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DXC.N - Q2 2018 DXC Technology Co Earnings Call

EVENT DATE/TIME: NOVEMBER 07, 2017 / 10:00PM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the DXC Second Quarter Earnings Call. Today's program is being recorded. At this time, I would like to hand the conference over to Mr. Jonathan Ford, Head of Investor Relations. Please go ahead, sir.

Jonathan Ford

Thank you, and good afternoon, everyone. I'm pleased you're joining us for DXC Technology's Second Quarter Fiscal 2018 Earnings Call. Our speakers on today's call will be Mike Lawrie, our Chairman, President and Chief Executive Officer; and Paul Saleh, our Chief Financial Officer. We've posted slides to our website at dxc.com/investorrelations, which will accompany our discussion today.

Slide 2 explains that the discussion will include comparisons of our results for the second quarter of fiscal 2018 to our pro forma combined company results for the second quarter of fiscal 2017. The pro forma results are based on historical quarterly statements of operations of each of CSC and the legacy Enterprise Services business of HPE or HPES, giving effect to the merger as if it had been consummated on April 2, 2016. As a consequence of CSC and HPES having different fiscal year-end dates, the pro forma combined company results include the results of operations of CSC for the 3 and 6 months ending September 30, 2016, and of HPES for the 3 and 6 months ending July 31, 2016.

Slide 3 informs our participants that DXC Technology's presentation includes certain non-GAAP financial measures and certain further adjustments to these measures, which we believe provide useful information to our investors. In accordance with SEC rules, we have provided a reconciliation of these measures to their respective and most directly comparable GAAP measures. These reconciliations can be found in the tables included in today's earnings release as well as in our supplemental slides. Both documents are available on the Investor Relations section of our website.

On Slide 4, you'll see that certain comments we make on the call will be forward-looking. These statements are subject to known and unknown risks and uncertainties, which could cause actual results to differ materially from those expressed on the call. A discussion of risks and uncertainties is included in our quarterly reports on Form 10-Q and other SEC filings.

I would like to remind our listeners that DXC Technology assumes no obligation to update the information presented on the call, except as required by law.

And now I'd like to introduce DXC Technology's Chairman, President and CEO, Mike Lawrie. Mike?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Okay. Thank you. Welcome, everyone. Thanks for your interest in DXC. As always, I've got 4 or 5 key messages. I will develop those in a little detail, and then Paul will come on. And then as always, we'll have an opportunity for some questions.

So first key message here is second quarter non-GAAP EPS was $1.93. This includes a cumulative benefit of $0.26 from reclassification of leases, which I'll cover in a moment.

EBIT, adjusted for restructuring, integration, amortization of intangibles was $876 million, including a cumulative benefit of $121 million from the lease reclassification. Adjusted EBIT margin was 14.2%, or 12.3% excluding the lease reclassification. We generated $589 million of adjusted free cash flow in the quarter.

Second point. Revenue in the second quarter was $6.163 billion on a GAAP basis. Excluding the impact of purchase price accounting, GAAP revenue was down 2.7% year-over-year and grew 2.5% sequentially. In constant currency, revenue was down 3.5% year-over-year and was flat sequentially. Book-to-bill was 1.0x for the quarter.

Third point. Excluding the impact of purchase price accounting, our digital GAAP revenue grew 23% year-over-year and 15% sequentially. Industry IP and BPS GAAP revenue was relatively flat year-over-year, driven by the completion of several large health care contracts last year. The 7.5% growth in the insurance business partially offset the decline in health care. And sequentially, industry IP BPS GAAP revenue grew 4%. And in the second quarter, our digital book-to-bill was 1.2x, and our industry IP BPS book-to-bill was also 1.2x.

Fourth point. During the second quarter, we continued to achieve key merger integration milestones. We're executing our synergy plan and are on track to meet our targets of $1 billion of year 1 cost savings as well as $1.5 billion of run rate cost savings exiting the year. We're also on track in the early stages of separating our U.S. Public Sector business and combining that company with Vencore Holding Corporation and KeyPoint Government Solutions. As discussed in our announcement on October 11, this will create a separate, mission-focused, independent, publicly traded technology company to serve U.S. government clients.

And then finally, for fiscal 2018, we continue to target revenue of $24 billion to $24.5 billion in constant currency. We're increasing our fiscal 2018 target for non-GAAP EPS to a range of $7.25 to $7.75, reflecting the benefit from the reclassification of leases.

On that basis, our adjusted free cash flow target will now be 90% of adjusted net income, since net income will include the benefit of the lease conversion and corresponding asset adjustments.

So let me just develop each one of those points in a little more detail. As I said, second quarter non-GAAP EPS was $1.93. This included a benefit of $0.26 from the reclassification of leases, which I'll talk about in a moment. The effective tax rate was 31%.

Second quarter EBIT, adjusted for restructuring, integration, and amortization of intangibles was $876 million. Adjusted EBIT margin on that basis was 14.2%. Adjusted EBIT in the quarter included a cumulative benefit of $121 million or $0.26 of EPS from the reclassification of HPES operating leases to capitalized leases and a corresponding adjustment of those assets to fair market value.

In subsequent quarters, we expect a continued benefit of roughly $60 million per quarter or $0.13 of EPS.

Excluding this benefit, adjusted EBIT would have been 12.3%, an increase of 630 basis points year-over-year and 80 basis points sequentially. The EBIT improvement reflects ongoing cost actions that we are taking consistent with the synergy plans outlined at our Investor Day, including automation and supply chain efficiencies. Our delivery teams continue to increase productivity and effectiveness through our global automation program, Bionics. By replacing manual tasks with automatic -- automated scripts, we minimize the labor required to support run environments, and we're also leveraging predictive analytics to reduce incidents by up to 70%. This significantly improves the stability of IT operations of our clients.

In supply chain, we're consolidating suppliers to create global, highly leveraged relationships to reduce costs and more effectively serve our clients. We're working closely with third-party providers to ensure that the benefits of scale are translating into realized savings at an account level. We're also leveraging our internal delivery productivity initiatives such as service desk automation to help reduce external spend. And collectively, second quarter cost actions generated approximately $110 million of in-quarter savings, which keeps us on track for $1 billion of fiscal 2018 synergy realization.

Adjusted free cash flow for the quarter was $589 million or 106% of adjusted net income. And for the year-to-date, adjusted free cash flow was $1.2 billion or 116% of adjusted net income.

Now, revenue in the second quarter was $6.163 billion on a GAAP basis. And in my comments to follow, all year-over-year and sequential comparisons exclude the impact of purchase price accounting on revenue. On a GAAP basis, revenue was down 2.7% year-over-year and grew 2.5% sequentially. In constant currency, revenue was down 3.5% year-over-year and flat sequentially. And total bookings in the second quarter were $5.95 billion for a book-to-bill of 1.0x.

In the second quarter, GBS revenue was $2.3 billion. On a GAAP basis, GBS revenue was down 3.2% year-over-year and grew 1.2%, sequentially. In constant currency, revenue was down 4.3% year-over-year and 1% sequentially.

As was the case last quarter, a large portion of this year-over-year decline was driven by the completion of 2 large government contracts in the U.K. GBS bookings were up 2% sequentially with a book-to-bill of 1.1x for the quarter.

And in the quarter, GBS segment margin was 16.4% compared with 11.1% in the prior year. There was very little impact in GBS from the lease adjustments, so the margin improvement reflects the impact of our cost takeout actions.

In the second quarter, GIS revenue was $3.1 billion. On a GAAP basis, GIS revenue was down 4% year-over-year and was up 3.1% sequentially. In constant currency, revenue was down 4.8% year-over-year and flat sequentially. GIS revenue reflects the continued moderation of headwinds in the legacy infrastructure business. GIS bookings of $2.8 billion were up 38% year-over-year and represent a book-to-bill of 0.9x.

In the quarter, GIS segment margin was 14.9% compared with 4.7% in the prior year. Now, excluding the impact of the lease reclassification and corresponding fair value adjustment of the assets associated with those leases, GIS margin was 12.2%, up 750 basis points year-over-year and 240 basis points sequentially, again reflecting cost actions and the automation of processes.

In the second quarter, USPS revenue was $710 million. USPS revenue was up 5.5% year-over-year and was up 4.2% sequentially. USPS bookings of $644 million were up 133% year-over-year and represented a book-to-bill of 0.9x. The USPS segment margin in the quarter was 15.4% compared with 10.1% in the prior year. Again, excluding the impact of the lease reclassification and corresponding fair value adjustment of the assets associated with those leases, margin in the second quarter was 10.8%. And I'll talk more in a moment about the separation of USPS business and the combination with Vencore KeyPoint.

DXC also in the quarter continued to expand its client base by adding 27 new logo deals greater than $1 million in total contract value.

Now let me move to our digital industry IP and BPS results. On a GAAP basis, digital revenue was up 23% year-over-year and up 15%, sequentially. Digital book-to-bill was 1.2x in the quarter. And as we've discussed, digital cuts across all 3 of DXC's reporting segments of GBS, GIS and USPS and includes enterprise cloud apps, consulting, cloud infrastructure, analytics and security.

Now, enterprise cloud apps and consulting GAAP revenue was up 26% year-over-year and up 16% sequentially. Book-to-bill in the quarter was 0.9x. The enterprise cloud apps team is continuing to drive this momentum by introducing 16 Quick Start offerings to help clients plan, pilot and test enterprise and cloud applications software, accelerating their digital business solutions with software from DXC as well as our strategic partners.

Cloud GAAP revenue was up 33% year-over-year and was up 25% sequentially. Bookings were up 24% year-over-year with a book-to-bill of 1.4x. The drivers of the bookings growth in cloud include a deal with a major insurance company to provide a large-scale digital transformation enabled by DXC's cloud offerings.

Analytics GAAP revenue was up 30% year-over-year and up 2% sequentially. Bookings were up year-over-year 24% with a book-to-bill of 1.1x.

Security GAAP revenue was down 4% year-over-year and was up 5% sequentially. We continue to invest in this business through increased hiring of security consultants, and we're already beginning to see growth in managed security services. And this was reflected in our bookings for the quarter, which were up 78% year-over-year with a book-to-bill of 1.6x.

Industry IP and BPS includes our IP offerings in health care, insurance, travel and transportation and banking as well as our industry business process services business. Industry IP and BPS GAAP revenue was relatively flat year-over-year and was up 4% sequentially, and the book-to-bill was 1.2x in the quarter.

Industry IP GAAP revenue was down 3% year-over-year and was up 5.5% sequentially. The year-over-year decline reflects the completion of several large health care contracts during the second quarter of last year. This was partially offset by 7.5% growth in the insurance business. And the book-to-bill in the quarter was 1.4x, including a large win with Lloyd's Market Association and the International Underwriting Association of London. We developed a transformation road map that builds on DXC's deep industry vertical expertise while leveraging our end-to-end offerings across both traditional and digital capabilities.

BPS GAAP revenue was up 1.9% year-over-year and was up 2.5% sequentially. And the book-to-bill in the quarter was 1 -- was 0.9x. The revenue growth is driven by the continued ramp-up of our large insurance contracts such as MetLife. We also had several key wins in the second quarter at large global banks. These deals leverage solutions such as our cognitive knowledge center, which significantly reduces call volumes handled by human operators by providing automated natural language answers to branch employees' inquiries.

Now as I previously discussed, a new transformation-oriented sales motion is needed to capture the shift from traditional to digital that is occurring in the marketplace. We formed a new digital business team to shape a unified digital transformation approach, leveraging assets from across the company as well as our partners. The objective is to jointly develop digital road maps with our clients, targeting clear business outcomes and efficiency gains in traditional IT, while unlocking greater share of wallet and overall revenue growth for DXC.

Now in the quarter, we continued to expand our partner offerings, including solutions to more effectively leverage the benefits of public cloud and greater breadth for our go-to-market alliance with PwC.

We announced new application and managed services offerings for Microsoft Azure and the Azure stack. These offerings provide a wide range of services to accelerate and scale digital strategies across public and private clouds. They include application services, analytics offerings and hybrid cloud solutions based on the Azure stack.

With VMware, we announced an expansion of our long-standing partnership with the unveiling of new DXC managed cloud services enabled by VMware's next-generation hybrid cloud services platforms. This expansion allows clients to move existing workloads to AWS and also connect native AWS workloads to the enterprise while maintaining service visibility and operational control.

Our alliance with PwC also continues to show positive momentum with a significant win during the quarter with luxury brands, Bally, Jimmy Choo and Belstaff. In collaboration with PwC, DXC will optimize their e-commerce, finance and accounting services to reduce operating costs and deliver process innovation. We're also strengthening the pipeline with PwC by expanding areas where we provide services for each other that we can then take to market together. And we currently have 2 dozen large accounts where we're teaming to develop joint proposals for digital transformations.

We also continued to invest in the business and our people consistent with the plan we outlined at Investor Day.

We recently announced the acquisition of Logicalis, a leading European provider of technology-enabled solutions for the service management sector. The combination of Logicalis with DXC's Fruition Partners business further solidifies DXC as one of the most experienced global integrators for ServiceNow, a key strategic partner.

We also continue to focus on the most important asset for our services organization, our people. DXC University now provides over 120,000 learning assets, including training courses, videos and e-books. And more than 85,000 employees have completed training programs so far this year. We're expanding our sales training and certification program beyond our go-to-market teams. And almost 16,000 employees have completed the training and passed the certification exam. We also established certification training programs with strategic partners, including AWS and Microsoft Azure.

We're gaining traction on the Dynamic Talent Cloud, our crowdsourcing platform that enables us to bring new people and skills to DXC in a more flexible way. This platform links us to individual practitioners in the industry, and we leverage algorithms to match specific skills to projects, assign work, evaluate performance and then determine appropriate rewards. This allows us to better serve our clients while increasing the flexibility of our workforce and talent base. We're rolling out the pilot globally, and we have about 5,000 subscribers now engaged.

Now the fourth point. We achieved several key merger integration milestones during the second quarter and continue to execute on the build, sell, deliver operating model we previously discussed. We're on track to meet our targets of $1 billion of year 1 cost savings and $1.5 billion of run rate cost savings exiting fiscal 2018.

As we announced on October 11, we're combining our USPS business with Vencore and KeyPoint to create a separate, mission-focused, independent, publicly traded technology company to serve U.S. government clients. The new company will be highly differentiated, mission-enabled solution provider with meaningful scale and end-to-end technology solutions. We will be 1 of the top 5 independent IT service providers to the U.S. federal, state and defense sectors. The company will have approximately $4.3 billion in combined revenues and a highly skilled workforce of more than 14,000 people.

DXC will continue to serve global commercial and non-U. S. government clients across 70 countries. Our mission will remain the same, leading clients on their digital transformation journey with diversified next-generation IT offerings, industry-leading partnerships and innovation and delivery excellence.

And for our clients, employees, shareholders and our partners, it will be business as usual. We have launched planning and integration efforts targeting a deal close by the end of March of 2018. And prior to that, we will schedule an Investor Day for the new company.

And then finally, before I turn this over to Paul, for fiscal 2018, we continue to expect revenue to be $24 billion to $24.5 billion in constant currency. And as I said earlier, we're increasing our target for non-GAAP EPS to a range of $7.25 to $7.75, reflecting the benefit from the reclassification of leases. And on that basis, our adjusted free cash flow target will now be around 90% of adjusted net income, since net income will include the benefit of the lease conversion and corresponding asset adjustments.

So with that, I'll turn it over to Paul for a little more detail, and then we will open it up to any questions that you may have.

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

Well, thank you, Mike, and greetings, everyone. Now before I review our second quarter results, I'd like to take a moment to clarify the basis of our financial presentation.

First, the pro forma results for second quarter of last year conform to the same methodology we used in the first quarter. And as such, all references to the unaudited pro forma statement of operations for the prior year include the results of operations of CSC for the 3 and 6 months ended September 30, 2016, and of HPES for the 3 and 6 months ended July 31, 2016. Also, prior year pro forma non-GAAP results assume a flat quarterly tax rate of 27.5%. In addition, fiscal '18 second quarter results reflect revenue adjustments for purchase price accounting, whereas the prior year pro forma does not. And lastly, non-GAAP results exclude restructuring, integration and amortization of intangibles consistent with CSC's non-GAAP methods from prior years.

And with that, I'll now cover some items that are included in our non-GAAP -- in our GAAP results in the quarter.

In the current quarter, we have restructuring costs of $192 million pretax or $0.50 per diluted share. These costs represent severance costs related to workforce optimization programs and expense associated with facilities and data center rationalization.

Also in the quarter, we have $66 million pretax or $0.15 per diluted share of integration and transaction costs. Year-to-date, restructuring, integration and transaction costs amounted to $572 million pretax or $1.45 per diluted share, which is in line with the $1.3 billion spend envelope we laid out for fiscal '18.

In the second quarter, amortization of acquired intangibles was $169 million pretax or $0.39 per diluted share.

Excluding the impact of these special items, adjusted EBIT was $876 million, or on a non-GAAP EPS, $1.93.

Turning now to our second quarter results. Revenue in the quarter was $6,163,000,000 on a GAAP basis. Purchase price accounting reduced revenue in the quarter by $22 million, representing a write-down of deferred revenue. For the full fiscal year, the deferred revenue write-down for PPA is now expected to be $230 million, which is better than our prior estimate of $335 million.

Excluding PPA, GAAP revenue was down 2.7% year-over-year and up 2.5% sequentially. In constant currency, revenue was down 3.5% and roughly flat sequentially.

EBIT in the quarter was $876 million after adjusting for restructuring, integration and amortization of intangibles. Adjusted EBIT margin on that basis was 14.2%. Adjusted EBIT in the quarter included a cumulative benefit of $121 million or $0.26 of EPS from the reclassification of HPES operating leases to capitalized leases and a corresponding adjustment of those assets to fair value. In subsequent quarters, we expect a continued benefit of roughly $60 million per quarter or $0.13 EPS from this lease reclassification.

Excluding the reclassification benefit in the quarter, adjusted EBIT would have been 12.3% compared with 6% in the prior year and 11.5% in the first quarter. This improvement in our margin reflects cost actions we're taking to optimize our workforce, extract greater supply chain efficiencies and rationalize our real estate footprint.

In the quarter, we continued to rebalance our workforce. We reduced our labor base by about 4% in the quarter through a combination of automation, best shoring and pyramid correction. We also continued to rebalance our skill mix, including the addition of almost 4,800 new employees and the ongoing retraining of the existing workforce. Also at the end of the quarter, our nearshore and offshore labor mix was 54.5%.

In supply chain, we're extracting greater procurement efficiencies. We completed renegotiations with key strategic suppliers (technical difficulty) ensuring that we capture the benefits of our global scale, and we continue to consolidate our overall supplier base. In addition, we're implementing tighter procurement review practices across all of our regions.

In real estate, we've rationalized 49 sites and eliminated 900,000 square feet of space during this quarter. This represented 5% total square footage reductions in our facilities footprint. And on a year-to-date basis, we've reduced our facilities costs by roughly 9%. So in total, we delivered $110 million of incremental cost takeouts in the quarter and are on track to meet our $1 billion in-year and $1.5 billion exit run rate of synergies for fiscal '18.

Non-GAAP diluted EPS from continuing operations in the second quarter was $1.93, including the cumulative benefit of $0.26 from the lease reclassification and corresponding asset revaluation.

In the quarter, our non-GAAP tax rate was 31%, reflecting our global mix of income and certain tax attributes in key foreign jurisdictions. Year-to-date, our non-GAAP tax rate was 27%, which is in line with the non-GAAP tax targets for the full year of 25% to 30%. Bookings in the quarter were $5.95 billion for an overall book-to-bill ratio of 1x.

Now let's turn to our segment results. Global Business Services revenue was $2.3 billion in the quarter. Excluding the impact of purchase price accounting of $6 million, GBS GAAP revenue was down 3.2% year-over-year and was up 1.2% sequentially. In constant currency, revenue was down 4.3% year-over-year and down 1% sequentially.

In the second quarter, GBS segment profit was $380 million, and profit margin was 16.4%. This compares with 11.1% in the prior year. The impact of lease reclassification in GBS was minimal, so the margin improvement reflects the impact of cost takeout actions in the business, particularly as we optimize our workforce in complex countries.

GBS bookings were $2.5 billion in the quarter for a book-to-bill of 1.1. Year-to-date, GBS revenue was $4.6 billion, segment profit was $662 million, margin was 14.5%, and bookings were $4.9 billion for a book-to-bill of 1.1.

Turning now to GIS, our Global Infrastructure Services. Revenue was $3.1 billion in the quarter. Excluding the impact of purchase price accounting of $15 million in the quarter, GIS GAAP revenue was down 4% year-over-year and up 3.1% sequentially. In constant currency, it was down 4.8% year-over-year and was flat sequentially.

In the second quarter, GIS segment profit was $469 million, and profit margin was 14.9% compared with 4.7% in the prior year. Excluding $86 million cumulative impact from the lease reclassification and corresponding fair value adjustments of the assets associated with those leases, margin in the second quarter was 12.2%. The year-over-year improvement in profitability reflects the impact of cost actions we're taking to drive greater operating efficiencies, including best shoring, labor pyramid rebalancing, workforce optimization from our Bionics automation program and supply chain efficiencies.

Booking for GIS were $2.8 billion in the quarter for a book-to-bill of 0.9x. Year-to-date, GIS revenue was $6.1 billion, segment profit was $759 million, margin was 12.4%, and bookings were $6.5 billion for a book-to-bill of 1.1.

USPS segment profit -- sorry, excuse me, turning now to our USPS sector. Revenue was $710 million in the quarter. USPS revenue was up 5.5% year-over-year and up 4.2% sequentially. Our USPS segment profit was [$109] million (corrected by company after the call) in the quarter, and profit margin was 15.4% compared with 10.1% in the prior year. Excluding $32 million cumulative impact of the lease reclassification and corresponding fair value adjustments of the assets associated with those leases, margin in the second quarter was 10.8%.

Bookings for USPS were $644 million in the quarter for a book-to-bill of 0.9x. Now year-to-date, USPS revenue was $1.4 billion, segment profit was $186 million, margin was 13.4%, and bookings were $828 million for a book-to-bill of 0.6x.

Now let me turn to other financial highlights for the quarter. Adjusted free cash flow in the quarter was $589 million or 106% of adjusted net income. This reflects ongoing improvement in working capital management with an increased focus on collections and improved vendor terms. Adjusted free cash flow excludes proceed from receivable securitization programs. And year-to-date, adjusted free cash flow was $1.2 billion or 116% of adjusted net income.

Our CapEx was $549 million in the quarter or 8.9% of revenue, reflecting the cumulative impact of the reclassification of operating leases to capitalized leases. Year-to-date, CapEx was $804 million or 6.7% of revenue.

Cash at the end of the quarter was $2.7 billion. Our total debt was 8 point five billion, including capitalized leases. Net debt to total capitalization ratio was 27%.

During the quarter, we returned $97 million of capital to our shareholders. This included $51 million in dividends and $47 million in share repurchases. And year-to-date, we've returned $138 million of capital to our shareholders in the form of $72 million in dividend and $66 million in share repurchase.

Now in closing, let me review our fiscal '18 targets. We continue to target revenue for the fiscal year to be $24 billion to $24.5 billion in constant currency. We're increasing our full year target for non-GAAP EPS from continuing operations to a range of $7.25 to $7.75 and which includes the benefits of lease reclassification and corresponding fair value adjustments of the assets associated with the leases.

Our EPS target assumes a tax rate of 25% to 30% for the full year as we continue to work on tax planning strategies to optimize our effective tax rate. Our adjusted free cash flow for the fiscal 2018 will now be 90% of adjusted net income, since net income will now include the benefit of the lease conversion and corresponding asset adjustments.

And with that, I'll hand the call back to the operator for the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Jim Schneider, Goldman Sachs.

James Edward Schneider - *Goldman Sachs Group Inc., Research Division - VP*

I wanted to maybe start with a revenue question. Came in a little bit better than our expectation. But can you maybe, Mike, help us with an update on your conversations with clients? Any update on the dialogue regarding customer dissynergies, specifically some of the larger customers like the U.K. government, the U.S. Navy, et cetera. And maybe just give us a sense of how your progress is going with upselling existing clients to increase their contract size in exchange for cost synergies, et cetera.

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Yes, listen, in terms of the U.K., we continue to see a runoff there. I'm not sure I'd call it dissynergy. It's more a reflection of some of the contracts concluding. But we still see pressure in the U.K. around some of the dissynergies. On a global basis, I'd say the revenue dissynergies are pretty much tracking as we thought. I'd say probably a little bit less than what we had originally planned at the Investor Day. In terms of conversations with clients, I mean, I got to tell you, every -- we just had our global customer advisory board in London several weeks ago. We've got our Americas advisory board going on this week in New York. I mean, the clarity of the messaging back to us is incredible. Every one of these clients is trying to figure out how they can improve their current IT operations. This is through automation. It's through simplification, it's a whole host of different things. And then we continue to encourage them to take those savings and invest in other digital platforms, whether that be the modernization of applications or new cloud native applications, the deployment of those or cybersecurity platforms or analytics, are moving to a hybrid cloud environment. So we have done several deals very similar to the one that we announced before. So the messaging back from the clients and our messaging to the clients has not changed one bit. They like our scale. They like the breadth of our portfolio. The partnerships that we have are clearly differentiated. In many cases, we are showing up as one in front of those clients, which they greatly appreciate and simplifies their decision-making. So I'd say the continued challenge we have, Jim, is to continue to attract and retain and retrain the talent necessary to capitalize on those opportunities. And that's one of the reasons we put this digital transformation unit in place as we begin to pilot a different approach to some of these clients by helping build the methodologies and the tools and the process and procedures to help with the complete end-to-end digital transformation.

James Edward Schneider - *Goldman Sachs Group Inc., Research Division - VP*

That's very helpful color. And then maybe one for Paul. With respect to the $1 billion of in-year cost synergies, if I just mathematically look at the $140 million you achieved in the first quarter and I believe you said $110 million in the second quarter and run those through for the impact of the full year, even understanding we're kind of getting into the second half of the year now, any reason to believe you wouldn't be tracking ahead of those, or any reason to believe those cost synergies would slow materially heading into Q3 and 4?

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

We just really are on track to meet maybe slightly above that $1 billion. Again, the second half of the year will have less of an impact on the overall synergy realization. I think the things that we do in the first half of the year are so critical for us. And -- but I think right now, we're tracking to the $1 billion to slightly above.

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

And Jim, we still have a lot of work to do. So this is not a lay down hand. We still have a lot of work to do as we continue to integrate the companies. So this is business as usual as we march forward here in the second half of the year.

Operator

Our next question will come from Darrin Peller, Barclays.

Darrin David Peller - *Barclays PLC, Research Division - MD*

First question is just on overall growth. I mean, I guess, USPS accelerated quite a bit. Maybe I missed it on the call, but I didn't hear any good explanation as to what drove the year-over-year acceleration there. And then really on top of that, I mean, when we look at the GBS and GIS segments sequentially, revenue looks fairly stable at this point. Is there anything again that would -- any seasonality or anything else? Or should we now start to expect that the majority of the revenue that you've been trying to attract (technical difficulty) given areas you don't think made sense from this go over pricing. Is that coming closer to finalization now so that we can have more sequential stable, maybe start to show some of the new add-ons benefit year-over-year over the next few quarters?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

I would not draw that conclusion. I think there's still -- there are many things in the second half of the year. We've got price downs, which is consistent with our seasonal plan. That needs to be factored in. So I would not get off the original sort of track that we have provided for you. What we are seeing is we are seeing a moderation in some of the headwinds in the ITO business. And more importantly, we're seeing good growth in our digital offering as we reported this quarter, and we're seeing pretty good growth in our industry IP and BPS, particularly when you adjust for the runoff of some of these big health care contracts. I wouldn't jump to any conclusions here that there's a significant change over what we've already talked about. In the case of USPS, USPS has a pretty significant backlog. And as they hire more people and bring those people on, then they're able to build that revenue out, and that's a partial explanation to why you saw a slight acceleration in the revenue. And then candidly, we have had some acquisitions. So we added Tribridge, which is the big Microsoft Dynamics business that we bought out of Tampa. And those businesses are also performing well, which is again providing some offset to the revenue dissynergies and the decline in the ITO business.

Darrin David Peller - *Barclays PLC, Research Division - MD*

Okay. So it sounds like the GBS, GIS core commercial side of your business could still see some of the year-over-year declines at similar rates, maybe not worse, not much better in the near term but obviously trending the right way. And USPS, it sounds like that could be sustainable. I mean, there was an improvement overall, just based on the math.

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

Yes. Except I would say to you that last year, if you remember, on the USPS side, everything had shifted by a little bit from the time line. Remember, this is my first comment about their -- our second quarter basically is their first quarter, so to speak. So I think the comparison with the third quarter will be a little bit more difficult. I would look at it much more sequentially. Sequentially, they grew, and they're in good position to continue to do well for the remainder of the year.

Darrin David Peller - *Barclays PLC, Research Division - MD*

All right. And then just -- that's helpful. Just a quick follow-up, and then I'll turn it back. But Paul, when we look at this new guide for EPS at $7.50, midpoint $7.50, should we still expect the 20% -- you guys have given 20% CAGR for 2020. Obviously, I know USPS is coming out of that. But is the CAGR still on track just after the capital lease adjustments were made?

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

I think you have to exclude the capital lease adjustment because what the capital lease adjustment, particularly when you start to adjust the asset to fair market value, gives you that benefit that, that is going to be playing out over the next 2 to 3 years, 2.5 years in a sense from a remaining life. And so what I would suggest is when -- we've got to wait a little bit till the end of this fiscal year. We'll be updating basically with the USPS business spinning off and merging with those 2 other businesses. And we'll give you a better feel for what remain cost targets will look like.

Operator

Up next, we'll hear from Bryan Keane, Deutsche Bank.

Bryan Keane - *Deutsche Bank AG, Research Division - Research Analyst*

Paul, just want to follow up on that. Of the increase in the guidance, the $0.75, it doesn't look like that's all lease reclassifications. Or is that all lease reclassifications? I just want to be clear there.

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

I think there is in total about $0.53 in the sense of the reclassification on a full year basis. $0.26 of it came into the second quarter because there was a catch-up to the first half of the year and $0.13 per quarter. So if you add that, it's about $0.53 for the full year. And then we've done a little bit better than -- given the synergies, a little bit better than we had expected in the first half of the year.

Bryan Keane - *Deutsche Bank AG, Research Division - Research Analyst*

And then did you say the lease reclassifications continue for another couple of years? So how do we model that going forward? I guess, it's going to change, the model's going to change for that divestiture. But I guess, just for today's purposes, would that continue going forward?

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

I think it has at least in term, I would say, on average, of about 2.5 years.

Bryan Keane - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. That's helpful. And then I just want to ask on the overall ITO mix and digital mix of percentage of revenue, I guess, once we divest the USPS business, what would be the total mix of business of ITO, of DXC and of digital once we get rid of USPS?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

To be honest, I don't know. I mean, we have to remodel that. As I said, the digital business cuts across all 3 reporting segments: GIS, GBS as well as USPS. But we have not sort of dissected that and segmented that yet. What I would tell you in terms of the total mix, fundamentally, the digital business is growing about what we thought it was going to grow and what we modeled in the Investor Day. And the IP business is not growing quite as fast. And that's largely due to the runoff in the health care business. The insurance business is basically growing the way we thought it would grow, and the BPS business continues to gain momentum as some of these large insurance contracts continued to come onstream. So by and large, the -- and the ITO business is declining a little bit less than what we anticipated, but the mix hasn't fundamentally changed since the Investor Day.

Bryan Keane - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And then that ITO business mix, does that change -- because I'm trying to figure out if that's in the USPS numbers or not. Is it a larger percentage or not as big in USPS?

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

They do have some BPS business, particularly in the states, and then they do have their ITO. I think if you just really bear with us, we'll provide you some of that breakdown a little bit more. Particularly after we file our Form 10, we'll be in a better position to share that information with you.

Operator

Up next, we'll hear from Tien-tsin Huang, JPMorgan.

Tien-tsin Huang - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Just wondering how bookings -- I know you gave out the book-to-bill measures, nothing too surprising, but how did bookings come in versus planned? And with that rolling in and traditional runoff, does it change your thinking around the next couple of quarters in terms of revenue production?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

So I think the -- as I said at the end of the first quarter, the bookings are tracking pretty much the way we'd expected. I think what I've been most pleased about has been the digital bookings. So we're seeing really good growth on the digital bookings, and that's an important measure of backlog and future revenue generations. The other thing I shared in the previous call, and we haven't been able to really quantify, we're still probably at least several quarters out, is we have moved sales force to an annual billed revenue measure. And we are seeing some benefit of that because it provides more focus on in-year revenue. That's on a rolling 12-month basis. So we've seen some increase in our performance against that annual billed revenue. The problem is, in all candor, we have no comparison with previous years. So until we get a year under our belt and understand a little bit more, it's a little hard to ascribe a great deal of veracity or meaning to those numbers. However, what is clear is that we are seeing more focus on that annual billed revenue, which I think is important. And it also takes some of the focus off of total TCV, which often drove capital intensity, which as you know, we're trying to reduce the capital intensity as we go forward. So there's a lot of knobs that we turned around sales compensation, how we're motivating the sales force. So far, I think that's going well, but we have a lot more to learn before I'm going to be comfortable giving you some sort of an equation that you can use in the models.

Tien-tsin Huang - *JP Morgan Chase & Co, Research Division - Senior Analyst*

All right, that's good to hear. Just on the -- within the digital, since you mentioned it, cloud, obviously, up strong, digital. I guess, security revenue this quarter looked a little bit different than the bookings, which was strong. So is that an area where we might see DXC sort of double down more on the security side? Just trying to understand the priorities within the digital book.

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

I'd say to be candid, probably some disappointment in that security number. That security number is driven a lot by our consultants or advisers, and that is a highly competitive market in terms of skills. So the more people that you can hire, then the more billings you generate. And as I said, we hired quite a few people in the quarter, and that shows up in the improved book-to-bill. But the revenue, in some respects, demonstrates the fact that some of those people were not in place as we entered the merger, and we progressed through the first quarter. So there's always a time lag on some of these things, but you're right, the book-to-bill is usually an early or leading indicator.

Operator

Next up, from Citi, we'll hear from Ashwin Shirvaikar.

Ashwin Vassant Shirvaikar - *Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst*

So my first question is on digital growth. It's good to see that number. I guess the question is as some of these digital contracts ramp and you prove out your digital capabilities, are you seeing a difference in perception from your clients, which can kind of lead to a resurgence in sort of a good virtuous circle of demand from them? Or is it too early?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Yes, that's a good question. What we are seeing is when our clients understand the full breadth of our offerings, frankly, that does change their perceptions. We see this show up all the time when our clients are visiting our digital transformation centers in India, or the U.K. or we just announced new centers in Australia the last -- about 2 weeks ago. So yes, that is changing the perception. The other thing is many of these digital solutions start out small. So that's why you're seeing steady new logo growth around some of these new digital offerings. And our Quick Start program is geared to that as well. So many times, we're going in with our partners on offerings that start out much smaller in scope. But if you deliver, you then have a chance to really grow. And that is the difference. It's think of it more as a journey than as just 1 contract that's in place for 5 years. So over time, as we deliver against those digital platforms in a digital road map, one that does change the perception, yes, that does create a virtuous cycle, and it also creates a backlog that rather than see price pressures over a period of 5 or 10 years like a traditional ITO contract, you actually see the opportunity to grow that contract and then grow that engagement over time. And that is a remix that we're talking about of the business. So these digital offerings have a different composition. They have a different profile than some of the more traditional businesses.

Ashwin Vassant Shirvaikar - *Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst*

Got it. Good to hear. And then one for Paul. Paul, I get the segment level impact from the lease reclass. Is there also a tax rate impact that persists?

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

Tax, did you say?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Tax impact.

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

The tax impact.

Ashwin Vassant Shirvaikar - *Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst*

Yes. Yes, right.

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

No. I think the tax rate that we apply, I think it all depends where the leases are. For example, on the USPS side, the leases are U.S.-based. I don't think it makes a ton of difference to the tax rates.

Ashwin Vassant Shirvaikar - *Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst*

Got it. And since it's topical, and staying on tax rate. In your early analysis of the proposals that have kind of come out, any takeaways that we should take from that?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Not yet. I mean, we've done some really just basic modeling on this and don't really have anything I feel comfortable sharing yet, I mean, certainly it would be a benefit. And I really want to see what comes out of the markup this week with the House and what comes out of the Senate. So it's still early, early days in terms of understanding that impact.

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

But having said that though, the lower U.S. tax rate goes from 35% to 20%, that's will be a plus for us from a mix perspective given our income. And some of the other provisions again are so much in flux right now that the net-net, I think it would be a benefit to us.

Operator

Next up is Bryan Bergin, Cowen & Company.

Bryan C. Bergin - *Cowen and Company, LLC, Research Division - VP*

Can you talk about your nonfederal government business, the public services business that you have? Is that something that you can carve out? I'm trying to understand if there were synergies there relative to your commercial business as well?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Yes, there are some synergies. I mean, we have a very large U.K. public sector business. We've got a very substantial Australian public sector business. We've got a very strong business in France. We've got a very strong business in Germany. And there are a lot of synergies between those public sector businesses and what we're doing on the commercial side. We share the same solutions. We share the same partnerships. We go-to-market. So yes, I don't -- it's not something that we are planning to carve out. The U.S. federal government is a very unique marketplace. It's just like the state Medicaid business that we have in the U.S. That's not being carved out. That's part of our commercial business, and it's part of our worldwide health vertical. But the U.S. federal government is a slightly different animal. But in all cases, whether it be in Australia or France or the U.K., it's all about trying to drive this digital transformation. We were in Australia a couple of weeks ago, and the Australian government is taking a very strong position on digitizing their business process and workflows moving forward. So that's exactly what the commercial clients are doing. So in that sense, there is quite a bit of synergy.

Bryan C. Bergin - *Cowen and Company, LLC, Research Division - VP*

Okay. That's helpful. I heard the growth rates across digital, the industry IP and BPS. Did you breakout share, where those are now as a share of revenue?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

No. What I said is the mix is about what we said it was when we did the Investor Day. Nothing has shifted dramatically from there.

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

If you remember, on Investor Day, we were saying that our digital business is running on about $4-some billion on a run-rate basis. It's a little bit higher than that, and then the industry IP...

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Slightly less.

Paul N. Saleh - *DXC Technology Company - Executive VP & CFO*

A little bit less.

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Due to the runoff in the U.K. health care. So net-net, it's about the same.

Operator

Next, we'll hear from Rayna Kumar, Evercore.

Rayna Kumar - *Evercore ISI, Research Division - Research Analyst*

You had some very strong bookings across your newer work like cloud security and analytics. Is that type of bookings growth sustainable going forward? And could you comment on the pricing trends you saw with these new bookings?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Well, the pricing is, of course, much different in a lot of these digital businesses because many of these are much more consumption-based. And over time, as the volumes, as the transactions grow, then our revenue from those offerings increases. So the dynamic, the pricing dynamics around many of these new offerings are entirely different than our traditional ITO business or our application maintenance and management business, which is usually characterized by longer-term contracts that have significant productivity improvements baked into them. That's what I'm saying. It's really a different world, and we're developing and are piloting new pricing tools around these digital offerings that are more consumption-based. So the trends within that are -- they have not materially changed at all. We continue to see the pricing pressure due to productivity expectations in the more traditional business. And it's really way too early to understand the long-term consequences of more as-a-Service consumption-based pricing in the new offerings.

Operator

Our final question will come from Ramsey El-Assal with Jefferies.

Ramsey Clark El-Assal - *Jefferies LLC, Research Division - Equity Analyst*

I wanted to ask about synergy realization on the labor side. And first, on the optimization of your labor footprint, meaning moving right shoring more headcount. Can you talk about the challenges or points of friction in doing that, operational, logistical, political? How much runway is -- where are we at in the process? I know you talked about a pretty material move in the context of the merger. So sort of an update on where we are and sort of also on how -- what are the challenges you face kind of accelerating that shift or at least tracking it?

John Michael Lawrie - *DXC Technology Company - Chairman, President & CEO*

Let me give you a couple of thoughts on that. One, I don't really see the political so much. I think what you have to understand is that the labor dynamics around these digital transformation projects are much different than the labor dynamics around the outsourcing business. So when you talk about digital offerings and digital transformation with our partners, you do talk about much more client intimacy. These are projects that are often done locally, sometimes with landed resources. But in any regard, they're really done very local. When we talk about right shoring, we don't necessarily talk about offshore. Probably the biggest hurdle we have when we do choose to move workload to a right sourcing location is just the transition. So you go -- you have to ramp up the skill someplace else before the skills in the current place can be redeployed or optimized. I'd also say that automation is clearly adding a different dimension. So rather than thinking about moving positions from point A to point B, in many cases, we can displace those and retrain those people around our digital profile. The other thing is as we rethink our labor strategies, we're thinking much more about college graduates. We're thinking about internships program. We're thinking about co-op programs. We're thinking about different training programs. Because the mix of our business as it changes over the next 3 or 4 years will have an entirely different labor dynamic than what we've seen in the traditional businesses. So it's a combination of rethinking how you bring people in. That's what our Dynamic Talent Cloud is all about. It's about retraining. It's about reskilling, and it's about a whole different approach to where we set up our locations. I've said before we are looking at creating some lower-cost facilities in the United States and moving some of our workload there. So it's that mix of location, the type of business, is it a digital business, requires more customer intimacy, is it driven by productivity improvements. And then that drives a whole reskilling, training and recruiting process. And that's what makes this so exciting and I think so dynamic as we move forward. Okay. Well, listen, guys, thank you again very much for your interest, and look forward to catching up after the first of the year. Thank you.

Operator

Ladies and gentlemen, that does conclude today's conference. We would like to thank you all for your participation. You may now disconnect.
