day.

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

What I would tell you is that the North American mailing business has benefited most in terms of the earliest implementation of the go-to-market strategy. And we just did essentially what's the final piece of that. The beginning of this quarter, beginning of April.

And so a lot of what you've seen as benefits in the margin have come through that go-to-market strategy. We're earlier in the process in the international markets. And actually in the software business I would say we're more in an investment mode where we have been expanding our sales coverage on a global basis.

So those are some of the factors in that. And what we'll talk to going forward is how other activities beyond just go-to-market including ERP will ultimately affect our ability to achieve operational excellence as we go forward.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Got it. That's really helpful, Mike. And just last one for me, free cash flow was very strong. And I think 25% of the total for the year of your guidance at the midpoint.

So could you speak to maybe some of the dynamics that are going on there that are a little bit stronger if there are any than would have been anticipated in the March quarter? And what are some of the forces that will be influencing the cash flow or how should we be thinking about the influences as we move through the year in the context of your guidance?

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

As far as cash flow is concerned it was a good solid quarter for cash flow. I would say we benefited from adjusted income growth. Obviously over the long-term that's going to be key driver for cash flow.

The other quite frankly is timing of some tax payments. So that's a driver that's embedded in there as well. I guess I would look at it and say that where we've ended the first quarter puts us in good shape relative to our annual guidance.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Okay. Thanks a lot, guys.

Operator

Kartik Mehta, Northcoast Research.

Kartik Mehta - *Northcoast Research - Analyst*

Marc, I wanted to ask you a little bit about the digital commerce business and trying to get a feel for when you say dollars invested maybe how much you're investing and what kind of driving that's putting on margins right now?

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

Kartik, I'll take that one. In terms of investment if you look at the margin profile of the digital commerce business, obviously it's composed of a number of different businesses. The software business would typically have a higher margin profile, typically in the teens to even 20%.

Obviously the overall margins in this segment right now is being impacted by the fact that we are building out both from an IT perspective the software capabilities as well as the physical infrastructure for e-commerce. And when you scale a business as we are today, obviously you want to invest ahead of that. And we're confident we'll reap the benefits of that as we go forward.

The other thing embedded in there is what I mentioned before which is the investment in our go-to-market strategy and our software business where we believe the third quarter in a row that we saw software revenue growth, so we're beginning to see the early benefits of some of that specialization. But we still have a ways to go in terms of building pipeline and getting productivity out of that channel investment.

Kartik Mehta - *Northcoast Research - Analyst*

Mike, since that business is doing, the digital commerce business is doing obviously better than you anticipated and better than we anticipated, could this be that there's going to be an investment needed for the next 12 to 18 months so it might take a little while before you really start reaping the benefits on a margin side for the business?

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

Yes, our goals around that business are to grow across the couple different vectors, not -- obviously we'd love to continue to expand our domestic US outbound with eBay. We've been bringing in additional third-party direct merchants that we're doing work with.

And we believe that this is a global business, so we'll make investments along those lines to gain scale and build the capabilities we need. We believe the market opportunity here is big enough and fast-growing that it's the right time to make investments in the cycle.

Kartik Mehta - *Northcoast Research - Analyst*

And then finally, Mike, you talked about paying down I believe $100 million worth of debt on your bank line. Any type of goals as to where you'd like to be from a debt perspective by the end of the year?

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

That was really related to the fact that part of what we sold within the document imaging solutions business in Canada was a portion of the lease space that was associated with that business. So the pay down of the debt was pretty much keeping that debt profile in line with the exit of that.

So we feel good about where we are from a maturity profile, from a credit ratio perspective. And we'll continue to monitor that mainly around how our lease asset base changes.

Kartik Mehta - *Northcoast Research - Analyst*

So I guess will the pay downs just reflect the lease asset base rather than paying down other debt?

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

We'll continue to look at it and evolve it, but quite frankly, the maturities we have right now are very manageable. Either with refinancing or with cash that we have on the balance sheet or will generate. So I think we have options around how we deal with that.

Kartik Mehta - *Northcoast Research - Analyst*

Thank you very much.

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

Thank you.

Operator

Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

My first question's just a clarification to make sure we've got it right. With regard to the sale of the Canadian DIS business and then your guidance, should we assume that your guidance you're reiterating it even though you're going to be down $22 million on sort of a normalized basis I guess or a reclassified basis? Given the sale, so the $0.01 of EPS that you did this quarter if we assume $0.04 for the year, you're effectively raising guidance or at least making this more comfortable at the high-end?

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

I would say that's certainly the way you could interpret it. Obviously losing the benefit of that business contributing to the EBIT but maintaining our guidance range.

Shannon Cross - *Cross Research - Analyst*

Got it. Just wanted to confirm, okay. And then can you talk a little bit about production mailing a bit weaker, I think that it can be lumpy.

How do we think about production mailing as we go through the year? Is it -- are there any product launches that could drive bigger deals or how do we think about this year with regard to that business?

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

Production mail had a very good year last year driven by as we talked about in the second quarter last year a couple of very big deals that included both printers as well as inserters. They were big white paper factory type deals.

This quarter and in the second quarter a lot of that revenue came through last year. So this quarter reflected some of the lower print revenue, printer revenue placements than we had last year. There was actually an increase in inserter and sortation placements on a year-over-year basis but the -- ultimately the difference in revenue was around printers.

Really, the second quarter compare is tough. The second half of the year I think will be a more normalized comparisons for the business.

Shannon Cross - *Cross Research - Analyst*

Okay. That's helpful. And then with the locational data deal that you did, obviously the IBM deal during this quarter, how do we think about revenue and profit contribution?

I assume these are one-time licensing deals? And obviously it's a good testament to be working with these companies. I'm just trying to get an idea of your -- I guess your idea of the potential addressable market for these services so is this something that you expect we will continue to see through the year or how do you sign the low hanging fruit and the big guys at this point?

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

So the way I think about relationship, Shannon, is as a channel partner, deal, so it's not a license deal per se. It's more of a channel agreement and a technology agreement.

The reason that that's important is if you think about one of the secret sauces in that business and that technology is the integration technologies. And I think what you see with IBM is they saw the same thing we did. Those integration technologies specifically, and in general, location intelligence is an important space as it relates to commerce. So that's the color that I would add around that.

In terms of your second question, or other question about other partnerships to come, I would just tell you that the IBM partnership was a very important one but we are in many other meaningful conversations. So I would not lead you to believe that that will be last but it's certainly a very important one.

Shannon Cross - *Cross Research - Analyst*

Great. And then my final question and I'm curious because it's getting a lot of talk recently in terms of digital payments, is there a place for Pitney Bowes within this business, you've got encryption technology, you've got a number of different technologies, is that something where we might look at you perhaps entering at some point or playing a role in? I'm just curious it's definitely the interest from an investor standpoint in just the general technology industry is growing in digital payments.

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

Listen, as I said last year, I like the hand we've got. I think we're in spaces that make a lot of sense for us. I would comment that our relationship with eBay affords us also a relationship with PayPal which we think is a very important asset in the mix. But we'll continue to evolve our portfolios as we see the markets evolve.

Shannon Cross - *Cross Research - Analyst*

Okay. Great. Look forward to seeing you at the analyst day.

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

Thanks.

Operator

George Tong, Piper Jaffray.

George Tong - *Piper Jaffray - Analyst*

First question is could you give us a sense of what your e-commerce revenues were for the quarter and provide some color on what your e-commerce growth expectations are based on what you're expecting from expansion from eBay as well as growth in capacity from your sortation facilities?

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

Yes, George, in terms of e-commerce we don't break it out separately but clearly it was a key driver of the growth on a year-over-year basis in total dollars within the digital commerce segment. It's been ramping nicely. We saw growth even on a sequential quarterly basis in addition to obviously significant growth on a year-over-year basis.

In terms of capacity, we have a combination of processes we run and partner processes. We have what we believe is a fair amount of capacity right now that would enable us to manage through the upcoming holiday season. And then the opportunity to expand capacity if need be.

So we feel good about where we're positioned in the business. We are now able to deliver into 55 countries around the world which is an expansion over the last couple of months as well. So we feel good about where we are in that business.

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

I would also add, George, if you look at eBay's announcement last night they talked about $58 billion of commerce that they enabled, now certainly not all that was global commerce but we think we're just scratching the surface of what we can do there. So as Mike said we're in 52 countries but we've got a lot of opportunity to enable more listings and drive that business much deeper.

George Tong - *Piper Jaffray - Analyst*

That's helpful. And do you think about capacity utilization at your sortation facilities? Where would you place that? From a percentage perspective?

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

In terms of that, I'd say we have a fair amount of capacity. We're probably under two thirds utilized but there is the ability to flex capacity within that. We partner for some of the capabilities within that, so that will not be a limiting factor for us.

George Tong - *Piper Jaffray - Analyst*

Got you. And could you give us some details on what actions you have in place to help manage some of the gross margin trends that you're seeing?

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

Well, I would say overall gross margins for the business on a business-by-business basis are relatively good, often those are influenced by the mix of the revenue that we see. So we saw for example equipment sales margins improved nicely in the quarter. That was in part due to the fact that we had less production mail printer placements than the prior year.

So we look at each business as part of the operational excellence initiatives that we have in place. We look at both SG&A as well as product related costs and look at optimizing that on a business-by-business basis.

George Tong - *Piper Jaffray - Analyst*

Great. And lastly I'm revisiting some of the comments you made on delevering. Where would you like to see your leverage ratios by the end of this year and by the end of 2015?

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

I think obviously where we are today with our credit ratios we're comfortable with. We think that we'll continue to monitor those relative to the performance in the business but we think as we continue to expand and grow the business that's going to give us improved ratios because of the growth in earnings on a debt level that we see as being consistent or shrinking over time depending upon what happens with our finance receivables portfolio.

George Tong - *Piper Jaffray - Analyst*

Great. Very helpful. Thank you.

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

Thank you.

Operator

Scott Wipperman, Goldman Sachs.

Scott Wipperman - *Goldman Sachs - Analyst*

Mike, can you remind us what the CapEx guidance is for the year? I know it was lower in the quarter but I think you are expecting it to be up for the year I believe. Then I have a few follow-ups.

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

Yes. Sure. We had talked about typically our CapEx as about $125 million to $150 million but we did say that we expected an increment on that related to our ERP systems so I think we gave guidance --

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

$30 million to $50 million.

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

$30 million to $50 million incremental for the ERP program. So probably in the $150 million to $175 million range as an annual CapEx target. As you noted, we were a little lower than that on a run rate basis in the first quarter.

Scott Wipperman - *Goldman Sachs - Analyst*

Got it. And then maybe can you discuss the go-to-market strategy? More as it pertains to North American mailing. I guess I was just interested, how much of the success that you're seeing in stabilizing that business is coming from attracting new customer relationships to the company as opposed to maybe just doing a better job supporting and selling to your installed user base?

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

I think the benefits of the go-to-market are primarily in terms of more effective and efficient reach into your existing customer base. And those are the benefits that you've seen right now.

Over time what that will allow you to do is to redeploy your face-to-face salesmen and your field sales to more acquisitions but those benefits are still in front of us. So right now the way I would characterize the benefits that we've seen is better and more effective reach and obviously more efficient.

Scott Wipperman - *Goldman Sachs - Analyst*

Got it. And then maybe last one just Mike, jumping back to the balance sheet, you guys have obviously done a lot of work, good job in addressing the maturity profile. With the tapping of the institutional debt market, earlier this quarter as you look out at the curve, you do still have some towers, 2016 I guess still stands out to me when I factor in the preferred securities that you guys have as well. Is that -- should we expect Pitney to be back in institutional market maybe on a more consistent basis going forward as you look to address the maturity profile?

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

Clearly, what we did in the first quarter was aimed at getting back into the institutional market and making sure that we had access, so I would see that clearly as an option for us to manage the maturities that come due both in 2015 and 2016. Obviously we're looking at the preferred as a different animal and looking at our options around that but some combination of accessing the markets and free cash flow is how we will address our maturities.

Scott Wipperman - *Goldman Sachs - Analyst*

Great. Thank you very much for the questions.

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

Thank you.

Operator

Glenn Mattson, Sidoti & Company.

Glenn Mattson - *Sidoti & Company - Analyst*

Maybe a minor point but have you guys talked about the larger than normal postage rate increase and whether or not you expect it to have any effect on your business? I mentioned it because also it just went into effect late in January so there might be a 60 or so day lag. Do you have any view as to the utilization rates of the printers, of the equipment at the printers that you deal with, that kind of thing?

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

I would say, Glenn, what we've seen is obviously the addition of a postage discount has given us something to go and talk to our clients about and market against that opportunity to mitigate some of that increase. I wouldn't say that that's been a big deal to date but certainly it gives us something to talk about.

Where we have seen a little bit of an impact from it is more on the presort side in standard class mail where customers are I think retrenching and figuring out how best they use direct mail in their overall mix. And the good news is we had 5% growth in presort despite that impact of standard class mail and that growth really came in first-class mail volumes as well as improved sortation rates.

Glenn Mattson - *Sidoti & Company - Analyst*

Okay. So more of just a neutral effect when you put together all the factors then?

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

Correct.

Glenn Mattson - *Sidoti & Company - Analyst*

Okay. Great. Thanks.

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

Thank you.

Operator

And we have no more questions in queue at this time.

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

Then I will take the opportunity to wrap up. First of all I'd like to thank everyone again for your participation in our call. We appreciate your interest in the company. We think it's a very interesting and compelling story.

As I said at the outset we had a very good quarter, in some ways an excellent quarter. And I take great solace in that. That said to me the most important part to me about the quarter wasn't what this 90 days meant by itself but what this quarter meant as it relates to our long-term model.

I think it is an important point of reaffirmation of our strategy, and as I said, most importantly, our ability to execute that strategy. So it was a good 90 days.

We're off to a good start to the year and we will look forward to hopefully seeing many of you next week at our analyst meeting. So thank you again and we'll talk soon.

Operator

Thank you. Ladies and gentlemen, this conference will be available for replay today after 10:00 a.m. Eastern through May 30 at midnight.

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That concludes our conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.