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PBI - Q1 2016 Pitney Bowes Inc Earnings Call

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OVERVIEW:

Co. reported 1Q16 revenues of $845m and GAAP EPS of $0.30. Expects 2016 constant-currency revenues to be in the range of 1% decline to 2% growth and GAAP EPS to be $1.80-2.00.

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PRESENTATION

Operator

Good morning, and welcome to the Pitney Bowes first-quarter 2016 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, Chief Operating Officer and Chief Financial Officer; and Mr. Adam David, Vice President, Investor Relations. Mr. David will now begin the call with the Safe Harbor overview.

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

Good morning. Included in this presentation are forward-looking statements about our expected future business and financial performance. Forward-looking statements involve risks and uncertainties that could cause actual results to be materially different from our projections. More information about these risks and uncertainties can be found in our 2015 Form 10-K Annual Report, and other reports filed with the SEC that are located on our website at www.PB.com, and by clicking on Investor Relations. Please keep in mind that we do not undertake any obligation to update any forward-looking statements as a result of new information or developments.

Also, for non-GAAP measures used in the press release or discussed in this presentation, you can find reconciliations to the appropriate GAAP measures in the tables attached to our press release, and also on our investor relations website. Additionally, we have provided slides that summarize most of the points we will discuss during the call. These slides can also be found on our investor relations website.

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

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

Thank you, Adam, and thanks everyone for joining this morning for our first-quarter earnings conference call. Last week we made one of the most consequential announcements in Pitney Bowes' history. We introduced the Pitney Bowes Commerce Cloud, along with several SaaS-based products and solutions. This aligns our physical and digital capabilities, along with our mobile, location and e-commerce technologies, with all of the end-to-end requirements that drive commerce.

To my mind, this was more than a product announcement. This was the foundation for all of our future products and solutions, adding digital capabilities, and web-based solutions, that span all of our business units. It is also a demonstration of how we are redefining and transforming Pitney Bowes, by expanding our reach, as we cement existing client relationships and cultivate new ones.

And it broadens our addressable market for our 1.5 million clients by an order of magnitude. This is a substantial opportunity for our Company, and it is consistent with the strategy we've been pursuing for the past three years. While our competitors may have parts of the commerce solution, we are the only Company that provides such a broad range of commerce solutions that deliver the functionality, speed, and agility our clients need, from small businesses, to large, global companies.

In addition to the launch of the Commerce Cloud, we achieved a number of milestones during the first quarter that will further advance our transformation. In January, we launched our first major television advertising campaign in 20 years. We completed our move to a dealer market in Mexico, South Africa, and five markets in Asia. And finally, we deployed our newly-designed business processes and accompanying technology in April.

While we sometimes refer to this as an ERP project, it is much bigger. It is a complete redesign of our business processes. As we have said, this project is key for us to realize the benefits of the investments we have made, and deliver new products, such as those enabled by our Commerce Cloud. Those benefits are clearly in our sights, and we are evaluating the feasibility of accelerating our business case.

Turning to the results for our first quarter, our financial performance was largely consistent and in line with our expectations, save our software solutions businesses. We turned in another strong performance in pre-sort and global e-commerce businesses, while SMB revenue trends continued to stabilize and improve. SMB new equipment sales, a leading indicator of our future recurring revenue streams, were positive, highlighted by the largest growth in North America equipment sales in several years.

However, our software solutions business performance was disappointing. Simply put, we did not execute, and while the business issues we see are not complicated, we need to fix them. I'm confident that the new leadership team will.

We have the right products, and our software solutions strategy is resonating with our clients. During the quarter, we added a new President, a new leader to drive our channel strategy and a new Head of Marketing. In December, we appointed a new Worldwide Sales leader to drive sales efficiency and productivity globally.

We expect that this business can and should be better. While the market conditions and the technology industry are currently not great, I'm confident that we will see a slow and steady improvement in our software solutions business throughout the year.

Now as I have every quarter, let me update you on our three strategic initiatives for creating long-term value. Reinventing mailing, operational excellence, and growth by providing access to our digital commerce capabilities across our business.

First, reinventing mailing. The positive year-over-year growth in North America mailing equipment sales and continued moderation of declines in international mailing revenue reflect the benefits of moves we made to stabilize the business, including go-to-market changes and realigning our geographic footprint. We're not done, and we'll continue to focus on enhancing sales productivity globally.

Last week's launch of SendPro as an application in the Commerce Cloud is a great demonstration of how we are reinventing mailing to deliver new value to our SMB clients. We are integrating physical and digital technologies into more relevant solutions, and enhancing their experience with us through digital interfaces.

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Next, operational excellence. The new business processes and accompanying technology we are deploying is foundational to be globally integrated in a more efficient Company. In two years, the benefits have moved from possible to probable, and now to a reality, and we did it on time.

Our successful launch in April in the US, and ongoing stabilization in Canada are already starting to provide benefits for our clients in terms of improved business processes, enhanced productivity improvements, and easier access to a web store. The early returns are good, and the issues are what we would have expected, and are manageable.

As part of this initiative, we also deployed a client portal that provides better visibility into transaction data and client activity, to help them better manage and anticipate their enterprise-wide needs, and help us provide relevant recommendations for next actions.

And finally, grow our digital commerce solutions by leveraging our existing client base. In the first quarter, digital commerce solutions grew 11%, despite being negatively impacted by our software solutions business. e-Commerce continued to grow, with the inclusion of retail revenue from Borderfree, and marketplace growth in the UK.

Today, the Pitney Bowes Borderfree retail platform has 222 storefronts, and we are adding more every month. We also saw an increase in the outbound package volumes. We are well-positioned to capitalize on the large opportunities that this market represents. I continue to believe this is one of the most exciting opportunities I have ever seen in the technology industry.

We are disappointed with our software performance, and software solutions business, but the issues are addressable, and the other aspects of our long-term plan are coming together nicely. We see a clear path forward, and will not be deterred. I am confident in our ability to deliver our long-term strategic plans, and continue to unlock value for our shareholders. With that, let me turn the call over to Mike.

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Thank you, Marc, and good morning. As Marc discussed, the start to 2016 has been about achieving a number of milestones in the Company's transformation. Important milestones, in that they are solidifying the key financial drivers of our results over the next two to three years. We have now delivered a new operating platform, and an initial set of cutting-edge solutions designed to sit on that platform.

Additionally, we completed a first quarter that validated our actions to stabilize and reinvent our mailing business, but also highlighted areas like software, where we have further work to do. Over the past two-plus years, we have implemented both a go-to-market channel transformation and a recasting of our direct distribution geographic footprint in our SMB business.

Our first-quarter results represent an important milestone. On a constant currency basis, and when adjusted for recent market exits, global SMB grew equipment sales 3%, led by growth in North America mailing, which had its best quarter of equipment sales growth in several years.

In April, we took another critical step forward in delivering operational excellence that will not only reduce costs, but dramatically enhances our ability to deliver and manage new products and services. Following on our pilot in Canada in late 2015, we delivered our ERP platform in the US, along with a new web store and client portal, that support our new Commerce Cloud solutions.

While we remain in ramp-up phase, we have now enabled nearly 80% of our revenue base on the new platform. This new platform and the solutions it supports further fulfills the goal of bringing enterprise capabilities to our entire client base.

Before turning to the specifics of the quarter, I also wanted to highlight that our investments in the Company's future have been balanced with our commitment to managing total return to shareholders. In addition to providing a competitive dividend, we repurchased 6.8 million shares of our common stock during the first quarter.

I will take you through our first-quarter results in a moment but it's important to reiterate Marc's sentiment that we have our eye on the prize. The business model innovation we are achieving as a Company, be it through our brands, infrastructure, technology, or the solutions we offer to our clients, all are keeping us on track for attaining our long-term objectives.

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Turning to the quarter, we again experienced positive trends in a number of key indicators. SMB equipment sales growth accelerated, which coupled with our recent market exits and previous EBIT margin improvements, reflect the successful transition in our go-to-market model in our SMB solutions group. Our pre-sort services continues to turn in the strong performance, once again growing revenue, and maintaining a strong EBIT margin.

Global e-commerce also continues to perform well, with improving trends in both retail and marketplace volumes, with particular strength from our UK marketplace. We also continued to add new brands to our retail platform.

Production mail and software results were below our expectations, and were impacted in part by a weaker macroeconomic environment. Our production mail results, which can be lumpy at times, were a function of a weak pipeline coming into 2016, a shift to third-party mailers, and recent small market exits. As a result of focused pipeline build, we expect this business to strengthen beginning in the second quarter.

As Marc discussed, we have more work to do in our software business as the new management team focuses on improving sales efficiency, and expanding our indirect channels to broaden our pipeline of opportunities, while also focusing on our new offerings.

When we provided guidance for 2016, we identified three factors that would affect our year-over-year comparison in the first quarter: First, the sale of our Imagitas business last May. Imagitas contributed about $0.02 to earnings per share last year, which was not repeated this year.

Second, incremental expenses related to our advertising campaign and ERP implementation. In aggregate, these lowered earnings per share lowered by $0.04 per share in the quarter compared to the prior year.

And third, we announced the exit of direct operations in Mexico, South Africa, and five markets in Asia, and the conversion of those markets to a dealer network. In aggregate, these markets generated approximately $6 million in revenue in last years first quarter, which was not repeated this year, and thus had an adverse impact on our revenue comparison, particularly in the international mail and production mail segments. I will detail this further when I review our segment results.

Let me now take you through the high level financial results, and then I'll drill down in each of the segment's results, and some provide additional color around our guidance. Please note that a reconciliation of adjusted to GAAP financial information can be found in the financial schedules in our earnings press release and earnings slides posted to our PitneyBowes.com website, under the investor relations section.

Revenue for the first quarter totaled $845 million, which was a decline of 3% on a constant currency basis, adjusted for recent market exits, a decline of 4% on a constant currency basis, and 5% on a reported basis. Revenue in our SMB segment group declined 3% on a constant currency basis, adjusted for recent market exits, declined 4% on a constant currency basis, and 5% on a reported basis.

Revenue in our enterprise business solutions group declined 1% on a constant currency basis adjusted for market exits, declined 2% on a constant currency basis, and 3% on a reported basis. Digital commerce solutions revenue grew 11% on a constant currency basis, and 9% on a reported basis.

Adjusted earnings per share from continuing operations were $0.34 for the first quarter. As noted, when compared to the prior year, our adjusted earnings per share results were $0.02 lower due to income in the prior year, before the sale of Imagitas, as well as $0.03 of incremental advertising expense and $0.01 of incremental ERP systems expense.

GAAP earnings per share were $0.30, which includes $0.02 in restructuring charges, and $0.01 in disposition costs related to the recent market exits. Free cash flow was $60 million, and we generated $58 million on a GAAP basis in cash from operations. Compared to prior year, free cash flow declined in part due to the early payments to critical vendors resulting from the go-live blackout period of the new ERP program in the US.

Free cash flow this quarter was also impacted by the lower net income which was partly due to the incremental expenses related to the advertising campaign, and ERP. The slower decline in finance receivables resulting from favorable equipment sales also impacted the comparison to prior year.

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During the quarter, we returned cash to our shareholders in the form of share repurchases and dividends. We spent $128 million on the repurchase of our common stock, buying 6.8 million shares in the quarter. We also paid $36 million in dividends to our common shareholders. Additionally, we made $22 million in restructuring payments, and made a $37 million contribution to our UK pension fund.

From a debt management perspective, we obtained $300 million of bank term loans, and refinanced a $371 million note that matured in January. We disclosed this information on our prior earnings call.

Turning to the income statement, adjusted earnings before interest and taxes, or adjusted EBIT, was $144 million this quarter, which was $34 million lower than the prior year, as a result of the incremental advertising and ERP expenses, the sale of Imagitas, acquisition costs related to Borderfree and the decline in revenue. Adjusted EBIT margin was 17%. Adding back depreciation and amortization, adjusted EBITDA for the quarter was $188 million.

SG&A for the quarter was $327 million, which was $12 million or 4% higher than the prior year. As a percent of revenue, SG&A was 38.7%, which was 340 basis points higher than the prior year. The increase in SG&A was the result of incremental costs associated with the new advertising campaign and ERP implementation, as well as the net increase in SG&A resulting from the acquisition of Borderfree. SG&A excluding these factors declined year-over-year.

During the quarter, we recorded a pre-tax restructuring charge of $7 million for actions taken in the first quarter to align our operations. Net interest expense, which includes financing interest, was $34 million, which was a decline of about $9 million when compared to the prior year. Average outstanding borrowings during the quarter were $178 million lower than the prior year.

The average interest rate this quarter was 4.66%, which was 74 basis points lower than the prior year. The effective tax rate on adjusted earnings for the quarter was 36.7%, which was 60 basis points lower than the prior year's tax rate, but above our expected tax rate for the full year, which we expect to still be between 32% and 35%.

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 post to the PB.com website under the investor relations section.

For SMB solutions, in North American mailing, revenue for the quarter was $350 million and EBIT was $156 million. Revenue declined 3%, both on a constant currency and a reported basis. The rate of decline in revenue was in line with the prior quarter's results, which reflects a portfolio that is stabilizing, and the maturing of our go-to-market changes, as well as our targeted marketing initiatives.

On a constant currency basis, equipment sales grew a strong 6% over prior year, which was the highest rate of growth in several years. Recurring revenue streams continued to decline, but are expected to benefit in future periods, as the trend in equipment sales revenue improves. EBIT margin continued to perform strongly at 44.6%, reflecting ongoing focus on productivity improvements.

In the international mailing, revenue for the quarter was $104 million, and EBIT was $12 million. Revenue declined 7% on a constant currency basis, and 11% on a reported basis. Adjusting constant currency revenue for the recent market exits, revenue declined 5%, which is an improvement from prior quarters.

Revenue benefited from equipment sales growth in France, Germany and Japan, as the go-to-market strategy matures, and productivity benefits are being recognized. The decline in the recurring revenue stream was consistent with prior quarters, and the trend is expected to improve in future periods, as the trend in equipment sales revenue improves. EBIT margin was 11.4%, which was 130 basis points higher than prior year as a result of lower costs associated with the change in go-to-market.

Turning to enterprise business solutions, in production mail, revenue for the quarter was $87 million and EBIT was $7 million. Revenue declined 11% on a constant currency basis, and 12% on a reported basis. Adjusting constant currency revenue for the recent market exits, revenue declined 8%.

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Equipment sales declined from prior year, partly due to fewer inserting equipment installations, and the timing of closing some large deals. Support services and supplies revenue declined, in part as a result of some in-house mailers shifting their mail processing to third-party outsourcers, and the recent market exits.

EBIT margin was 7.8%, which was a decline of 130 basis points versus the prior year, due to the lower revenue, especially the higher-margin inserting equipment sales. In pre-sort services, revenue for the quarter was $127 million, and EBIT was $29 million.

Revenue and EBIT both grew 5% on a constant currency basis, and reported basis. Revenue benefited from the higher volume of first-class mail processed, as well as expansion into the St. Louis market. EBIT margin continued to perform strongly at 22.7%.

Turning to digital commerce solutions, in software, revenue for the quarter was $78 million and EBIT was a loss of $3 million. Revenue declined 7% on a constant currency basis, and 10% on a reported basis. Revenue declined due to fewer large licensing deals, and lower data-related licenses versus the prior year.

The Company is expanding its channel reach and focus on several high potential industries and solutions, which have longer sales cycles. As I mentioned earlier, the new management team is focused on improving sales efficiency and expanding our indirect channel to build the opportunity pipeline.

EBIT margin was a negative 3% largely as a result of the lower licensing revenue, which has a high margin, and increased selling and marketing investments. In global e-commerce, revenue for the quarter was $98 million, and EBIT was about $1 million. Revenue grew 31% on a constant currency basis, and 30% on a reported basis.

Results included another full quarter of revenue from Borderfree. In the quarter, we grew the number of retail storefront clients, and had strong growth in the UK marketplace. And although the stronger US dollar continued to have an impact on outbound demand, the recent trading range against key buying currencies resulted in improving volume trends through the course of the quarter in our US marketplace.

EBIT margin was about 1%, due to the amortization of acquisition-related intangible assets and investments in the business, which more than offset early synergy savings. The business remains on track to achieve its synergy run rate objective by the end of the year.

That concludes my remarks on the segments. Let me now take a moment to discuss our 2016 guidance. The Company is reaffirming its annual revenue growth, adjusted earnings per share and free cash flow guidance. We expect revenue on a constant currency basis to be in the range of a 1% decline to 2% growth.

We also expect earnings per share to be in the range of $1.80 to $2, on both an adjusted and GAAP basis. We also expect free cash flow to be in the range of $425 million to $525 million.

It is important to note that the recent market exits will have an adverse impact on revenue comparisons each quarter this year. In aggregate, the markets we exited generated approximately $26 million in revenue in 2015, and had an immaterial earnings contribution.

While we have moved to indirect operations in most of those markets, we do not expect the same level of revenue in 2016, particularly in equipment sales and support services, which will negatively impact our year-over-year comparisons. We're providing further detail on the timing of advertising and ERP expenses among the quarters. For the year, we now expect incremental marketing expense in the second quarter to have a similar impact on earnings as the first quarter.

The change in timing of the expense is related in part to an extension of the Company's advertising campaign, and support for the launch of the new Pitney Bowes Commerce Cloud solutions. Total annual expense is expected to remain the same.

Incremental ERP expense is expected to be the highest in the second quarter, as the Company supports the post-launch implementation phase of its ERP platform in the US. The aggregate of these incremental advertising and ERP expenses in the second quarter are expected to be at a similar

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level to the impact on earnings in the first quarter, or approximately $0.04 per share higher than the prior year. As a reminder, we still expect to recognize the early benefits from the ERP implementation some time in the third quarter, and then ramp up more in the fourth quarter.

Before I open the line for questions, I'd like to take a moment to note the recent launch of our Commerce Cloud, which is enabled by our new ERP platform. The Commerce Cloud is a commerce enabler, providing access to solutions, analytics and APIs across the full commerce continuum. The Commerce Cloud will enable us to easily and quickly provide our solutions and capabilities to all our clients.

As many of these SaaS based solutions will be subscription or usage-based, the financial impact will build over time, especially as we continue to add new applications. The Commerce Cloud and ERP platform are providing new value to our existing clients, and the opportunity to acquire new clients.

Operator, that concludes my remarks. Please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We'll go to the line of Kartik Mehta with Northcoast Research.

Kartik Mehta - *Northcoast Research - Analyst*

Marc, I just wanted to ask you a little bit more about the software business. It seems like you have confidence that business can turn around, but it's not performed up to your expectations the last couple of quarters. I'm wondering, what gives you the confidence that can turn around, or what changes have been made that you can talk about, that would give others confidence that business could turn around?

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

Thanks for the question, Kartik. I think it's an excellent question, and one we obviously thought a lot about.

So let me start with the market. If you look at the market in the first quarter, business investment in the United States was down 6%. If you look at several of the large technology companies, they had, I would say, similar results, so it's not a great market. And as you know, our long term aspirations for this business are exactly that, long term, so they transcend any one quarter.

Let me, that being said, I still think we can do better than the market here, and let me give you a little bit of texture on the kinds of execution issues that we talked about. So there's different buckets. The first, and Mike mentioned it, one of the places where we've been working, and this, by the way, isn't the last three or four months, this is the last several years, is to build an indirect channel with systems integrators. We're making progress on that, albeit it's much slower than I would like. And by systems integrators, it's the large technology systems integrators that you would be familiar with.

Another change that we're making: Our services attach rate to our license revenue has been less than what we thought, so we changed the compensation model to pay our sales force for services attach rate. To give you a third example, we had too much of our resource stacked up on our installed base, so in the first quarter, and by the way, again, this was something contemplated before the previous regime, so I don't want to paint this as something the new guys have thought of. This is something that started well before. But we had too much of our resource base, too much of our resource stacked on our install base.

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So those are three examples and now let me get to the underneath part of your question. Why not continue the confidence? First of all, if you look at the nature of the problems, these are problems that while frustrating, and there's no one more frustrated with our software performance than me, they're fixable. Secondly, what I take great umbrage in, and gives me the ultimate conference, is we got good products, and you can see it in the affirmation that we've gotten from third parties.

We've got important affirmation in the first quarter. You can see it in the quality and sophistication of the clients that are buying our software. We just need to do a better job executing, so that gives you a texture of how I think about the problem, why I'm confident, and we will improve going forward.

Kartik Mehta - *Northcoast Research - Analyst*

Marc, just the software business over the last couple of years, have you made changes to sales comp that you'd think could have resulted in this issue, or have there been changes in the sales force that maybe as a result are taking a little bit longer for you to see the results you want? Could any of those issues have impacted the business?

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

I would say we fine tuned the comp model in 2013, 2014, and 2015, that's what I'd say is the ongoing process. I don't personally consider any of those changes that have been made the last several years, that material. In terms of things that take longer, it does take longer to build an indirect sales channel. These arrangements with systems integrators take awhile to land. Candidly, they've taken longer than I would hope. I've now personally interjected myself in those conversations, reaching out to my peers of these firms, to see if we can accelerate it.

And finally moving resources to white space, while something I'm highly confident will pay off over the long term, takes a while. So you've got new folks calling on new clients, they have to establish those relationships, they've got to reintroduce Pitney Bowes to these clients, and it underlines why the advertising campaign is so important. The advertising campaign is so important for multiple different reasons, but as you're trying to break into new markets, whether that be systems integrators or any other aspects of indirect channel or new customers, having a degree of air cover so that we spend a little bit less time explaining who we are and the technology that we have, and more time focused in on the client issues is a good thing.

Kartik Mehta - *Northcoast Research - Analyst*

And then Mike, just wanted to get your perspective on the second quarter. I know you gave some remarks about how you think second quarter outlook is going to be, but I just want to make sure that we're on the same page. As you look at the second quarter and some of the expenses related, were your comments more intended to say that second-quarter earnings would mirror first quarter, or were you saying that second quarter for this year would be equivalent to second quarter last year?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

I was just using year-over-year comparisons to highlight where there are differences. So to the extent that people look at prior year to extrapolate from a given quarter, what I was highlighting was the fact that on a year-over-year basis, there is about $0.04 of incremental expenses specifically related to marketing and ERP. That was not a comparison to the first quarter, only a comparison on a year-over-year basis in the second quarter.

Kartik Mehta - *Northcoast Research - Analyst*

Just last question, Mike, obviously the first quarter didn't start off like you wanted it to, but you seem confident about the full year at least from a guidance standpoint. And I'm wondering why the confidence? Is it the pipeline of business that you see, or something else, just greater cost savings than you anticipated? Maybe what are the things that make you comfortable with the guidance?

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Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Yes, in terms of what makes us comfortable, I think they are all the same things that we talked about at our Analyst day, and when we gave guidance, originally. So you do have a first quarter versus the rest of the year, or first half second half, where we have significant higher marketing costs, related to our advertising campaign in the first half versus the second half. We have higher ERP expenses because of the launch of our ERP program in North America, and settling of that out.

That reverses itself in the second half, where the expenses related to build and all begin to come down, and then the benefits start to accrue to us. In addition to that, we fully expect to get the full amount of synergies in our e-commerce business, that we had outlined, and that's part of our confidence as well. So a number of things as well as obviously we would expect, as we talked about, improvements in the underlying operations of the business, in line with the comments you heard.

Kartik Mehta - *Northcoast Research - Analyst*

Thank you very much.

Operator

We'll go to the line of George Tong with Piper Jaffrey.

George Tong - *Piper Jaffray - Analyst*

With the US dollar weaker in Q1, can you discuss how much of a lift that provided to cross border e-commerce volumes, and highlight factors that may have prevented e-commerce revenue growth from accelerating above Q4 levels?

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

So first of all, we did, as you point out, George, see the strengthening of other currencies vis-a-vis the dollar, and we noticed that almost immediately in our business. It was, predominantly we realized the benefits more in March than we did in the first two months. It is one of the things that gives us confidence as we get into the balance, the rest of the year. Of particular interest is the Canadian Dollar and the Australian currency, and both of those strengthened vis-a-vis the dollar.

So we think that turns from what has been a headwind for the last several quarters to something that potentially can help us more in the back half of the year. We'll see how it unfolds. A lot of people have guessed on our currencies over the last couple of years, and a lot of people have lost. So while a couple months doesn't make a trend, we'd like this currency environment to stay this way and continue to move, but it's going to be predicated on what happens with interest rates in the United States and around the world, and that's hard to call.

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

George I would say relative to the fourth quarter obviously there's some seasonality that plays into that as well. Fourth quarter is always the biggest quarter because of the holiday period, and first quarter is generally a slower, if not the slowest quarter in the year, from an e-commerce cross border perspective. So the performance relative to that is also affected by seasonality.

George Tong - *Piper Jaffray - Analyst*

Got it. Would you expect, if you look at the growth from a year on year perspective, does that help wash away some of the seasonality?

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Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Maybe you can explain a little bit more about what you're asking?

George Tong - *Piper Jaffray - Analyst*

Yes, we can I guess, take that question offline. In the quarter, SG&A as a percentage of revenue increased about 300 BPs on a year-on-year basis. Notwithstanding incremental costs from the ERP implementation and marketing campaign, could you describe where expenses may have exceeded expectations?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

I think generally, they were in line with what we would have expected. I think the other big variable from a year-over-year basis is the inclusion of the costs associated with the Borderfree acquisition, so that would be the amortization of intangibles and the like versus Imagitas, which had a relatively low SG&A load. So that's one of the other drivers of comparability. As we go forward we begin to recognize the benefits of the ERP program, we'll begin to see that reverse back.

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

I'll just build on your question a touch. I mean if you look at the primary variances in first quarter from what we expected versus what we saw, it really was, as we said, principally around software expense followed, pretty much what we thought, the other businesses followed what we thought. Production we knew was going to be lumpy. We thought there might be some deals in the first quarter, it turns out they were second quarter. But when we say the quarter turned out the way we expected, save one item, that's how we saw it.

George Tong - *Piper Jaffray - Analyst*

Very helpful. And lastly, last week, you introduced your new Commerce Cloud software offering. Can you discuss when you might expect to see revenue contributions from that launch and what the opportunities and challenges might be from a competitive and execution perspective?

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

We expect to see revenue from that in the second quarter and we've already seen first-day orders, and we're moving forward. That said, I think it's important to understand that this is principally a SaaS-based model, and if you look at the evolution of SaaS-based companies, and this is salesforce.com in 1999 and several others, it's a slow build, and that's what we expect here. But it was written about by several analysts this week, we see this as foundation to begin to unlock a whole new dimension of value to our 1.5 million clients, so we're taking orders, it will help, but this is mostly material from a long-term perspective.

George Tong - *Piper Jaffray - Analyst*

Great, thank you very much.

Operator

Our next question will come from Ananda Baruah from Brean Capital.

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Ananda Baruah - *Brean Capital, LLC - Analyst*

Actually, I'd like to congratulate you on a pretty solid operational quarter, and I'd like to start Marc, my questions from there. The headline EPS obviously is a bit of a miss, but operationally, the revs were just 3% off of Street, and software explains all of that. And the EBIT was just 3% off of Street and the software explains all of that. So our mass mark completely aligns with your comments. And I guess what was a little bit different in our model, aside from software, would be the interest, tax and other income. So that I would love to get, Mike maybe just thoughts around how we should think about that, the non-operational stuff going forward, and then I have a couple quick follow-ups. Thanks.

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Sure, on interest as I mentioned, we're year-over-year about $178 million lower in average debt outstanding in the quarter, so that's a factor. We have a little bit more of a mix because we did some term loans of floating rate versus fixed rate, which has driven the overall interest rate down. So we would expect interest expense to continue to have some favorability on a year-over-year basis.

But with respect to taxes, we had a higher than projected full-year tax rate in the first quarter, in large part because of the concentration of our earnings in the US, which has a higher average tax rate. So to the extent that we start to see a little better mix of earnings outside the US, and software being 50% outside the US, is part of that factor, as well. We're still projecting an annualized tax rate in the 32% to 35% range, albeit we might be trending a little bit towards the higher end than the midpoint.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Got it, that's helpful. So sounds like some mitigation on taxes as we go through the year, but interest expense should we think of as being relatively stable from a dollar perspective, as we move through the year?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Obviously it will all depend on any changes in our overall debt levels, but I think the factors I described of lower average interest rate, which you saw in about 4.66% versus 5%-plus last year and the lower average balances should keep interest expense down on a year-over-year basis.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Okay, great. And then Marc, going back to what's been I guess the success in the core metering business over the last few quarters, I believe this might be the third quarter in a row where you've had equipment sales growth. And it sounds like you feel pretty good about the potential for maybe even the growth to hold in the near term. I'd love to just get your view on how you'd like us to think about not just the sustainability of what's been the equipment sales dynamic and how that's manifested into the revenue growth dynamic, but also, where maybe you guys follow that you are holistically.

In the saturation of the inside sales force, I don't think you're quite there yet, in Europe, what you sort of announced this week ties into the web-based aspect. Is that the entirety of the web-based dynamic, the interfacing, or is there more to go there? And the comments on the call you made about St. Louis expansion and increase in its first mail volume, I'd love to just get your holistic view on that, so we can dimension that appropriately. I know that's a lot.

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

A heck of a question. So I continue to think about our SMB and mailing business in the same dimensions that I always have, that we can get that business stabilized, that market is between minus 2% to minus 4% and we're at minus 3%-ish in the first quarter. Clearly with equipment sales 6%,

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that means streams will catch up with that. And you're right, that's been for the last several quarters, so we just plan that takes a year or so to begin to run through the balance sheet, but the trends are clear.

I would take the opportunity to talk about the balance of the year and equipment sales. We think there's more we can do here. That said, our second quarter may be, with the deployment of impact in ERP, we've got work to do in the second quarter as it relates to equipment sales. So there might be timing issues second quarter to third quarter, but I think the trend over the last few quarters is clear, and that new go-to-market as we move from face-to-face sales to inside sales is not only stabilizing, but it's beginning to work.

That being said, there is another turn of the crank, and you intimated it, as we move to the web. So one of the important things about the new technology platform that we have rolled out, one of the important things about the Commerce Cloud announcements is digitally enabling our relationships with our clients. So that not only allows you more efficiency, but it will provide you a better way to make realtime offers to those clients. So it's one thing to make calls to 1.5 million clients. It's another thing to send out a e-mail blast to 1.5 million clients, targeted based on their particular usage.

So I think there's another turn of the crank here that will take us awhile to get to, and then you throw on top of that the ability to drive new content into those relationships, and I think you've got a whole new ballgame. And that's why we are so excited about what we talked about last week.

It is admittedly to the previous question, it's going to be a slow burn, but to have these 1.5 million client relationships, and now have the ability to digitally interact with them and drive new content, new value into those relationships, that I believe is a game changer for us. So we're really excited about where we sit with that.

Ananda Baruah - *Brean Capital, LLC - Analyst*

That's great. That's good context, and I appreciate it. And just to finish that out, just as the remarks about St. Louis expansion and increase in first class mail that were in the prepared remarks?

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

Sorry I forgot. I'll let Mike do that one.

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Sure, so in terms of pre-sort we continue to have a very solid growth in that business at 5% top line growth. That really was driven by increasing first class mail volumes, and the reference to St. Louis, as we continue to see opportunities for expansion of the network, given our ability to process mail and move it across the country. So we'll continue to look at other market opportunities for the pre-sort business to leverage the efficiency of that network.

Ananda Baruah - *Brean Capital, LLC - Analyst*

I've got it. Okay, great. Thanks a lot.

Operator

Our next question will come from Shannon Cross with Cross Research.

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Shannon Cross - *Cross Research - Analyst*

Mike, a question for you. I'm just trying to go back to the EPS. Given the EPS miss relative to expectations this quarter, or at least relative to where the Street was at, I'm trying to figure out how to think about second quarter, and I understand you have incremental expense related to ERP, and the marketing, which is $0.04. Tax looks like it will be, on a year-over-year basis, somewhat negative. And then you have benefit from share repurchase.

So I'm just looking at the Street at $0.46, and looking at the fact that you did $0.34 this quarter and trying to think about where we should all, in your mind, come out given the puts and takes. So maybe if you can just walk us through again, because I'd rather not see another quarter like this, where we obviously were off relative to where your expectations were, given the underlying trends in your business, so anything you can give us to walk through that would be really helpful.

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Sure. So very specifically, I would say where we modified our guidance was in the timing of marketing expense So where we indicated last quarter that we expected the first and fourth quarters to be the highest for marketing expense spend, we shifted that. We're continuing some of our advertising spend into the second quarter. We're supporting our Commerce Cloud launch. So we've increased that Marketing spend anticipation, so as I said, the marketing expense second quarter versus second quarter last year, we expect to be $0.03 higher.

ERP, now that we're out live with the US in April, we're now in that, what we call hyper care period, where we really are going through and investing all of the training and those types of things. We said that's a $0.01 or so higher than the prior year. I think those are two things that are specific guidance adjustments that we've made, in terms of timing of expenses. Now knowing that we've got the system out and knowing what we want to do in terms to support a Commerce Cloud and advertising.

Beyond that, I think the biggest variable from the first quarter is what the questions were about, which is the performance of the software business. And as Marc said, we expect to continue to see improvement in there, but it's not quite where we wanted to be yet. So I would say those are the major variables on a year-over-year basis.

Shannon Cross - *Cross Research - Analyst*

Okay thank you and then can you talk a bit about, as the revenue comes through from the Commerce Cloud, what segments we should expect to see it in? Because I mean, it's SMB and probably tied somewhat to the mail meters, but also I think there are parts of it that are commerce, and parts of it that are software so how should we think about it, as it ramps through your business?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Yes, so in terms of the Commerce Cloud, as you saw, there were five different solutions that were announced initially, and there will be additional as we go forward. Some of those will accrue, particularly the software and the e-commerce related ones will accrue to the DCS businesses, e-commerce and software businesses, location intelligence in the software business.

Where you'll see some accruing to the SMB business will be particularly around SendPro, which is the multi-carrier shipping solution. There are add-on products around SendPro, so we have something called a SendKit that provides scale and other solutions for a printer, label printer, for using the SendPro application.

And then we've included the SendPro application in our high end meter series as well, so it's accessible through that. So in that case it accrues as basically a subscription added on to that equipment sale. So those are the main ways that it will affect the SMB business. To Marc's earlier comment, in most all these cases they will generate levels of recurring revenue that will help further mitigate the declines we've seen in some of our recurring revenue streams.

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

Shannon, can I just build on your question for a second, because it's one we're thinking about a lot, as the business evolves, how it is that we portray ourselves in a way we are easily understandable. But one of the points that we've made for a while is the import of our digital capabilities transcends our software segment. So a lot of these capabilities are things that were capabilities that were born or nested within our software business, per se. Other businesses are accruing the benefits of those, so it's an important question, it's an important question in how we present ourselves, but it's also I think an important question in terms of how it is that we amortize these capabilities over the breadth of the business.

Shannon Cross - *Cross Research - Analyst*

Great, thank you. And maybe Marc, if you can talk a bit about, and now I absolutely lost my question, but here hold on one second, because I did write it down. If you can talk a bit about any more divestitures, and you've done a good job of cleaning the business up. There have been a number of things that have moved, and clearly we understand going indirect in some of the countries that you're going indirect in this quarter.

But as you look at sort of the assets you have right now, do you think we're through that period, and so we won't have some of these where you've got to pull revenue out, even though its business is still ongoing? And then also, are there any other areas where you think you might want to augment more?

And of course I'm getting back to my usual use of cash question here at the end of this. So just any discussion about that? And then also, you're getting through the end of the share repurchase. Any more thoughts on what your Board is thinking with regard to return of cash to shareholders? Thanks.

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

Sure, so again, great question. The way I think about the portfolio, broadly, is the portfolio needs to be congruent with three basic principles: They got to be leaders in their businesses, they have got to be strategically coherent, and they have to cover their return on invested capital.

The problem with answering your question is those dynamics move, so as value continues to move in different segments, then that equation changes. So we will continue to evaluate the portfolio in context of what we think is the best decision for our shareholders, and best way to create value. So in the end, I like all of the businesses, I'm wed to none of them. And we will continue to evaluate a business's role in the portfolio vis-a-vis those three strategic criteria.

As it relates to potential acquisitions, our focus continues to be within our digital commerce space broadly, and e-commerce, I would say is the first amongst equals, but that's where we think we can get the best return for our shareholders. But again we've put pretty strict criteria in terms of the types of financial metrics that acquisitions would have to conform to, and we are not backing off those.

And what I would say is acquisitions appear to us right now to be pretty expensive, so that's not to say we won't do some, but when we look around the neighborhood, it seems it's hard for us to close the math. So we continue to look. We continue to think that's an important option to have available to us, but at these prices, hard to close the math.

In terms of uses of cash, one again, a question that we think about a lot, I would just double click on your point. I mean, we did buy 6 million shares in the first quarter, and if you look out from 2015 to 2016, those two years, we're close to $260 million of share repurchases. If you put that in context of what we said at Analyst day, we talked about $1 billion of available free cash balance between acquisitions and return of cash to shareholders, with a bias towards return of cash to shareholders.

So I think we're fulfilling that promise, as we saw, at that time. In terms of conversations with the shareholders, you wouldn't expect that conversations with the Board, you wouldn't expect I would reveal that, beyond that this is an ongoing conversation that we talk at about almost every Board meeting in terms of trying to balance our uses of cash in a way that generates the best return for our shareholders.

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Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Shannon, I would just note that at the end of the first quarter, we still had about $90 million of authorization outstanding. So we still have a ways to go on current authorization.

Shannon Cross - *Cross Research - Analyst*

Great, thank you very much.

Operator

Our next question will come from the line of Glenn Mattson with Ladenburg Thalmann.

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

I would echo Ananda's comments that the quarter was pretty good ex-software. But I would add that the SG&A expense is a little higher than I expected, about $7 million. And given the fact that you shifted the expense throughout the year from a barbell approach to more front-end loaded, Mike, can you just give us an update if you include the cost savings expected this year from less expense on ERP, netted with the higher marketing expense, what the SG&A would be year-over-year for the full year?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

What I would say is we have not changed our annual outlook for, obviously for earnings per share, and quite frankly on these expense items. So in aggregate, they're still in line with what we outlined for the full year. It's really more of a timing related issue. So those are baked into our assumptions, with the higher expenses in the first half of the year, and those coming down in the second half of the year.

From a marketing perspective, the full year, we did talk to the fact that we had higher year-over-year total expense for the year, and then we're trying to give some greater clarity on the timing of it. ERP, highest in the first half and then declining in the second half. As we begin to ramp down, we still have some smaller markets to implement, but the bulk of the big build done, and then beginning to get the benefits. So in aggregate on the year, we don't expect to change.

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

But I guess at this point you are confident you won't come back in the middle of summer and evaluate this and say, we really need to continue to support these new initiatives, the Commerce Cloud and whatnot, and raise the marketing expense as we look in Q4?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

I would say that's something we obviously continue to look at, but our plan right now encompasses the expenses, as I laid it out. I would assume if we're having a tremendous benefit from it, we would always reconsider it, but that is the plan as we have it right now.

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

I would say the other thing on the advertisement in particular, as you get into the back half of the year with the political campaigns going on, the advertising buys get progressively more expensive. So it's a different dynamic as you contemplate the second half of the year than it is right now.

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

Okay, thanks. And then just as we talk about the software. Two comments you made, one that it was somewhat lower in the data related revenue, I'm wondering a little more clarity on what that means. And secondly, I think Mark you mentioned tying the business to industries, high impact industries, something along those lines that have longer sales cycles. So can you talk about where we are in penetrating that longer sales cycle at this point?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Yes, on the first one, we generally find that with license revenue, there's also the opportunity for data sets to be sold into that as well. So on the lower license revenue, we did see some lower data as well, so that was part of the overall revenue challenge in software in the first quarter.

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

As it relates to your second question, one of the changes that began with the last year and we continue with this year is we've taken a portion of our software sales force, moved them from an industry focus to more of a solution focus. So for example, move people from the finance industry to financial crimes. As we did that, and this is the part that takes a little bit longer, we've moved them to what we call white space. So think of that moving the resource from the install base to prospects. So that's what takes a while longer to begin to realize the benefits.

The other thing I'd say about software is in the context of the size of this business, 5 or 10 transactions can make a big difference one way or the other in a quarter. So it's one thing when you have a volume based business that gets behind, and trying to catch up throughout the course of the year. It's another thing when you have a business that has the potential for larger transactions to catch up.

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

Okay great, thanks.

Operator

Our next question comes from Chapin Mechem with Northeast Investors.

Chapin Mechem - *Northeast Investors - Analyst*

I know that you haven't talked over, but I'm wondering if you can address the PBIH preferreds, and what your plans are for them?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

We continue to evaluate the market on those, and whether we do a similar type of PBIH offering, or if we were to replace it with traditional PBI debt. But we have an ongoing evaluation of the market.

Chapin Mechem - *Northeast Investors - Analyst*

So it sounds though like you'll probably do something with them, not extend on them in October?

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Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

I would say it's very probable we will do something with them rather than extend them, because the rate on those goes up quite a bit.

Chapin Mechem - *Northeast Investors - Analyst*

Great, thank you.

Operator

Our next question will come from the line of Allen Klee with Sidoti.

Allen Klee - *Sidoti & Company - Analyst*

In the prior two years, if we look at the first quarter versus the second quarter, we've seen a jump up of $0.04 to $0.05 in EPS sequentially. Could you remind us of what's been behind that, and if there's any reason that anything has changed on that?

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

Yes, there is always seasonality. First quarter is generally always, particularly for the mailing business, the lightest revenue quarter, and the fourth quarter tends to be the greatest. But the second and third are usually bigger than the first. There's also some seasonality in some of the other businesses, particularly the software business as well, which generally class its largest quarter in the fourth quarter and its lightest quarter in the first quarter. So a lot of that is related to client buying cycles, and that generally gets better in the second and third quarter, relative to the first.

Allen Klee - *Sidoti & Company - Analyst*

Okay, great and then on software, I had two questions, and I don't know if I missed this. But first, have you said anything or any thoughts about a growth rate for the year? And second, it seems like in the last couple of quarters, the competitive environment has gotten tougher, I would imagine, and can you comment on that also? Thank you.

Michael Monahan - *Pitney Bowes Inc. - EVP, COO and CFO*

In terms of the growth rate, we haven't given a growth rate specific to the software business. We do expect the DCS business as a whole to be a double digit grower, and that incorporates software, so that's within that context.

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

In terms of competitive environment I don't think anything has materially changed in the competitive environment over the last couple of quarters. These have been and continue to be competitive marketplaces, there's a lot of great companies in there. That being said, we've evaluated the competitive dynamics of all these segments and businesses that we're in, and we're comfortable we can manage them.

Allen Klee - *Sidoti & Company - Analyst*

Okay, thank you.

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Operator

Currently, we have no further questions in queue.

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

Great, so out of deference to everyone's time, let me wrap up. Before I close, I would like to acknowledge Charlie McBride. As you all know, we announced Adam David as our new Vice President of Investor Relations. Consequently, this will be Charlie's last call with all of us.

Charlie's been a longstanding and important contributor to Pitney Bowes, he's been here for 42 years, he's been in this particular role for 19. That's 76 quarters for those of you who think of life in that context as I do. And I can't tell you how important he's been to our transformation and to me personally.

Charlie's been a tireless advisor, he has helped us in what has been a very difficult transition over the last couple of years, and I personally will miss him, and I wanted to take this opportunity to acknowledge and thank Charlie for all he's done for our Company for the last over four decades, which is hard to even contemplate. So Charlie, I will miss you, and thank you for all you've done.

Let me now close. It's easy to get lost in a maze of numbers, but the bottom line is we continue to make good progress in transforming our business. Our advertising campaign to reintroduce PB to the world, the deployment of our totally reengineered processes and technology for 80% of our business, setting the stage for substantial benefit realization, resumption of equipment sales, our cash generation machine in North America, and finally the introduction of PB Commerce Cloud opening up a whole new set of opportunities to our 1.5 million clients.

Bottom line, we're creating the foundation for our Company to be successful well into the future. I've never been more confident about our ability to deliver long-term strategic value to our shareholders, as I've said countless times before, transformations are not a straight line. We admittedly have some things that we need to clean up, but I think as we talked about, if you look at the body of work that we are undertaking, the problems have become very isolated into a single dimension.

That's not to say we won't have future problems in different places, but as we contemplate our transformation, we're now down to a fairly narrow set of problems that I think are manageable. We've got a lot more to do, but we have created the foundation for this Company to be successful well into the future. So we'll talk again in 90 days. Thank you for your attention this morning.

Operator

And ladies and gentlemen this conference will be available for replay after 10:00 this morning and running through Friday, June 3 at midnight. You can access the AT&T Teleconference playback service by dialing 1-320-365-3844, and entering access code 389666. That number again, 1-320-365-3844, with the access code 389666.

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

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