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PBI - Q2 2017 Pitney Bowes Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 revenues of $821m and GAAP EPS of $0.26. Expects 2017 constant currency revenue to be flat to 1% vs. 2016 and adjusted EPS to be $1.70-1.78.

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PRESENTATION

Operator

Good morning, and welcome to the Pitney Bowes Second Quarter 2017 Results 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 your participants on today's conference call. 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 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 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 statements as a result of new information or developments. Also, for non-GAAP measures used in the press release or discussed in this presentation, you can find reconciliations to the appropriate GAAP measures in the tables attached to our press release and also on our Investor Relations website. Additionally, we have provided slides that summarize many of the points we will discuss during the call. These slides can also be found on our Investor Relations website.

Now our Executive Vice President and Chief Financial Officer, Stan Sutula will start with a few opening remarks. Stan?

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

Thank you, Adam, and thank you, everyone, for joining the call this morning.

Today, I will take you through the details of our second quarter results and provide an update on our annual guidance. Marc will follow with an update on our performance against our strategic initiatives, and then we will open the call for questions. Unless otherwise noted, my statements going forward will be on a constant currency basis when talking about revenue comparisons and on an adjusted basis, when talking about earnings-related items, including cash flow. Reconciliations of all non-GAAP to GAAP measures can be found in the financial statements posted with our earnings press release and on our Investor Relations website.

This quarter is a reflection of our ongoing investments around our strategic vision, which is becoming apparent in our revenue performance. The year-over-year revenue trend is improving from where we have been in the last 2 years, and our businesses are moving toward their long-term growth ranges. While we expect revenue to continue to improve, our margins are experiencing some pressure as a result of the shifting portfolio and the required investments. We have work to do but are confident we have the right initiatives in place in order to improve the bottom line for the second half of the year. I will talk more about that after I take you through the details on the quarter.

In the second quarter, we delivered $821 million in revenue, adjusted EPS of $0.33 and free cash flow of $18 million. Revenue was flat to prior year and continues to be in line with our annual guidance. Revenue in the quarter benefited from continued double-digit growth in our Global Ecommerce segment as well as growth in our Presort Services segment. Within SMB, revenue declined 2%, which is in line with the long-term market range, and equipment sales grew again this quarter in North America Mailing.

Production Mail revenue declined but ended the quarter with an improved backlog. Software revenue declined, but performance this quarter is a continued improvement from where we have been over the last 2 years. At the midyear mark, total revenue is flat to prior year, which is a reflection of the company's transformation as we continue to shift our portfolio to higher growth businesses. Our SMB and enterprise segment groups are both performing within their respective long-term market ranges.

On Digital Commerce, our software revenue is showing slight growth and Global Ecommerce remains consistent with strong double-digit growth. Adjusted EPS was $0.33, which was a decline of $0.06 from the prior year. As I mentioned on our call last quarter, when compared to the prior year, this quarter's results were impacted by higher marketing spend of $0.04 per share, mostly related to our advertising campaign and enhancement of our digital capabilities. This quarter's results reflect our continued investment, primarily in our Global Ecommerce business, including shipping APIs, in order to take advantage of the market opportunity. EPS also includes a benefit of $0.05 from the resolution of tax examinations.

Year-to-date, adjusted EPS is $0.68, which is down $0.04 from the prior year. GAAP EPS was $0.26, which included restructuring and asset impairment charges of about $0.09, as well as a gain of $0.03 from the sale of technology for a mining industry application used mostly in Australia to a channel partner. As part of that transaction, the channel partner will continue to sell licenses of our product in conjunction with sales of the application. We are always looking for ways to monetize pieces of our software asset base, including when an alternate channel will be able to better leverage that asset.

Year-to-date, GAAP EPS is $0.61, which is up $0.02 from the prior year. Free cash flow was $18 million for the quarter, which was a decline of $67 million from prior year, largely attributed to the timing of accounts payable and accrued liability payments as well as the lower net income. On a GAAP basis, we generated $31 million in cash from operations. During the quarter, we used cash to pay down $150 million of debt, $35 million in dividends to shareholders and $7 million for restructuring payments. At the midyear mark, free cash flow is $130 million, which is $21 million lower than prior year for the same period.

Looking at the P&L, starting with revenue performance by line item as compared to prior year, business services grew 9%, driven by continued double-digit growth in Global Ecommerce as well as single-digit growth in Presort Services. Equipment sales grew 5%, driven by growth in our North America Mailing business and partially offset by a decline in Production Mail and International Mailing. Supplies revenue declined 1% and software revenue declined 2%. Rentals declined 6% and financing revenues declined 8%. Our support services declined 11%, impacted by a decline in SMB and Production Mail. Gross profit was $452 million with a margin of 55%, which is about 210 basis points lower than prior year and largely reflective of the decline in SMB's recurring streams.

SG&A was $304 million or 37% of revenue. Compared to prior year, SG&A increased by $15 million, largely driven by incremental marketing expenses. R&D expense was $33 million or 4% of revenue. Compared to prior year, R&D expense declined about $2 million. EBIT was $115 million and EBIT margin was 14%. Compared to prior year, EBIT declined $39 million and EBIT margin declined 440 basis points. This decline was driven by the decrease in gross profit and incremental investments largely in marketing and e-commerce.

Interest expense, including financing interest expense, was $40 million, which was $6 million higher than prior year. Taking the redemption of our PBIH preferred securities into account, the combination of interest expense and minority expense was relatively flat to the prior year. The provision for taxes on adjusted earnings was $14 million, and our tax rate was 18.3%. At the midyear mark, our tax rate was 26.4%. Diluted weighted shares outstanding at the end of the quarter were 187.4 million, which is just under 1 million shares lower than prior year.

Turning to the balance sheet. We ended the quarter with $1 billion in cash on hand and short-term investments. Short-term and long-term net finance receivables were $1.5 billion, which was a decline of $47 million from year-end and $92 million from prior year and reflective of the decline in our financing portfolio.

Short-term and long-term debt at the end of the quarter totaled $3.5 billion, which was $164 million higher from year-end and $435 million higher than prior year. During the quarter, we issued $400 million of 5-year notes. A portion of the net proceeds was used to repay a term loan in the second quarter. The remaining balance will be used together with cash on hand and/or other financing options to repay the $385 million of notes that come due in September. As of the end of the second quarter, we had no commercial paper outstanding.

Let me now discuss the performance of each of our business segments this quarter. In the SMB Solutions segment group, revenue was $436 million, a decline of 2% from the prior year. EBIT was $135 million and EBIT margin was 30.9%, a decline from prior year of $25 million or 450 basis points respectively. This EBIT margin performance remains in line with the long-term market range of 30% to 35%.

In North America Mailing, revenue is $341 million, which was flat to the prior year. Equipment sales grew again this quarter driven by mail finishing, which includes the initial SendPro products launched last year. Total equipment sales revenue returned to 2015 levels, which we believe is a good leading indicator of the future stabilization of this portfolio's recurring revenue streams. All of our direct channels, including Web, experienced strong growth in the quarter. The growth in equipment sales was offset by a decline in the recurring revenue streams, largely around lower service, financing and rental revenues.

EBIT was $121 million and EBIT margin was 35.4%, a decline of 740 basis points from prior year, due primarily to the decline in the recurring streams. Service margins were impacted by the overall decline in the portfolio and billed labor variability. Cost of rentals were also higher on an increased level of scrap costs this quarter. We expect service performance to improve in the second half of the year, driven by revenue in conjunction with cost reductions. Rental margins are also expected to improve in the second half. This segment also had higher marketing spend resulted from our targeted, competitive SendPro campaign as well as higher commissions paid related to the equipment sales growth.

We also experienced higher residual losses due to the timing of trade effectivity and higher bad debt reserves, which impacted SG&A. We do expect SG&A to improve going forward and reduce marketing spend and improve collections as well as benefits from recent restructuring actions taken and ongoing operational excellence initiatives. With the launch of our new SendPro products, we expect a benefit to equipment sales performance. We also expect to see short-term margin pressure, particularly around the cost of rental, due in part to higher depreciation. However, this recapitalization of our asset base is expected to improve the recurring revenue streams over time.

In International Mailing, revenue was $95 million, a decline of 7% from the prior year. A decrease in equipment sales and recurring revenue streams both contributed to the revenue decline. Equipment sales decline was driven by weakness in the U.K., France and Italy, but partially offset by growth in Japan. EBIT was $14 million and EBIT margin was 14.7%, an improvement of 310 basis points from prior year, largely due to the improved equipment sales margins and lower expenses.

In the Enterprise Business Solutions segment group, revenue was $204 million, which was a decline of 3% from the prior year. EBIT was $27 million and EBIT margin was 13.2%, a decline from prior year of $7 million or 290 basis points, respectively.

In Production Mail, revenue was $86 million, a decline of 10% from prior year. Equipment sales decline from prior year, largely due to lower sorter equipment placements, where prior year had a large sorter deal, which is impacting the comparison.

Inserter sales did show healthy growth. During the quarter, we sold our 95th Epic inserter, which is 20% faster than our last flagship product launch, and an indication of how we continue to innovate in this space. Support services revenue declined as a result of the shift last year of some in-house mail production clients moving to third-party service bureaus, who tend to self-service. Service is expected to improve in the second half. EBIT was $8 million and the EBIT margin was 8.9%, a decline of 460 basis points over prior year, driven by the decline in revenue in addition to the mix of inserter equipment sales.

In Presort Services, revenue was $118 million, which was a growth of 2% and driven by higher-standard class mail volumes processed, along with improved revenue per piece related to Flats. EBIT was $19 million and EBIT margin was 16.3%, a decline of 200 basis points from prior year, driven by increased mail processing costs. In addition, certain client contractual disputes were resolved in the quarter, which accounted for approximately half of the margin decline.

In the Digital Commerce Solutions segment group, revenue was $181 million, which represents growth of 7% over prior year. EBIT was $4 million and EBIT margin was 1.9%, a decline from prior year of $6 million or 360 basis points, respectively.

In software services, revenue was $86 million, a decline of 2% from prior year. Revenue benefited from growth in Location Intelligence licenses as well as growth in maintenance and data revenues. This was offset by lower Customer Information Management license revenue. Our indirect channel continues to make progress as our partners invest and build the pipeline of our products. Over the last year, the pipeline generated by the indirect channel has grown incrementally each quarter. EBIT was $8 million and EBIT margin was 8.7%, a decline of 250 basis points from prior year, largely due to the decline in license revenue.

In Global Ecommerce, revenue was $95 million, which represents growth of 16%. Our sustained double-digit revenue growth was largely driven by strong volumes in the U.K. outbound marketplace solution as well as growth in domestic shipping. This quarter, we also enhanced our shipping APIs with more than 15 new features, including adult signature, SCAN Form enhancements and additional postage financing options. These improved capabilities are a result of close collaboration with our domestic shipping business clients to meet their needs and support their business growth through our contemporary platform.

Since the end of the first quarter, label volumes through these shipping APIs have nearly tripled. EBIT was a $4 million loss and EBIT margin was a negative 4.3%, which is reflective of the significant investments we have made to expand the capabilities that we bring to our clients. We continue to invest in future growth opportunities, including our domestic shipping capabilities around our shipping APIs, enabling our retailers to offer their goods on market place sites, supporting retailers to generate consumer demand and expansion of our cross-border offerings to additional outbound countries.

Let me wrap up with our full year guidance. Based on our year-to-date results, we are narrowing our annual guidance range for revenue, adjusted EPS and free cash flow. We now expect revenue on a constant currency basis to be in the range of flat to 1% when compared to 2016. We expect adjusted EPS to be in the range of $1.70 to $1.78, and free cash flow is now expected to be in the range of $400 million to $430 million.

Let me provide more color on where we are and what we expect. As I mentioned, revenue at the midyear mark is flat to prior year. We expect revenue to ramp up throughout the second half of the year from the launch of new SMB products and enhancements to our digital capabilities. We expect volumes through our shipping APIs to continue to gain momentum through the second half, driven by the expanded functionality and capabilities launched this quarter. Additionally, we continue to have success bringing new clients onto our e-commerce platforms.

We expect our software partner channel will continue to expand and contribute more to results in the second half of the year. We also expect to see an improvement within our Presort Services as we continue to expand the network and focus on building out the parcels rotation side of that business. The revenue performance will have a mixed impact on EPS as we anticipate the growth will be driven predominantly in Global Ecommerce. We are continuing our investments to become more digital and web-enabled to better serve our clients. We are driving ongoing improvements in cost and expense across the portfolios, including the restructuring charge taken in the second quarter. This restructuring and our ongoing operational excellence initiatives are designed to help stabilize the SMB margins.

E-commerce margins will improve as we yield the revenue benefits from our high-margin shipping APIs and our cross-border business continues to scale. In the near term, the changing business mix will impact our bottom line and is the reason why we are narrowing our EPS guidance range. We will continue to invest in bringing innovation to our clients through R&D investments, and we are starting to see the results of this investment.

As I mentioned earlier, we've seen label volumes through our shipping APIs nearly triple versus last quarter. We are also starting to build out markets for parcel sortation within our Presort network and preparing for the release of the next generation of our SendPro family of products in North America Mailing.

As I mentioned last quarter, we are committed to a high-performance culture and part of that is performance-based variable compensation. We expect to reinstate a portion of our variable compensation, which will impact the year-to-year comparison in the second half of the year. And our annual tax rate on adjusted earnings is now expected to be in the range of 31% to 33%.

In closing, our first half revenue performance is within the annual guidance range with good opportunity for the second half, which we expect will drive an improvement in earnings and free cash flow in the second half. We are confident the investments we are making position us to attain our long-term strategic goals.

With that, let me turn it over to Marc, and then we will take your questions.

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

Thank you, Stan, and good morning. Our second quarter represents a continuation of the progress we are making against our strategic agenda. As Stan reported, our top line performed within the annual guidance range and our earnings were impacted by necessary investments this quarter. We're continuing to see the shift of our portfolio to higher-growth digital solutions, which gives us confidence that the investments we have been making are the right ones and what will drive our future growth on both our top and bottom lines.

Let me take you through what we've achieved this quarter and how it relates to our overall strategic agenda. In terms of reinventing our mail business, last year, we launched the Commerce Cloud, which gives our clients access to the broad range of innovation across Pitney Bowes and our partners in the shipping, mailing and Digital Commerce markets. The Commerce Cloud enabled us to offer our initial flexible multi-carrier stemming solution to meet the office shipping and mailing needs of our clients. Our initial SendPro product has been well received in the market. We have since been investing in bringing this offering across our middle-of-the-line portfolio through a unified platform, which leverages our SmartLink IoT technology and will be available for our current and prospective clients to convert to as their secure platform. This is the next generation in the evolution of office shipping, mailing and e-commerce fulfillment.

In the next few weeks, we will launch this new SendPro family of products. Let me be clear, this is more than an upgrade to an existing product line. This is a game changer for Pitney Bowes, and there is no equivalent product like this in the market. For our SMB clients, whose business needs and the way they do business are changing, we're moving from a monolithic analog set of applications to a digital, multifunctional enhanced set of possibilities, which will be available at several different price points. The SendPro C Series leverages the latest cloud technology to securely deliver greater value and convenience to users through a range of apps, analytics and services on an open platform, which is available for third-party developers to easily build upon. The fact that this is an open platform that third-party developers can build applications on, exponentially increases our ability to create value for our clients and prospects alike.

In short, this new product is a SaaS utility tailored specifically for our market. This launch is the result of the foundational work we have done over the last few years. Additionally, our Enterprise Business Solutions segment group also continues to invest in growth-oriented products and solutions. Our Production Mail and Presort Services businesses both have assets that we're leveraging in the area of parcel services in sortation, which presents a great opportunity for these businesses.

Looking at our progress around operational excellence, as I have said before, we have made and we'll continue to make the necessary investments to shift our portfolio and move to the higher-growth businesses while also continuing to optimize our business core efficiency. This quarter was no exception. We ramped up our investments in market for brand awareness, continued to enhance our digital capabilities and launched a targeted competitive campaign. We also continued to invest in new product development in order to bring our competitive digital offerings to market.

During the quarter, we launched our shipping APIs with enhanced capabilities, which I will come back to in a moment. And as I mentioned, we'll launch our next generation of SMB SendPro family of products in the next few weeks. We expect to start realizing returns on these investments in the second half of this year as we sign up new clients, trade-up our existing base, win competitive placements and build volumes through these products. This is not only a part of our second half strategy, but our long-term strategy as these offerings provide a unique value proposition for new and existing clients, while also building new revenue and enhancing our existing streams.

Our Enterprise Business platform also continues to improve efficiency in our operations as we see greater web adoption and streamline processes as we become a more digitally-enabled business. As this platform continues to scale, we will continue to leverage its capabilities and optimize the business. It's also worth noting again, in addition to providing operational efficiencies, this platform supports our new digital products in SMB and e-commerce. Our last strategic pillar is to grow Digital Commerce Solutions.

Let me first circle back and talk about our Global Ecommerce business. Revenue continues to grow double digit. And you can see that EBIT was directly impacted by some of the necessary investments I spoke about earlier. In the second quarter, we continued to add new clients to our platform, including another large cross-border client. Given the platform nature of this business, the profitability relationship to client maturity is driven by the optimization of volume post onboarding. This is evident when we look at the profitability of clients from earlier years compared to those that we've signed over the last 12 months.

During the quarter, we also launched new features with our shipping APIs that allowed us to bring on new clients and partners. We made the necessary investments not only to get these shipping APIs to market, but to be at the forefront of our competition on a contemporary platform. Since launching these new features, label volume through our shipping API platform has increased nearly 3x from the last week of March to the last week of June. And that label volume continues to grow incrementally each week. While it took us a little longer to get these new features in the market, we exited the quarter where we need to be with momentum that continues to significantly build. This has created more revenue opportunity for us in the second half, and as Stan mentioned, we're able to leverage that revenue quickly as the volumes build. We also expect to see margin improvement as the business scales as witnessed typically through the holiday season.

Turning to software. This business continues to perform better from where it has been in the past 2 years. Last quarter, we grew revenue. This quarter, revenue was down about 2% from prior year at constant currency. At the midyear mark, our software revenue was up slightly and both EBIT dollars and margin have improved from prior year. But we know we have more work to do. The partner channel continues to make progress and the contribution to our pipeline from that channel has grown incrementally each quarter over the last year.

As I've said in the past, this is a second-half story as these efforts continue to build. When you look at the 3 strategic pillars under one umbrella, you'll see why we have confidence in our results going forward. We have new products focused around parcels and shipping in our SMB, enterprise and Global Ecommerce businesses. Coupled with that is our continued focus in building our software partner channel. Future profitability will come in the form of e-commerce volumes, revenue leverage from our software business, along with new equipment sales and streams, which we'll build over time. That, along with efficiencies from our Enterprise Business platform and continued focus on our operational excellence initiatives create the path for improved results going forward.

Let me put our first half results in a more strategic context. Excluding the impacts of currency in 2015, revenue declined 3%. And in 2016, revenue declined 4%. In the first half of this year, revenue was flat, and we are exiting the half with momentum. In the same time period, gross margins have declined from 58% to 56%, as the mix of our business has changed. Simultaneously, we have decreased our overall level of expense while making investments in our systems, our brand and our products.

In the first half of 2017, our SMB and Enterprise Business performed consistent with the expectations that we laid out in 2013. We have more work to do in our Digital Commerce segment particularly in our software business, but you can begin to see the unmistakable signs of progress.

Let me close with this. Four years ago, the weighted average market growth rate of our portfolio was negative, around minus 2%. Today, because of our changing business mix and the markets we have targeted, the weighted average market growth of our portfolio is a positive 2%. As many companies going through a transformation struggle to find additional revenue opportunities, we found ours and are going after it. As long as we see the path, we will choose to follow it and make the investments needed to get there. I've said countless times that this will not be a straight line to the top. Transformations take time. Transformations take investment. We have been putting the time and investment in. We are starting to see the returns take hold as revenue begins to improve and the margin will follow as we scale.

We will now take your questions. Operator, please open the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from the line of Shannon Cross, Cross Research.

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

I guess, the first question I have is just somewhat digging in, in what you were just talking about, but I'm trying to figure out how long you see this period of investment? At what point do think you'll start to see some decent leverage so that we'll see upside to operating profit. And I'm just trying to think about this year, next year, what -- I know this is a long process, but I guess I was a little disappointed in what we saw in North America Mailing. So just any idea you can give us on timing or how you were thinking about it maybe from a 15,000-foot level.

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

Sure, Shannon. It's Stan. Let me start here. So for the investment levels, we're going to continue to invest where we see that opportunity. And we talked about the investment in Global Ecommerce and particularly around shipping APIs and building out the outbound market place including Australia. Those investments also go across the rest of the business, and as we look at the rest of the business and how we think about that, we believe that those investments will manifest themselves over time in particular as we do scale. And the North America Mailing, as you mentioned, we have a big product launch here coming up in the next few weeks, and that's the C-Series. And that product addresses about half of our installed base in the market opportunity that's out there. So we do expect that as we go through time, we'll see some benefit that comes through. Now I can't give you an exact time frame of how that plays out, but as you look across our lines of business combined with our ongoing operational excellence, we're going to continue to drive productivity, and I think you'll see that we front-end loaded marketing this year, so we expect that improvement as we go through the back-half of the year.

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

And I'll just add that -- I'll go to a higher level, Shannon, as I'm inclined to do. I think if you kind of look at the segments one at a time, and starting with SMB and zeroing specifically on North America, to your question, we expect to see improvement in the second half of the year. Some of that is because of some, I would say, timing issues in the business. That's largely because of the product announcement that we'll have. So to your question about when does this start paying off, my answer is, it starts paying off at the second half. As it relates to the other side of the business, the Digital Commerce business, again, in our Global Ecommerce business, we expect to see leverage in the second half of the business as volume increases. We're very excited about the API opportunity, that family of good revenue opportunity. That's a good profit opportunity for us as well, and that scaled quickly in the second quarter so we see leverage on that in the second-half of the year. And as we always said, software is a second-half story, and so we expect to see the investments in the channel that we're -- that we have made paying off in the second-half of the year. And we'll continue to have, I would say, puts and takes on any given quarter as we see and react to different opportunities. But I think the point that I would step back and say is that the trends are clear, the revenue is beginning to fill in. The margins in SMB and enterprise are within the long-term guidance, so those will moderate on any given quarter. But the basic answer to your question is we expect to see leverage in the second half.

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

And I guess with -- Xerox also reported this morning, and they had a pretty significant pressure on their equipment sales because of the new product launch that they had in timing and all of that. How should we think about potential for, I don't know, training, channel, slowdown, anything like that, as we see that this launch of SendPro, because again, at Xerox, their equipment sales were down, I think it was 16%. Again, different companies, but also both going through a pretty significant refresh of their product lineup.

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

Sure. And I've got a lot of respect for our neighbors up the street. I would start with by just providing a little bit of baseline. Our equipment sales actually increased in the second quarter. And candidly, we said last year 2016 was an anomaly, so I'm going to go back to the 2015 SMB equipment sales where we're actually up versus 2015. And that's important because we're able to make this transition and still keep equipment sales at the right basic trajectory. We don't expect to slow down. We have -- we're building the inventory. We're doing the training as we speak. So I do not expect to see a slowdown in our equipment sales in the second half of the year, on the contrary. And I would say the broader point is that this really is a game changer for us. We're going from a product, which has sustained this company, the mail meter, for almost 100 years to a whole new set of possibilities for our clients. Certainly, the evidence in the mail will continue to be central to how we think about our buyers from our market, but also shipping and other third-party apps. So you can kind of get lost in the sea of numbers here, but the basics are that we're creating a whole new set of possibilities to retain and attract the new customers. And importantly, regarding the economics of the firm, sustain those streams that are underneath that business.

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

Great. And then just my last question is, how should we think about sustainability of cash flow? What do you think is sort of an ongoing cash flow -- just when you think about the puts and takes and the pressure on the margin, but the growth and the investment and then potential for working capital improvements and continued runoff of, well, theoretically maybe not, but of finance receivables, how are you thinking about cash flow?

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

So Shannon, we did narrow our range for free cash flow for the year to $400 million to $430 million. That really reflects our experience here in the first half. And free cash flow in the first half, obviously, we're not pleased with that number. It's down roughly 67 million year-to-year, but a big chunk of that is timing. And when we look underneath, we saw accounts payable, a big swing year-to-year as well as if you look at accrued liabilities, there's 2 big items in there, presort customer deposits, which we've already seen recover. And then looking at actual payroll, we're on a biweekly for a roughly 2/3 of our population. That has an oddity in this quarter that had a year-to-year impact. So we see a lot of timing in that. We're confident in the $400 million to $430 million of free cash flow for the year.

Operator

Our next question comes from the line of Brendan Hardin, Northcoast Research.

Brendan Woodrow Hardin - *Northcoast Research Partners, LLC - Research Associate*

So just a couple of quick questions. I guess in terms of the software business, how much of the improvement in software is due to the deals that were kind of pushed out in 4Q '16 versus progress with the third-party integrators or just overall market improvement? And then how would you characterize the backlog in that business?

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

I would say kind of starting at the market, I would say we're continuing -- we continue to have confidence in the markets we've chosen. If you look at the first half results, out of the 3 deals that did not close in the fourth quarter, one of them closed in the first half or slightly less, so less than what we were anticipating in the fourth quarter. And if you look at the year-to-year progress, it's hard to isolate any one thing, but the indirect channel is driving all of the incremental improvement and growing well above double digits on a year-to-year basis. And importantly, to your last point about backlog, if you look at the pipe that's been generated internal, and specifically the pipe that's generated from the third parties or with the third parties, that what gives us confidence about the back half of the year, but that's -- we got to prove that, I mean, it's -- but that's the basic dynamics within the business.

Brendan Woodrow Hardin - *Northcoast Research Partners, LLC - Research Associate*

Okay. So -- and then, I guess we saw some promotions in SendPro, and I was curious, is that SendPro exclusive? Or is that across SMB-wide, whether it be meters? Or is it just more or less to try and improve user growth in the SendPro product line?

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

Well, Brendan, it was directed at the SendPro, in particular, the new offering here for the low end. But it really does blanket the entire base, and frankly, we've got some decent lift off of it, and we like the exposure of it so much, so we're going to continue that promotion versus our competitors at $5 per month. So it does -- was directed specifically at that low-end offering, but it does have a blanket effect over all the SMB offerings.

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

I would just add, I mean, we think -- one of our competitors in particular has had a free run in the low end of the market, in the API market. And they've done well, and we acknowledge that. That said, it's our intent to become much more aggressive in that space. And you saw it in the second quarter, and we'll sustain that.

Operator

Our next question is from the line of Ananda Baruah, Loop Capital.

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

Just 2 for me real quick. Are you guys -- or could you provide, you have in the past an update on anticipated costs, any cost savings from your Enterprise Business platform indefinite to the extent that, that isn't forming some of the investments that you're talking about, would love the sort of remaining costs and the expected benefits. And then I'll just ask on the free cash flow side, just to peel back a little bit more. The timing issues that you talk about, is there anything -- was there anything unusual about the timing issues and the context of the business dynamic that you spoke to? Or is it really just the business mix issue this quarter with regards to the way that timing showed up in the free cash flow?

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

Sure. Let me take the first one. So the Enterprise Business platform is an investment that really is pervasive across all of Pitney Bowes. It's not just as a cost savings. It actually enables a lot of the new offerings that we're putting out into the market. When we originally launched this, we said that in '17, we would generate between $45 million and $55 million of savings, and we are in fact, on track to achieve that for this year. Now this is ongoing. We're still going to roll this out in the non-U.S. in 2018. And in fact, we're already taking steps to do that like rolling out Salesforce.com out into there. So there's ongoing investments that are part of that, but we are achieving the savings that we are looking for.

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

I'll make just a broader point there. I mean, to Stan's response, I mean, that platform continues to be on track both in terms of the costs that we had estimated as well as the efficiencies that we were hoping to realize in 2017 is kind of right in the gearbox. The part that was never part of the business case that we didn't talk about, and we didn't base the economics, on it was all the new product announcements that we made. So the equipment sales in SMB that we've realized over the last year in our mail finishing products, that was enabled by this business platform. The Global Ecommerce results that we're achieving, the 15% to 20% growth, that was enabled by this platform. The new product, that we're about to announce in a couple of weeks, was enabled by this platform. So it was -- that was painful to go through last year, but when you look at the level of benefits that that platform is driving, it was well worth it. And it's somewhat a microcosm of the entire Pitney Bowes story. We're continuing to optimate those kind of investments and they're expensive and they're disruptive, but the possibilities they create for the firm longer term are very compelling.

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

And I'd add to that, that I think we're at the very beginning of truly leveraging the analytics that come out of having that insight into the business. And I think that's the exciting part for the future. So let me take you through the cash flow and the timing, and I'll go in a little bit more detail. So we were down $67 million year-to-year, and now part of that is driven obviously by net income. But there are 3 components to the timing. The first one is accounts payable, which is $39 million year-to-year. And as I mentioned last quarter, there is an accounts payable timing between 1Q and 2Q of prior year. In fact, when we launched the Enterprise Business platform, we elected to prepay a set of our invoices so that our vendors would not be impacted as we transition to that platform. That's what's driving the year-to-year timing in accounts payable. We expect that to normalize on a year-to-year basis as we go into 3Q. The second piece of timing is around presort customer deposits, and we saw into the month-end, done on Friday, and what we saw was the deposit level was lower. We've already seen that fill-in. We think that was roughly $18 million to $20 million of overall customer deposits, so we've seen that fill-in coming into 3Q. And then the last part is, we pay a large percentage of our population biweekly. And it's simply a timing of that days of accrued this quarter versus last quarter, and that's about $17 million. So as we head into the back half, we expect that the accounts payable and the accrued liabilities will normalize as we head into third quarter on a year-to-year basis. And what we're looking at with an improving net income as we ramp through the second half is that we're comfortable with the $400 million to $430 million of free cash flow guidance for the year.

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

All that's really helpful. And just one follow-up on the enterprise business platform comments. So are the investments that you've talked about on this call both for the just completed quarter and for the second half of the year, those are incremental -- are your investments incremental to the investments that you previously spoken about with regards to enterprise platform. Just a clarification on that.

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

No, there's no incremental investments beyond what we had originally outlined. Whether it be the Global Ecommerce or the new SMB products, those are the things that are enabled by the platforms. So like any platform, you get great leverage off of it as you scale, so that's the beauty of it.

Operator

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

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

In the SMB segment, can you help me understand a little more the give and takes with equipment sales and loss recurring revenue? More specifically, when you add equipment sales, do most of that equipment has recurring revenue attached to it?

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

Sure, Alan. So yes, when -- typically, when we add new equipment or replacing existing equipment that's out there, it does fall into and drive stream over time. Now remember, our portfolio has been facing a decline of 3x, so 1 quarter or frankly, even 2 quarters of equipment sales is not going to move the needle yet on the recurring streams. That's going to take us time to work through the normal lease space. Remember our leases are 48 months, plus or minus. So it's going to take some time for ongoing equipment sales to manifest themselves into the recurring streams. Now why we're confident about this is the new product addresses such a big part of the overall segment in which we play, roughly 50%. That will help, we think drive equipment sales over time, which will help drive the recurring streams as that plays out.

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

Let me add, it's -- there's 2 ends of this bucket. There's equipment sales, which you pour in each quarter, and then there's the erosion of the base. So one of the reasons we're excited about the new product is because we think it gives us a much better opportunity to stem the erosion at base. Because instead of just being dependent on how they use a meter and how they mail, it gives them other possibilities to retain that equipment and the streams.

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

Okay. When you do a SendPro sale, is it typically replacing a postal meter? So you're looking at the relative economics? Or can it also be an add-on?

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

So 2 components. So one, it can replace an existing meter that's out there in our installed base. So obviously, as we bring that, we think that brings additional value to the client because it also brings shipping capabilities, which they did not have on the old machine. We also think this is a great competitive play out into the market, and particularly, the middle of the line, where we have the most opportunity to gain share. We think there's nothing else on the market like this, and it really does position us well at a competitive takeaway in that middle of the line area.

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

Overall, our market share is well above 50% and the middle of the line, it's 40-ish. So it's -- that is the relative opportunity for us in the marketplace, and not only against competition but new prospects as well.

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

Okay. And then in e-commerce, is there any thought longer-term of -- you said longer-term operating margin guidance, but I understand that you're investing for growth now. But thoughts of like of the timing to get to those margins or when you might think it gets to break even?

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

So as we look at e-commerce, we're going to keep investing as long as we see that market opportunity. We've grown double digit for over 2 years. So let me do a quick rundown. We believe that those investments, the margins will improve as we build scale. And we've seen evidence of this. If you look at Q4 of last year, when we had our peak retail, we actually did drive an EBIT margin of 6%. Let me give you a feel for that portfolio and how this will manifest itself in profit. In shipping APIs, we're investing in our products and technology and we did announce over 15 new capabilities just this quarter. That profit comes with scale and it's relatively quick to monetize, and we expect that we'll see a contribution in the second half. On complete marketplace, we're building out that platform and integration capabilities for our retailers that allows them to offer their goods on global marketplaces, that's a volume and scale. We're also going to go through on a consumer experience on helping those retailers with their demand gen, and that's something unique to Pitney Bowes in the affiliated marketing. And again, as we scale those markets, we will see that -- the profit. On the outbound markets, we're investing in new outbound market opportunities, like Australia. And we've added 18 clients to that since we've launched. And again, that will come with scale, and we've seen that really with the U.S. outbound marketplace, the margins are pretty decent. The U.K. is scaling up, the margins continue to improve. And we believe that we will see the same thing as we look at Australia. And then we're going to continue to invest in marketing on proprietary events here as we launch our products and bring that visibility to our clients. So we're confident in the opportunity. We're going to continue to invest as long as we see that opportunity. And we believe that the margin and profit will manifest itself as these businesses scale.

Operator

(Operator Instructions) And our next question comes from the line of Glenn Mattson, Ladenburg Thalmann.

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

Marc, you called out a new client, a large new cross-border client, just curious since you mentioned it, is it a platform or a retailer? And is it significant to the level that it could drive growth for a period of time all by itself? Or is it just highlighting the progress you're making?

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

I'm not going to get into whether it was a marketplace or a e-tailer, it is significant in terms of its ability to drive growth and that's -- we wouldn't have called it out otherwise.

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

Okay. And then also, I think building on the last question on all the new features, the other thing that stuck out to me was the label volume of 3x from March to June. Can you talk about exactly how that happens? And maybe a little bit about how that maybe translates into revenue growth? In what form does that translate as far as the dollar terms?

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

Sure, Glenn. So as we add these new capabilities, clients who are out there in the market are looking for certain capabilities that meet their clients' needs. As they come onto the platform, they now start to print labels, and this monetizes our investments upfront with this. So as they print the labels, that's what monetizes and drives both the revenue and profit stream. As their clients come on, they embed it into their capability then as they go print those labels and grow their volume, we'll see a direct benefit in that quarter, both from the volume and the profit that goes along with that volume. Now we're continuing to invest here. We expect to continue to bring out new capabilities. We're very confident of what we have. We're on a very contemporary platform. We are out with our clients, helping them meet their needs, and we're going to continue to invest along those lines.

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

Let me just add to that. So as I said, the volumes scaled substantially from the beginning of the quarter to the end of the quarter. It was more skewed to the end of the quarter than what we expected. So while we exited the quarter the way we thought, it took us a little bit longer to get there. So we didn't quite get the revenue or the profit leverage that we expect in the second quarter. That said, this is unique versus other aspects of that business because it produces pretty immediate operating leverage to the marketplace. And then I would just double click on the point that Stan kind of made at the end, this is a big opportunity. And our approach to this market place is to really help these clients drive volume in their platforms. So we'll look at how we can leverage our own business, our own small and medium businesses platform coming out to help them drive volume.

So we think this is a good market opportunity. We think this is a place where one of our competitors has had the market to themselves for a bit, and now we're anxious to drive a very client-friendly approach into this marketplace that drives value for our clients and for Pitney Bowes.

Operator

And at this time, there are no other questions in queue.

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

Thank you, operator. Let me close. Second quarter was a complicated quarter. There were a lot of moving pieces. And candidly, we know we had the opportunity to do better than we did. That being said, if you step back and you look at our progress against our strategic agenda, I continue to be very encouraged about where we are. This new product that we're about to announce in SMB really is a game changer. It allows you to cement the relationship with the million clients that you have in that business and extend value to a whole new set of marketplace in a far different way than we've been able to in the past and anyone else in the marketplace. If you think about a digitally connected Software-as-a-Service, small and medium business, startup with 1 million clients, we talked about at Investor Day, this is the realization of that aspiration. Enterprise continues to kind of operate within the bandwidth that we had suggested in 2013. Software has been the second half story, continues to be a second half story. We think we're set up to succeed. We got to prove it. We got to prove it to the marketplace, and we need to prove it to all of you. And then finally, the Global Ecommerce business just continues to be one of the most compelling opportunities we've seen. Some of these opportunities that we encountered in the second quarter, we anticipated. Some of the opportunities in the second quarter that we realized, we hadn't anticipated. And we'll always opt for serving those markets as we go forward. So as I said, second quarter was a complicated quarter, lots of moving pieces as there has been over the last couple of years. I think the trend is clear, and we're excited about the second half.

So with that, I'll close, and we look forward to talking to you in 90 days. Thank you.

Operator

Ladies and gentlemen, this conference will be made available for replay after 10:00 a.m. today, running through September 1, 2017 at midnight. You may access the AT&T Executive Playback Service at any time by dialing 1 (800) 475-6701 and entering the access code of 426065. That concludes our conference for today. Thank you for your participation and for using AT&T Executive teleconference service. You may now disconnect.
