THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

DXC.N - Q4 2019 DXC Technology Co Earnings Call

EVENT DATE/TIME: MAY 23, 2019 / 9:00PM GMT

OVERVIEW:

Co. reported FY19 GAAP revenues of $20.75b and non-GAAP income before taxes from continuing operations (excluding impact of special items) of $3.06b or $8.34 per share. 4Q19 GAAP revenues were $5.28b and non-GAAP income before taxes from continuing operations (excluding impact of special items) was $778m or $2.19 per share. Expects FY20 revenues to be $20.7-21.2b and non-GAAP EPS to be $7.75-8.50.

CORPORATE PARTICIPANTS

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

Jonathan Ford *DXC Technology Company - Head of IR*

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

CONFERENCE CALL PARTICIPANTS

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

Darrin David Peller *Wolfe Research, LLC - MD & Senior Analyst*

James Eric Friedman *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Lisa Ann Dejong Ellis *MoffettNathanson LLC - Partner*

Rayna Kumar *Evercore ISI Institutional Equities, Research Division - MD*

Rod Bourgeois *DeepDive Equity Research - Head of Research and Consulting*

PRESENTATION

Operator

Good day and welcome to the DXC Technology fourth quarter earnings call. Today's call is being recorded.

At this time, I'd like to turn the conference over to Jonathan Ford, Head of Investor Relations. Please go ahead, sir.

Jonathan Ford - *DXC Technology Company - Head of IR*

Thank you, and good afternoon, everyone. I'm pleased you're joining us for DXC Technology's Fourth Quarter and Year-End Fiscal 2019 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. The call is being webcast at dxc.com/investorrelations, and the webcast includes slides to accompany the discussion today.

Slide 2 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.

On Slide 3, 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 annual report on Form 10-K and other SEC filings. I'd like to remind our listeners that DXC Technology assumes no obligation to update the information presented on the call except as required by law.

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

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

Okay. John, thanks very much. Welcome everyone. Thanks for taking the time today. As is my habit here, I've got 4 or 5 points. I'll go through those, go into a little bit more detail, and then turn it over to Paul and then we'll have plenty of time for Q&A.

First, fourth quarter non-GAAP EPS was $2.19. For fiscal 2019, non-GAAP EPS was $8.34. Adjusted EBIT was $827 million in the quarter, and the adjusted EBIT margin was 15.7%. For fiscal 2019, adjusted EBIT was $3.27 billion, and the adjusted EBIT margin was 15.8%. We generated $917 million of adjusted free cash flow in the fourth quarter. And for fiscal 2019, adjusted free cash flow was $2.1 billion.

Revenue in the fourth quarter was $5.28 billion on a GAAP basis. In constant currency, revenue was down 1% year-over-year and was up 1.7% sequentially. And for fiscal 2019, revenue was $20.75 billion, and we had a book-to-bill of 1.1x in the quarter and 1x for the year.

In constant currency, our digital revenue grew 22% year-over-year and 11.6% sequentially in the quarter. For fiscal 2019, digital revenue grew 15.8%. And the fourth quarter industry IP and BPS revenue was down 1.4% year-over-year and was roughly flat sequentially. And for fiscal 2019, industry IP and BPS revenue was down 0.3%. And in the fourth quarter, our digital book-to-bill was 1.8x, and our industry IP and BPS book-to-bill was 0.9x.

On my fourth point, we continue to make strategic investments in digital assets and capabilities, including the accelerated hiring efforts I've talked about before. We also expect to complete the acquisition of Luxoft by the end of June.

Now I'll go into each of these points in a little more detail, then I'll cover our targets for fiscal 2020 and turn it over to Paul. As I said, fourth quarter non-GAAP EPS was $2.19, and the effective tax rate was 24.3%. For fiscal 2019, non-GAAP EPS was $8.34, and the effective tax rate for the full year was 23.2%. Fourth quarter adjusted EBIT was $827 million. And the adjusted EBIT margin was 15.7%, roughly flat year-over-year and down 50 basis points sequentially, reflecting the investments in digital talent that we previously discussed as well as the upfront savings we're providing to clients to help accelerate their digital transformations.

For fiscal 2019, adjusted EBIT was $3.27 billion. And the adjusted EBIT margin was 15.8%, an improvement of 200 basis points. The margin improvement reflects ongoing execution against our key cost-saving levers, and the savings were in line with our fiscal '19 target that we've discussed before.

GBS segment profit margin was 20.4%, which was up 100 basis points year-over-year and 220 basis points sequentially. This reflects ongoing workforce optimization as well as the seasonality in the business. And for fiscal 2019, GBS margin was 18.9%, and this was up 240 basis points from the prior year.

In GIS, segment profit margin was 14.1%, which was down 50 basis points year-over-year and down 340 basis points sequentially, reflecting the investments I just discussed and the milestone achievement payments that I highlighted last quarter. And for fiscal 2019, the GIS margin was 15.8%, and this was up 270 basis points from the prior year. Adjusted free cash flow for the quarter was $917 million or 155% of adjusted net income, reflecting improvements in working capital. And for fiscal 2019, adjusted free cash flow was $2.1 billion or 90% of adjusted net income.

Now turning to revenue. Revenue in the fourth quarter, as I said, was $5.28 billion on a GAAP basis. In constant currency, revenue was down 1% year-over-year and was up 1.7% sequentially. Bookings were up 18.9% year-over-year and 2.5% sequentially for a book-to-bill of 1.1x.

Digital growth continues to offset more of the decline in our traditional business. And sequentially, digital revenue in the fourth quarter more than offset the decline in the traditional business. Now this balance between digital growth and traditional decline will continue to be lumpy as we go through the next year, but this is the revenue dynamic that we talked about before that will ultimately support long-term growth for the company.

For fiscal 2019, revenue was $20.75 billion on a GAAP basis, and book-to-bill was 1x. In the fourth quarter, GBS revenue was $2.2 billion. This was down 3.1% year-over-year in constant currency and up 0.9% sequentially. The year-over-year decline reflects headwinds in the traditional applications business, including the completion of several contracts in addition to the impact of accelerated cloud adoption. Now one of the drivers of increased cloud adoption is the ability to lift and shift existing workloads, which often eliminates the services associated with rationalizing and refactoring applications. GBS bookings in the quarter were up 40% year-over-year and up 27% sequentially for a book-to-bill of 1.3x. And for fiscal 2019, GBS revenue was $8.68 billion and a book-to-bill of 1.1x.

In the fourth quarter, GIS revenue was $3.09 billion, which was up 0.6% year-over-year in constant currency and up 2.3% sequentially driven by strong growth in our Workplace and Mobility business. Overall, GIS bookings of $2.97 billion were up 3.7% year-over-year and represent a book-to-bill of 1x. And for fiscal 2019, GIS revenue was $12.07 billion with a book-to-bill of 0.9x.

Now turning to digital and our IP and BPS results. In constant currency, digital revenue was up 22% year-over-year and was up 11.6% sequentially. Digital bookings continue to be very strong with a 1.8x book-to-bill in the quarter driven by continued strength in our cloud infrastructure and digital workplace bookings. And for fiscal 2019, digital revenue grew 15.8%. Digital growth in the quarter was driven by enterprise and cloud applications, cloud infrastructure and, as I said, digital workplace. All 3 businesses grew more than 20% year-over-year. The strong demand we're seeing for these capabilities is also reflected in our digital bookings and pipeline, both of which are up more than 50% year-over-year.

We're partnering with many of our clients to help generate savings to fund large digital transformations. In many cases, we provide these savings through lower operating costs on traditional services, which initially reduces revenue and profit on the account. And in return, we secure commitments from the client to expand DXC's wallet share and future digital spend, which allows us to grow revenue and profit over time.

A good example where we're leveraging our installed base to accelerate digital transformation is a contract we signed during the fourth quarter with a major global airline. Now building on our long-standing relationship with the client, we signed a 7-year transformation deal that provides upfront savings for the client through reduced operating costs. And in return, the client has committed to leverage those savings to fund digital transformation work with DXC. And this results in an initial reduction in revenue profit on the account but drives top line and bottom line growth over the full life cycle of the contract.

Now let me talk about the offering families within digital. In constant currency, cloud infrastructure grew 25% in the quarter and was up 8.9% sequentially driven by the accelerated cloud adoption I just talked about. Book-to-bill in the quarter was 1.5x, including the large airline deal as well as deals with the Australian tax office and a large European financial services institution. And for fiscal 2019, cloud infrastructure grew 22% in constant currency.

Enterprise cloud apps and consulting grew 20% year-over-year and 13.3% sequentially. Bookings in the quarter were strong with a book-to-bill of 1.4x. Wins in the quarter included a next-generation SAP deal with a South American utility provider and a CRM transformation program leveraging Salesforce.com for a large oil and gas company. And for fiscal 2019, enterprise cloud apps and consulting grew 10.1% in constant currency.

Analytics revenue was down 4.9%, up year-over-year in constant currency and was up 3.2% sequentially. We're seeing good bookings momentum in this business, particularly in the automotive sector. DXC's robotic drive solutions streamlined data analysis and algorithmic training to reduce the time and cost to develop autonomous vehicles. These solutions are very complementary to Luxoft's automotive offerings, and we believe the combined company has a compelling value proposition in this space. Bookings in the quarter were up 67% year-over-year for a book-to-bill of 1.3x.

We've continued to build on this momentum and recently signed a deal with BMW Group, leveraging DXC's robotic drive solutions. We're supporting BMW's autonomous vehicle development program, gathering massive amounts of road travel data from the global BMW test fleet. Using DXC's digital solution, BMW's R&D teams will achieve significantly faster autonomous drive development cycles.

Now not all areas of digital have done as well. Our security business was down 1.3% year-over-year in constant currency and down 1.5% sequentially as growth in Asia and Southern Europe partially offset the declines in the U.K. and Northern Europe. Book-to-bill in the quarter was strong at 1.2x. In constant currency, industry IP and BPS revenue was down 1.4% year-over-year and was roughly flat sequentially. Industry IP and BPS was down 0.3% or roughly flat for fiscal 2019. We continue to ramp revenue on some of the large insurance BPS contracts that I talked about before. This is offsetting declines we're seeing in some of our more generic BPS business, particularly in the U.K. and Europe where a few clients have in-sourced the work. Bookings in the fourth quarter were up 59% year-over-year, including a large deal with the California Department of Health Care Services.

Now turning quickly to point four. We continue to make significant investments in our digital talent, including accelerated hiring in our fastest-growing capabilities, expansion of our Digital Transformation Centers and capabilities and the ongoing build-out of our joint practices with partners such as AWS and Microsoft Azure.

During the fourth quarter, we hired an additional 2,000 people in our digital capabilities with an emphasis on software engineers, DevOps engineers, SAP consultants, data scientists and security engineers. We're making these investments to continue scaling the digital go-to-market model I previously discussed. For example, DXC has entered into an engineering relationship with DreamWorks Animation to develop a cloud-based pipeline for digital content creation. We're jointly shaping this solution with DreamWorks, leveraging our cloud, security and analytics solutions.

DXC will also expand our access to digital talent through the Luxoft acquisition. We'll leverage Luxoft's established presence in key markets such as Eastern Europe to attract digital talent, and we'll apply Luxoft's talent acquisition and management platform in support of DXC's broader digital capabilities. We expect to complete the Luxoft acquisition by the end of June. And as I've discussed, this acquisition builds on DXC's unique value proposition as an end-to-end mainstream IT and digital services market leader and strengthens the company's ability to design and deploy transformative digital solutions for clients at scale.

The addition of Luxoft will bring clients new capabilities in digital engineering, additional depth in key verticals and an expanded portfolio of digital offerings. And while we continue to operate Luxoft as a separate entity to protect its strong brand established recurring engine, DXC will undertake several changes to quickly apply Luxoft's strengths and capabilities to our broader business and help drive growth.

First, we're combining the existing industry expertise from both companies to create market-leading verticals in automotive and financial services. These 2 verticals will serve more than 20 major automotive OEMs and more than half of the top financial institutions in the Americas and Europe. DXC and Luxoft go-to-market teams will also work together to innovate and cross-sell solutions in other industry sectors where the company has a significant base of global business, including insurance and health care.

Now to my fifth point before I turn it over to Paul. For fiscal 2020, we expect revenue in the range of $20.7 billion to $21.2 billion, reflecting the impact of currency as well as the revenue dynamic between digital and traditional I previously discussed. This target assumes that Luxoft closes, as I said, at the end of June. And we're targeting non-GAAP EPS of $7.75 to $8.50 and adjusted free cash flow to be 90% or more of adjusted net income.

Now let me turn this over to Paul. Paul?

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

Yes, thank you, Mike, and greetings, everyone. As usual, I will start by covering some items that are excluded from our non-GAAP results. In the current quarter, we had restructuring costs of $47 million on a pretax basis or a $0.13 per diluted share after-tax. These costs represent severance related to workforce optimization programs and expenses associated with facilities and data center rationalization.

Now also in the quarter, we had $96 million on a pretax basis or $0.24 per diluted share after-tax for transaction, separation and integration-related costs associated with recent acquisitions such as Molina as well as activities related to the Luxoft acquisition. For the full year, restructuring, transaction, separation and integration costs amounted to $866 million on a pretax basis or $2.31 per diluted share after-tax driven by the cost of exiting more resources in complex countries and the higher-than-expected cost of exiting the shared IT environment with HPE. In addition, we had additional transactions costs associated with our digital acquisitions.

In the fourth quarter, amortization of acquired intangibles was $138 million on a pretax basis or $0.37 per diluted share after-tax. For the full year, amortization of acquired intangibles was $539 million on a pretax basis or $1.42 per diluted share after-tax. Also in the quarter, our annual remeasurement of pension assets and liabilities resulted in an accounting charge of $143 million. As of year-end, we had pension assets of $11.3 billion and pension liabilities of $11 billion for an overfunded pension position of $327 million. Excluding the impact of these special items, non-GAAP income from -- before taxes from continuing operations was $778 million for the quarter, and non-GAAP EPS was $2.19. For the full year, non-GAAP income before taxes from continuing operations was $3.06 billion, and non-GAAP EPS was $8.34.

Now I move on to our fourth quarter and full year results in more detail. GAAP revenue in the fourth quarter was $5.28 billion and $20.75 billion for the full year. Adjusted EBIT in the quarter was $827 million. Adjusted EBIT margin was 15.7%, relatively flat year-over-year and down 50 basis points sequentially. Adjusted EBIT in the quarter reflects additional investments we are making in our digital business, including additional digital transformation centers, acquiring new digital talent and enhancements to Platform DXC and Bionix.

For fiscal 2019, adjusted EBIT was $3.27 billion. Adjusted EBIT margin was 15.8%, up 200 basis points compared with the prior year. The year-over-year margin improvement reflects continued progress on our cost takeout plans in line with our targets for the year. Throughout fiscal '19, we accelerated the deployment of our Bionix automation program, which, combined with our other workforce optimization levers, allowed us to reduce our labor base by roughly 10,000 people or 7% on a net basis as we continue to shift the balance of our workforce to digital capabilities.

In supply chain, we're consolidating our supplier base, managing demand, leveraging our scale to renegotiate and restructure agreements and shifting more of our work to strategic vendors.

Turning to facilities. We eliminated an additional 4.6 million square feet this year, and we also rationalized 9 data centers. Since the merger, we have reduced our facilities footprint by more than 30%.

So in summary, we delivered over $500 million of in-year savings, which is roughly line with our full year targets. And as we previously discussed, we reinvested roughly half of those savings throughout fiscal '19. And primarily, those investments went into digital capabilities.

In the quarter, our non-GAAP tax rate was 24.3%. And for the full year, the non-GAAP tax rate was 23.2%, reflecting the net benefit of certain tax attributes in foreign jurisdictions. In the fourth quarter, bookings were $5.8 billion for a book-to-bill of 1.1x. And for the full year, bookings were $20.7 billion for a book-to-bill of 1x.

Now let's turn to our segment results. GBS revenue was $2.19 billion in the fourth quarter. In the fourth quarter, GBS segment profit was $447 million, and profit margin was 20.4%. The improvement in profitability reflects ongoing workforce optimization and the seasonality of that business. For the full year, GBS revenue was $8.7 billion. Segment profit was $1.6 billion. Margin was 18.9%. Booking were $9.3 billion for a book-to-bill of 1.1x.

GIS revenue was $3.09 billion in the fourth quarter. GIS segment profit in the fourth quarter was $436 million, and the profit margin was 14.1%. Now the profit margin reflects investments we are making in Platform DXC, Bionix as well as digital talent acceleration. GIS margin also reflects the timing of exiting resources in some of our complex markets. Now for the full year, GIS revenue was $12.1 billion, segment profit was $1.9 billion, margin was 15.8% and bookings were $11.5 billion for a book-to-bill of 0.9x.

Turning to other financial highlights. Adjusted free cash flow in the fourth quarter was $917 million. That is 155% of adjusted net income, reflecting tighter working capital management. For the full year, adjusted free cash flow was $2.1 billion or 90% of adjusted net income, which is in line with our original target for the full year.

Now our cash flow performance continues to exclude the impact of our receivables facility even though these transactions represent an outright sale of receivables with no recourse to DXC. Now our CapEx was $316 million in the quarter or 6% of revenue. And for the full year, CapEx was $1.15 billion or 5.5% of revenue. Cash at the end of the fourth quarter and at the end of the year was $2.9 billion. Our total debt was $7.4 billion, including capitalized leases for a net debt-to-capitalization ratio of 23.6%.

During the quarter, we paid $51 million in dividends and repurchased $91 million of shares for a total of $142 million in capital returned to shareholders. And for the fiscal year, we returned $1.55 billion of capital to our shareholders in the form of $210 million in dividends and $1.34 billion in share repurchases.

Now let me close by covering our fiscal '20 targets, which assume that the Luxoft transaction will close by the end of June. We are targeting revenue for the fiscal year to be in the range of $20.7 billion to $21.2 billion, and that includes roughly $250 million of currency headwinds from a stronger dollar compared with fiscal '19.

The revenue target reflects the impact of accelerated cloud adoptions on our traditional platform and application businesses. We're working with our clients to accelerate their digital transformation efforts by offering upfront savings on traditional services we provide. Near term, these actions reduce revenue and profit on those accounts. But in return, we expect to gain a greater share of their IT spend in digital, which should translate into a higher revenue and profit over time.

Our fiscal '20 target for EPS is $7.75 to $8.50, reflecting the incremental investments we are making in our digital business as well as the near-term impact of our efforts to accelerate clients' digital transformations. Now the EPS target also assumes a higher tax rate for fiscal '20 of 26% to 28%, reflecting a changing mix of tax attributes in foreign jurisdictions and delays in the implementation of our tax planning strategies. Now that is pending further clarification of U.S. tax reform regulations. Now these delays, however, do not impact our long-term targets for tax of 22% to 25%.

I also would like to mention that we're working diligently to complete the filing of our 10-K by May 30. However, because of certain audit procedures regarding updates to the U.S. tax reform regulations, we may file the 10-K in early June within the extension period allowed by the SEC. And lastly, our adjusted free cash flow target for fiscal '20 is 90% of adjusted net income.

Now I'll turn the call back to the operator for the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from James Friedman from Susquehanna.

James Eric Friedman - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

It's Jamie at Susquehanna. Good results here. Paul, I just wanted to ask about the EPS guidance. I see that you are adjusting your tax assumptions fairly considerably from where we were. But how should we be thinking about the margin cadence from here? So what should we be thinking about margin going forward?

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

Well, first of all, the 26% to 28% is higher than we had anticipated coming into -- for fiscal '20, just as I mentioned, just because of the uncertainty relating to some of these regulations or clarification. And as a result, once they are clarified, we'll be able to implement our tax strategies. Until then, we're taking a little bit more risk and not optimizing our taxes.

In terms of the margin progression, I think we'll see a dip in the first quarter. This is usually -- if I look at it compared to the prior year. But we'll see also the impact of some of the acceleration of the cloud transformation, digital transformation that we're doing with our clients and the savings that we're giving them upfront. We'll see that impact on the revenue upfront. That will also impact our margins, particularly on the GIS side. But we should start to see at least a point improvement every quarter from the first quarter on out until the end of the year. And again, this is assuming Luxoft comes to us in the second -- starting in the second quarter and is not going to be much of a contribution from the -- just a 10%-or-so contribution for the margin on the Luxoft business.

James Eric Friedman - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

With regard to Luxoft, I realize you're saying end of June, but what is contemplated in terms of the revenue contribution for the year?

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

I think about $700 million right now. And I would just really expect it to be relatively equal per quarter, somewhere around the $225 million to $230 million.

James Eric Friedman - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Okay. And then last one. Mike, in your prepared remarks, you talked about increase in digital hiring. Where are you in that journey? I know it seems like you made some great hires. But yes, how are you doing on the staffing side so you can fulfill that side of the demand?

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

Yes. I -- listen, I think the hiring issue is behind us, so I think we've demonstrated here we can hire. We made a pretty significant commitment to these DTCs. We're planning to have probably 1,500 people or so per quarter. I don't expect any problems with that. As we go forward, some of the skills may remix a little bit. In other words, we may need some additional analytic skills and less in some other areas, so we'll continue to combine that.

We're also really comfortable with this whole process we've put in place where customers come to these centers, we ideate with them, they get assigned to statements of work, approve our concepts, so I really feel very good about what we've been able to get done here on the digital skills. So we're not having problems finding people, recruiting people or onboarding them, and they're beginning to really contribute positively to the business as we go forward. You saw some of that in the growth that we reported.

We're also continuing to reskill hundreds of current DXC employees, so we're able to -- as we continue to move people off of the offerings where we have revenue runoff, we're increasingly retraining and reskilling so we can deploy them on other opportunities.

Operator

Next, we'll go to Lisa Ellis from MoffettNathanson.

Lisa Ann Dejong Ellis - *MoffettNathanson LLC - Partner*

Can you talk a little bit about -- I know you just both spoke about how you're now proactively making some of these investments with your clients, offering them some savings on the base work you're doing upfront in order to gain and win their digital spending. Clearly, with some success with the growth rates you're now seeing in digital, can you just give an illustration of what this sort of profile looks like with one of your large clients? Like meaning how much is revenue down initially? How long does that last? At what point does it flatten out? Does it eventually go positive? Just to get a little bit more color.

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

Sure. Let me provide a little color for you. I won't use any specific names here but an example would be a proposal I was working on this week as a matter of fact where we would extend somewhere in the neighborhood of $30 million in operational savings in-year. So this will be in-year, $30 million of operational savings. And in return, we would be the service provider that would move applications to the cloud. We would provide some additional analytics. We would provide some additional cybersecurity and some additional, what I'll call, operational optimization. That would be worth somewhere in the neighborhood, after we get through the first 6 months to 12 months, probably $40 million to $50 million of incremental revenue.

So what we're doing, and we're getting more and more comfortable with this model, is to provide those operational savings and then the customer commits to specific projects and workload. Now some of the revenue from those new projects are admittedly delayed a little bit, could be 90 days, could be 120 days, could be a little longer than that. But we're comfortable now that we're starting to get this model, get this into more of a standard process, and we're really encouraged by the receptivity on the part of our clients to this approach. So they can basically fund these digital programs through the operational savings that we give. And all we've got to be willing to do is to live with a little deferred recognition of some of the revenue and profitability. When we can grow these, then our view is we can take a lot of this traditional business and use that as an asset to fund future growth in the account and reposition DXC as not only a great operator of infrastructure but also a trusted digital partner.

Lisa Ann Dejong Ellis - *MoffettNathanson LLC - Partner*

And is that also -- is that allowing you to sole-source the digital work then too because you're doing this more proactively?

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

Well, yes. So what we're doing is we're getting commitments on revenue spend around digital. Commitments, okay? Now that could be different projects, so it doesn't say, "Okay, you are going to provide a cloud migration," or "You're not going to do this." But what it does do is it says we will commit to spend x amount of money with you in other digital projects.

Lisa Ann Dejong Ellis - *MoffettNathanson LLC - Partner*

Got it. Okay, and then just one last one. I saw the other 8 -- sorry, go ahead.

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

And by the way -- and Lisa, one other thing. A lot of this is done with our partners as well. So increasingly, we are going to these clients and saying, "We will do this together with our partners," which gives this a lot more not only credibility but it helps us from a skill standpoint to really get access to a broader set of skills. So I'd tell you, we've been talking about this thing. I've been talking about this thing for 1.5 years. All I'm saying here is we're starting to see some real traction and beginning to scale this. And that is what I think this next year is going to be all about is scaling this.

Lisa Ann Dejong Ellis - *MoffettNathanson LLC - Partner*

Got it. Okay. One last one for me. I saw the other 8-K that you added Mike Salvino to your Board who's very deep in the BPO space. Can you just comment then on sort of how you're thinking about the industry IP and BPS business? Is that an area where you might look to maybe make an acquisition of one of the stand-alone players in that space to beef it up or vice versa? Sort of just what's an update on how you're thinking about that business.

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

Yes, I'm not going to comment on the acquisitions. But yes, the BPS space, particularly, particularly in the health care business, as you know, we did acquire Molina this past year, which gave us some additional states and some real capabilities within the health care BPS space. As you know, we've had some very significant wins that we're now in the process of scaling around assurance BPS.

So Mike not only brings that skill set to the Board, but I think he also brings to the Board a person who has gone through some of these transformations where you see significant runoff in your legacy business and how to reinvent that business and drive it in a new direction. And it's very helpful to have that extra piece and someone who has actually lived through that. So we're very pleased that Mike joined the Board.

Operator

And next, we'll take a question from Bryan Bergin with Cowen and Company.

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

I just wanted to ask you on the outlook. Any changes here to your medium-term outlook on any -- or your revenue on margin? And then as you think about the ramp in the upfront savings programs, does that extend where you expected your revenue stabilization point or the timing of that to happen?

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

Well, actually, I mean these are rough numbers, so these are not audited by Deloitte. But the -- fundamentally, we crossed over this quarter. So our sequential growth in digital was greater than our sequential decline in the traditional business. So that happened this quarter, okay? And on a year-over-year basis, we -- I think this quarter narrowed this to like $30 million or $40 million, which fundamentally is at that point.

Now what I'm saying is as we go through next year, that will be lumpy. And the reason that is lumpy is each quarter slightly differs. Some quarters, you have a little more revenue runoff or you have a discontinuance or you have a price-down. So it is -- you can't say, "Okay, gee, you crossed here in the fourth quarter. Therefore, it's over." No, no, it's just great. We have narrowed this gap dramatically, dramatically in the last year, last 1.5 years. Now we're going to see some ups and downs as we go through the typical seasonality and the unique quarter layout of the revenue stream. Does that make sense, Bryan?

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

Yes, it did. Any changes to the way you've articulated in the past on those targets?

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

No, no.

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

Okay. Okay. And then just as far as free cash flow generation in '20, reverting your target there, how should we be thinking about capital allocation progression and share repurchases at current levels?

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

I think that we'll be -- we'll continue to be very opportunistic in the market. And we do have, as we have shown in the past, the opportunity to deploy capital to buy back shares as well as to reinvest in the business as we have done in the last year.

Operator

Rayna Kumar from Evercore ISI has our next question.

Rayna Kumar - *Evercore ISI Institutional Equities, Research Division - MD*

As you aggressively ramp up digital skill sets, can you help quantify that wage inflation that you might be seeing with these new skill sets?

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

With -- say that -- I'm sorry, I missed the last part of it.

Rayna Kumar - *Evercore ISI Institutional Equities, Research Division - MD*

Can you quantify wage inflation as you continue to ramp up on digital skill sets?

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

Oh, okay. Okay. We haven't seen that much wage inflation. A lot of these digital skills are people who are much earlier in their career. We're also augmenting this with graduate programs. We are experimenting with some very unique things. For example, we are helping to pay tuition costs of some students, graduate students, and then they agree to stay with us for 3 years after graduation. This is a way -- and then we actually work with the universities on curriculum around some of these digital, particularly data scientist skills, analytic skills and some other very important skills to our business going forward.

And we're really having quite a bit of success attracting some of these newer and early-in-career kind of people because we're really doing some really interesting projects. I tell you, we have this little videotape that we show on this BMW autonomous driving program. We play that for about 2 minutes, and they get exactly what we are talking about. So to answer your question, no, we're not seeing a lot of wage inflation.

Rayna Kumar - *Evercore ISI Institutional Equities, Research Division - MD*

Got it, that's very helpful. And just a follow-up from the margin question that was asked previously, could you quantify how much you expect EBIT margin, adjusted EBIT margin, to be down in the first quarter? And then just a commentary surrounding the margin progression throughout the year, is that 1 point increase sequential or year-over-year?

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

I think it's sequential, and the first quarter will be probably closer to a 14 type of percent on an EBIT margin perspective, down from the fourth quarter where we were at 15.7%.

Operator

Our next question will come from Darrin Peller with Wolfe Research.

Darrin David Peller - *Wolfe Research, LLC - MD & Senior Analyst*

Could you hear me okay?

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

You came through loud and clear.

Darrin David Peller - *Wolfe Research, LLC - MD & Senior Analyst*

Look, just when considering guidance, we're calculating around, I think, it's negative 1% constant currency organic for what's embedded in your outlook for the year revenues. I mean it's clearly better than negative 3%-or-so constant currency last year. But just in the backdrop of what seems to be pretty good visibility you're seeing now and digital expectation's strong and your book-to-bill, 1.1x, I mean is there just any element of onetime items that you're comparing against you want to call out or easier -- any conservatism maybe we should think about? And then also, maybe if you can give us a little color on the underlying pieces, whether it's the digital growth rate expected, the BPS and industry IP or the legacy would be great.

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

No, no. I think the -- nothing unusual except, as I mentioned to you, we are accelerating the program of giving -- working with our customers to give them upfront savings so that we can get a greater share of their IT spend overall on digital. And so that's why you see the upfront decline a little bit in the -- more pronounced in the first quarter, and then we expect to just really start to recover some of that throughout the year.

And we have some seasonality, as you may recall, from Q4 to Q1 that's been usually -- and a few -- last year, for example, alone, it was about $300 million. So this first quarter will be a little bit higher than that given again the plans that -- that we're working on to accelerate those digital transformations. But after that, as I mentioned, we see a progression, incremental revenue throughout the year, and then you top that off with the Luxoft that comes onboard for Q2, Q3 and Q4. And then from a margin perspective, as I mentioned earlier, it is a progression sequentially of about 1 point from where we would print in the first quarter.

Darrin David Peller - *Wolfe Research, LLC - MD & Senior Analyst*

All right. Just a quick follow-up on the industry IP and the BPS side. I mean, it seems like the digital side is taking -- is doing as well as you expected. That side of the business, the industry IP and BPS is, I think, it's a tad lighter than we thought it would be. And so just curious to hear, are there certain verticals that you're really going to be able to help accelerate? Is there something going on there that's a little surprising to the downside? Or maybe just more color on what you see there.

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

Yes. Let me take a shot at this. We have invested over the last, I don't know, 1 year, 18 months on what we call a digital insurance platform. And fundamentally, this is taking different components that we had in our IP portfolio as well as some of the IP from our partners. And we put that into what we're referring to as a digital insurance platform.

Now we have now sold this in a couple of large insurance companies. Matter of fact, I was just in India last week and went through this whole approach with a couple of customers that we're visiting one of our centers in India. We are expecting that to begin to get some traction this coming fiscal year. It really has only been in the market, I don't know, 3 or 4 months, so the lead times on these things are quite lengthy because they're significant transformation projects.

So we are getting more and more encouraged that, that investment will begin to pay off. But to be quite candid with you, I don't know how to model that, I really don't know how -- I don't have enough customer wins and enough experience in implementing this new platform to be able to give you -- I don't have insights so I can't then share what -- how that's going to play out this year.

We've also done some of the same things with our health care platforms. And there also, we're beginning to see some traction. But I just don't have enough visibility yet to see that. So we have been disappointed by the IP performance over the last year. As I said, it's roughly flat. We were really hoping to get a couple points of growth. That is definitely holding us back a little bit. But we have made the investment, and we're going to continue to invest. And we've got the platforms now, we'll see how this begins to play out.

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

Yes, Mike, I can add that one of the things that is actually showing up in the numbers for this year is that there were a couple of contracts where the customer decided to in-source work that we are previously...

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

Through the BPS side, yes.

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

Yes. Yes. And that's also that's why that segment is not showing the growth that we would otherwise had expected. But that should hopefully be something, going forward, that will stay behind us.

Operator

That question will come from Rod Bourgeois from DeepDive Equity Research.

Rod Bourgeois - *DeepDive Equity Research - Head of Research and Consulting*

Hey, so I'm wondering if you have substantial room in your fiscal '20 earnings guidance to invest significantly in digital and your plans for wallet share expansion. So I guess specifically, I want to ask if you can quantify the magnitude of digital investment that you're planning for fiscal '20 and also if you could some -- provide some dimensioning of the amount of investment you're making in these upfront client savings deals, presumably with the idea of expanding wallet share. Is there any way to quantify how much investment is being made there?

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

No. I got it, no problem. And Paul may add to this. Roughly -- these aren't exact numbers but roughly within this model, think of this as probably $100 million or incremental to what we have spent in the past. And think of that as probably $0.25, $0.35 per share roughly.

Rod Bourgeois - *DeepDive Equity Research - Head of Research and Consulting*

Okay. And fairly level loaded through the year?

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

Yes. I'd say we're making these investments now. We continue to invest in Platform DXC. So yes, I mean we're continuing with these investments. The 2 biggest investments we're making from an IP standpoint is Platform DXC, which we view as critical to allow digital workloads, digital projects, to be able to be integrated into mainstream IT. Now we brand this differently. We don't brand it Platform DXC. The customers we're working with, we brand it x company platform so that -- because it's not a proprietary platform. It's very open, and it's built on our partners' technology like ServiceNow and others. So we continue to invest in that.

And we're continuing to invest in taking our own digital offerings and integrating them into Platform DXC. And then we continue to make a pretty significant investment in Bionix. We got very good yield out of Bionix. And as you know, Bionix is advanced analytics. It's lean as well as the tooling that goes along with that. So those are the 2 sort of generic investments we're making that cut across our whole portfolio and then the investments that I mentioned we're making in digital, particularly in skills acquisition and, in some cases, hiring ahead for the demand. One of the things, Rod, is in this digital world, it's not like the old IPO world where you won a contract and you had a transition time of 6 months or 8 months, and skills were a month late or 60 days late. It wasn't the end of the world. A lot of these digital projects are very perishable. People want to do it. There's -- it's measured in weeks, not months. And that's why we're building more of a bench in these DTCs to be able to respond.

The other issue is that a lot of these digital projects are not prescribed offerings. It really results as a part of an ideation process, a minimally viable product or a proof of concept, which also requires people to actually run that process, and then they get assigned to the actual project. So digital, Platform DXC, Bionix and then the investments I talked about in the health care and insurance make up the bulk of that. But we are investing more. We are investing more because we see the opportunity and the growth, and we're getting more comfortable with the model as we go forward.

Rod Bourgeois - *DeepDive Equity Research - Head of Research and Consulting*

All right. Hey, Mike, let me ask you a question from a different angle. It's encouraging to hear the progress in hiring digital talent. As you approach the market for digital talent, can you explain your unique value proposition to attract new talent to DXC? I mean you're coming at this market from a different position than the other players, and I wonder if you have a way to articulate what's unique about your talent value proposition.

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

Yes, that's a very good question. What we do, Rod, is we differentiate around a couple of variables. One is we have an incredible client base, incredible client base. Two, we are working on some extremely innovative projects like the BMW project. We have an unbelievable relationship with our partners. So these kids have access to not only what we're doing in DXC and our clients, but they also have access to learn and grow through partners like Microsoft and AWS and others.

So -- and then finally, these recruits, if you will, see what we are doing with Luxoft and how we're entering that space from a digital engineering standpoint and then our global footprint, which gives them an opportunity to grow from a career path standpoint. Those are fairly compelling value propositions. And as I said, we're not having a lot of difficulty recruiting.

And I'll just make one other comment since this is the last question. I just was down in a couple of our centers. I'd tell you, it's like entering a new world. I did a town hall meeting in our New Orleans digital delivery center, transformation center. I mean it's just -- one, it's such a diverse group of people. I looked out in the audience, there was probably 300 or 400 people down there now, just all kinds of backgrounds, and there's -- the attitude is so different. I'd walk around in all these ideation rooms and enter with whiteboards and clients and talking about new opportunities and innovation. I mean it's -- and the tools that we have to help them with the -- it's just -- it's like a whole different world, which is just so exciting.

And as we continue to drive more of this digital revenue, that becomes more and more what the company looks like. And if you combine that with our unbelievable capabilities operationally with our ITO business and our application business, it really is a great opportunity to cocreate with the clients.

Jonathan Ford - *DXC Technology Company - Head of IR*

And operator, we will close the call now. Thank you.

Operator

Thank you. That does conclude our conference for today. Thank you for your participation. You may now disconnect.
