THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

DXC.N - Q1 2020 DXC Technology Co Earnings Call

EVENT DATE/TIME: AUGUST 08, 2019 / 9:00PM GMT

OVERVIEW:

Co. reported 1Q20 GAAP revenue of $4.89b, non-GAAP income before taxes from continuing operations of $591m and non-GAAP EPS of $1.74. Expects FY20 revenue, including Luxoft, to be $20.2-20.7b and non-GAAP EPS to be $7.00-7.75.

THOMSON REUTERS

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

Arvind Anil Ramnani *KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst*

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

Edward Stephen Caso *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

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

Jason Alan Kupferberg *BofA Merrill Lynch, Research Division - MD in US Equity Research & 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 Fiscal 2020 First Quarter Earnings Call. Today's call is being recorded.

At this time, I would like to turn the conference over to Mr. 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 First Quarter Fiscal 2020 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 we posted slides to our website, which will 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 as well as in our supplemental slides. Both documents are available on the Investor Relations section of our website.

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.

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

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

Okay. Thank you. Good afternoon, everyone. I am going to follow my standard format, then turn this over to Paul. And then we'll be available for any questions.

First, our non-GAAP EPS in the first quarter was $1.74. The adjusted EBIT was $652 million, and the adjusted EBIT margin was 13.3%. And we generated $72 million of adjusted free cash flow in the first quarter.

Our revenue in the first quarter was $4.89 billion on a GAAP basis. In constant currency, revenue was down 4.2% year-over-year, pretty much in line with what we expected. And the book-to-bill was 0.9x for the quarter, reflecting a couple of delays in some deals that we had expected to close in Q1.

In the first quarter, the Digital revenue grew 35% year-over-year primarily driven by enterprise and cloud apps, cloud infrastructure and our digital workplace. Our industry IP and BPS revenue grew 3.5% year-over-year. And the Digital book-to-bill was 1.3x, and the industry IP and BS -- BPS book-to-bill was 1.2x.

On my fourth point, in June, we completed the acquisition of Luxoft, which strengthens DXC's value proposition as an end-to-end mainstream IT and digital services market leader. We also announced a joint DXC and Microsoft Azure digital transformation practice, building on our long-standing relationship with Microsoft. And in the next few days, we also plan to announce a strategic partnership with Google Cloud, which will enable enterprise clients to modernize IT and integrate digital solutions capitalizing on Google Cloud Platform. And I'll talk a little bit more about that in a moment.

And finally, we now expect additional currency headwinds for the full year. Combined with some of the delays in these deals as well as additional pressure on our traditional business, we're revising our revenue guidance for the whole year to a range of $20.2 billion to $20.7 billion. And given this lower revenue and some delays in cost savings, which I'll talk about in a moment, our non-GAAP EPS target is now $7 to $7.75. And we continue to target adjusted free cash flow of 90% or more of adjusted net income.

Now let me just go into a little more detail. As I said, the first quarter non-GAAP EPS was $1.74. The effective tax rate was 20.1%. The first quarter adjusted EBIT was $652 million, and the adjusted EBIT margin was 13.3%, including the impact of the investments I discussed last quarter, an accelerated mix shift to Digital and some delays executing resources in high-cost complex countries, and I'll provide a little more color on these points.

As we discussed, we continued to make significant investments in digital talent, including both hiring new employees and upskilling our existing workforce. We also are expanding our digital transformation centers and investing in joint practices with partners such as AWS, Microsoft and Google. These investments are necessary to continue building on the strong momentum we have in the digital business, and we continue to plan on roughly $100 million of incremental investments this year.

The first quarter also has the most impact from the accelerated client savings we discussed last quarter. We're seeing these trade-offs translate into greater opportunities and a qualified digital pipeline, which was up roughly 80% year-over-year in Q1.

During the quarter, we saw an acceleration in the shift from traditional infrastructure to digital solutions. For example our cloud infrastructure business was up 36% year-over-year, which was faster growth than what we had expected. And as we migrate client workloads out of the legacy environments, there are stranded costs that we have to address including assets as well as people. Given the accelerated pace and expanded scope of cloud migrations, we weren't able to get these costs out during the first quarter, but we're taking action and expect to remove the stranded costs by the end of the third quarter.

Our delivery team was also behind on its fiscal '20 cost improvement plan, particularly on workforce actions in high-cost countries. As we continue to expand deployment of our Bionix automation program into additional geographies and client environments, it is taking longer to eliminate the headcount as we automate activities. And in some cases, we're required to implement the full automation solution prior to removing any of the resources. Now we're implementing actions to improve execution and second half profit, including accelerated labor pyramid improvements, reductions in nonbillable and underutilized resources and further optimization of nonlabor spend such as hardware maintenance and software rates.

As I said, adjusted free cash flow for the quarter was $72 million or 15% of adjusted net income, reflecting lumpiness of cash flow, including the timing of our sales commission payments, our fiscal 2019 bonus payments and prepaid software enterprise license agreements. However, we continue to expect adjusted free cash flow to be 90% or more of adjusted net income for the year.

Now let me turn to revenue. As I said, in the first quarter, revenue was $4.89 billion on a GAAP basis. Now all revenue comparisons I'll discuss will be in constant currency.

In the first quarter, revenue was down 4.2% year-over-year, in line with what we expected. And the book-to-bill in the quarter was 0.9, reflecting some delays on some large deals.

In the first quarter, GBS revenue was $2.2 billion, which was up 0.5% year-over-year. The year-over-year improvement reflects continued momentum in our enterprise and cloud applications business as well as the addition of Molina and 2 weeks of the Luxoft business. As I discussed last quarter, accelerated cloud adoption is eliminating some of the services associated with rationalizing and refactoring traditional applications. And this dynamic is an ongoing headwind for legacy application services. GBS book-to-bill in the quarter was 1.1, and bookings were up 22% year-over-year, reflecting strong bookings in the enterprise cloud apps, analytics and industry IP and BPS.

GIS revenue was $2.7 billion in the first quarter, down 7.6% year-over-year. This reflects the accelerated client savings we've discussed last quarter as well as increased momentum in digital migrations. Cloud and digital workplace both grew more than 35% year-over-year. And similar to the dynamic I discussed in traditional applications, these accelerated shifts pressure the traditional GIS business as clients lift and shift existing workloads to recognize immediate savings. Over time, we typically grow revenue by migrating additional workloads into our multi-cloud environment, but the initial shift often results in less near-term revenue. And we're also seeing some slowdown in additional add-on project work in legacy environment as more investment is made in the digital solutions.

Now to offset these traditional headwinds, we're taking a much more aggressive approach on the GIS pipeline development. We've expanded our sales efforts, targeting large infrastructure outsourcing opportunities for new clients with a focus on deals that involve modernization of the traditional environment while at the same time investing in digital projects. We're still early in this process, however, we're seeing good traction. Total infrastructure pipeline in the first quarter was up 32% year-over-year and 22% sequentially. And we expect to drive additional revenue during the second half of the year. The GIS book-to-bill in the quarter was 0.7x, reflecting the lumpiness in large deal signings and some of the delays that I had mentioned previously.

Now let me move on to our digital industry IP and BPS results. Digital revenue was up 35% year-over-year, including 2 weeks of revenue from Luxoft. Excluding Luxoft, Digital revenue grew 31%, and the book-to-bill in the quarter was 1.3x. As I've discussed, we're seeing good enterprise spend environment in digital, particularly with respect to enterprise cloud migrations. As we partner with our clients on these transformations, we continue to see strong momentum in our cloud infrastructure solutions. This business grew 36% year-over-year, reflecting accelerated migrations and continued demand for multi-cloud solutions. And we're seeing good traction in this business across geographies and across industries.

For example during the first quarter, we won a deal with a major European aerospace and defense company to provide cloud migration, security and analytics services. We're leveraging our knowledge of the legacy estate to modernize the client's IT architecture and help them thrive in a highly competitive market. We built an Agile platform that enables development and deployment of solutions such as next generation smart factories, asset use optimization and application of artificial intelligence to everyday business challenges.

Enterprise cloud apps and consulting continues to perform well with a 17.1% year-over-year growth, including strong growth in our Americas region, particularly in our Microsoft, ServiceNow and SAP practices. We're also partnered with Salesforce to win a major multiyear deal with 4 global luxury retail brands. We are providing development and support services on Salesforce Commerce Cloud, supporting roughly 35 B2C websites globally.

Security revenue performance improved in the quarter and grew 5.7% year-over-year with particular strength in Asia and Europe. And during the quarter, we won a multiyear deal to provide managed security services for a major European car manufacturer, leveraging standard DXC offerings as well as partnered offerings with Micro Focus, Fortify and Carbon Black. The solution includes threat intelligence, security event monitoring, vulnerability management, forensic investigations and regulatory and policy compliance controls.

We also saw improved performance in industry IP and BPS. Revenue was up 3.5% year-over-year in constant currency driven by a 7% growth in our industry IP offerings. And with the addition of Molina, we're seeing strong demand in our U.S. state Medicaid business. During the first quarter, we signed add-on deals with Tennessee, California and Ohio worth over $100 million each. And industry IP and BPS book-to-bill in the quarter was 1.2x.

Now my fourth point, during the first quarter, we completed the acquisition of Luxoft, which strengthens DXC's unique value proposition as a leading end-to-end IT services provider. As we previously announced, Luxoft will continue to be led by Dmitry Loschinin, who will report directly to me. Luxoft brings a 13,000-person workforce that provides digital strategy consulting and engineering services for companies across North America, Europe and Asia. Luxoft will retain its brand and operate as a DXC Technology company, but we've already launched joint go-to-market efforts to cross-sell solutions to both companies' current clients and to target new clients across industry verticals. Processes, incentives have been put in place to promote and reward cross-selling, and we're encouraged by the early progress we're seeing in the joint pipeline of opportunities.

The acquisition also expands DXC's access to digital talent by leveraging Luxoft's presence in key markets, especially Eastern Europe, and by broadly deploying Luxoft's unique talent acquisition and management platform. We're undertaking several changes to quickly apply Luxoft's strengths and capabilities to DXC's business.

Within Luxoft, we're creating industry-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. And 2 key digital offerings, the Internet of Things and blockchain, will also be combined within Luxoft.

Now we continue to expect Luxoft to provide roughly $700 million in revenue during the last 3 quarters of the fiscal year in addition to the 2 weeks of revenue we were able to recognize by closing the deal in the middle of June.

Now turning to our partnerships. We recently announced a joint practice with Microsoft Azure. The DXC and Microsoft Azure digital transformation practice enhances our deep and long-standing relationship with Microsoft. This joint practice will provide clients with a highly integrated approach to modernizing their IT systems on Azure. And the result would be a reduced time to digital and a more rapid movement of client workloads from legacy IT to a modern cloud architecture on Azure.

In addition, we recently signed a strategic partnership with Google Cloud. This partnership will allow us to modernize mission-critical IT for enterprise clients and integrate digital solutions capitalizing on the Google Cloud Platform. Now under our partnership agreement, DXC will also be launching centers of excellence for Google Cloud Platform and Google Cloud artificial intelligence to provide clients with secure, Agile and scalable cloud-based digital platforms that leverage our advanced analytics capability. And we'll be providing more information on this as the partnership evolves.

The Microsoft Azure and Google Cloud practice complement our ongoing cloud work with AWS, Oracle and VMware to give our clients access to the largest cloud providers in the world.

And my fifth point before I turn this over to Paul is we now expect an additional $150 million to $200 million of currency headwind for the full year. And as I've discussed, we're also seeing more impact on our traditional business as accelerated client migrations pressure near-term revenue. And combined with some of the delays I've talked about, we're revising our revenue guidance for the full year to a range of $20.2 billion to $20.7 billion. In addition to this lower revenue outlook, delays in some of our cost savings actions will lower our margins, and our non-GAAP EPS target is now $7 to $7.75. And as I said, we continue to expect adjusted free cash flow to be 90% or more of adjusted net income.

And with that, I will turn it over to Paul.

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

Thank you, Mike. As usual, I'll start by covering some items that are excluded from our non-GAAP results.

In the first quarter, we had restructuring costs of $142 million pretax or $0.42 per diluted share, and this is primarily related to workforce optimization. Also in the quarter, we had $105 million pretax or $0.31 per diluted share of integration, separation and transaction-related costs, including costs associated with the Luxoft transaction. In the first quarter, amortization of acquired intangibles was $138 million pretax or $0.40 per diluted share. Excluding the impact of these special items, non-GAAP income before taxes from continuing operations was $591 million and non-GAAP EPS was $1.74.

Turning now to our first quarter results in more detail. GAAP revenue in Q1 was $4.89 billion, down 4.2% year-over-year in constant currency. Adjusted EBIT in the quarter was $652 million. Adjusted EBIT margin was 13.3%, reflecting the investments we're making to help clients accelerate their digital transformations with us as well as incremental investments we're making to support the continued momentum in our digital business.

Our EBIT margin in the quarter was lower than we had anticipated. We experienced delays in executing on our cost takeout plans. And while we reduced our headcount by 3,900 people in the quarter, we fell short of our expectations as we experienced delays in exiting resources in high-cost complex countries.

Also in our Bionix program, we've expanded beyond DXC's delivery centers into clients' environments. Now this involves reengineering of client processes before savings can be realized, and it is taking more time to execute on these joint efforts.

Now we still intend to execute on our original workforce optimization plans, but the benefit will now be pushed out to the second half of the year.

In the quarter, our non-GAAP tax rate was 20.1%, reflecting our global mix of income and the benefit of a return to provision true-up in certain foreign jurisdictions.

Turning now to our segment results. GBS revenue was $2.16 billion in the first quarter, up 0.5% year-over-year in constant currency. In the first quarter, GBS segment profit was $366 million, and profit margin was 17% compared with 18.2% in the prior year. GBS margins reflect the investments we are making in hiring and training digital talent as well as the expansion of our digital transformation centers.

GIS revenue was $2.73 billion in the first quarter. GIS segment profit in the first quarter was $340 million, and profit margin was 12.4%. GIS margin reflects the investment we are making to help accelerate our clients' digital transformations and the timing on some of our cost takeout actions.

Turning to other financial results. Adjusted free cash flow in the quarter was $72 million or 15% of adjusted net income. And this reflects the timing of annual payments for software licenses and maintenance, investment made to consolidate real estate facilities and the timing of refresh programs on a few large accounts. As a result, our CapEx was $357 million in the quarter or 7.3% of revenue, but we expect our CapEx to moderate over the course of the year.

During the quarter, we paid $51 million in dividends. We also repurchased $400 million of shares through a combination of open market purchases and an accelerated share repurchase program. In total, we returned $451 million in capital to shareholders. And we continue to be opportunistic in returning more capital to our shareholders.

Cash at the end of the quarter was $1.9 billion. During the quarter, we funded the Luxoft acquisition with $2 billion of additional debt. We also paid down $430 million of current maturities of long-term debt. At the end of the quarter, our total debt was $9.4 billion including capitalized leases, for a net debt to total capitalization ratio of 36.5%.

Now let me close by covering our revised fiscal '20 targets. We're targeting revenue of $20.2 billion to $20.7 billion, including Luxoft. This revised outlook includes the impact of $150 million to $200 million of additional currency headwinds from a strengthening dollar since the beginning of May.

Our revised outlook also reflects the near-term impact from delayed deal closings as well as slippage on a few large transformation milestones. However, we expect a second half improvement in revenue as those deals close and we convert on our strong pipeline, including cross-sell opportunities with Luxoft.

We're now targeting non-GAAP EPS of $7 to $7.75 for the full year, reflecting the impact of lower revenue as well as the first half delays in executing on our delivery cost takeout programs.

We now expect to achieve $250 million to $300 million of cost savings this year versus our original target of $400 million. We expect the lower revenue and delays in cost takeout to impact second quarter margins by about 1 point sequentially, but we expect margins to improve in the second half of the year through labor actions, supply chain improvements and real estate consolidation.

Our workforce optimization actions include labor pyramids and location mix improvements. Now while we've driven significant productivity improvements in our delivery organization the last several quarters, we have additional opportunities to extract greater efficiencies from our middle-management layers, including the number of managers as well as their location mix.

In supply chain, we're in the process of renegotiating several large software contracts as well as driving additional vendor consolidation to achieve incremental savings.

In real estate, we plan to eliminate an additional 600,000 square feet of office space and close 3 additional data centers throughout the year.

Our EPS target assumes a tax rate of 26% to 28% for the full year, reflecting our tax attributes in foreign jurisdictions as well as the increased BEAT liability due to the Luxoft acquisition. Given our lower tax rate in Q1, we expect a higher tax rate over the next 3 quarters of about 30%.

We continue to expect adjusted free cash flow to be 90% or more of adjusted net income.

I'll now hand the call back to the operator for the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Lisa Ellis from MoffettNathanson.

Lisa Ann Dejong Ellis - *MoffettNathanson LLC - Partner*

Given the reduction in your outlook for the year just 3 months in, you appear to be seeing the business deteriorate a little bit faster, I guess to state the obvious, than you expected 3 months ago. So beyond the Luxoft integration and the organic investment you're making in digital, are there other strategic options you're considering, meaning at this point is there a plan B on the table? And sort of what are the options for plan B, particularly I guess with the focus on the industry IP and BPS, which you called out is doing fairly well at this point and I think is pretty independent of the rest of DXC?

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

Yes. I think -- Lisa, this is Mike. As always, all options are always on the table. The way I look at this is our digital performance is quite good. And if I look out over the full year, we see probably upside to that performance. You're right, our industry IP in particular and BPS business has strengthened since we exited last fiscal year.

I think the new news for me here as I look through the quarter were a couple of things. One, we saw a greater acceleration, particularly on the move to cloud. And that does impact our business. It impacts -- we've seen this impact certainly on the application business, but it also is impacting what I would refer to as sort of the volume metrics. In many of our contracts, we get paid on the amount of volume. So we are seeing some greater acceleration there. Now we're seeing the other side of it too because our cloud infrastructure business is growing faster than what we had expected.

Now that's requiring us to take more actions from a cost standpoint and how we do that. We didn't execute that as quickly as we wanted to in the first quarter. And we think we can catch up on that as we go through the second, third and fourth quarter of this year. But that's primarily the new news, is an acceleration of this cloud migration, and that does impact our infrastructure business in particular.

Lisa Ann Dejong Ellis - *MoffettNathanson LLC - Partner*

Okay. And then I guess my follow-up is at this point, do you feel like you have enough -- like what's your confidence level in feeling like this reset is, is it, if you know what I mean? Meaning do you now feel like you have a good sense of sort of the dynamics, the shift level, the rates, and so, at this point, you feel like you're pretty confident in the outlook for the remainder of the year?

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

Yes. We've got some very strong plans in place to recover. I felt it was important to reflect what we saw in the first quarter that was different than what we saw exiting in the year. And that's what I am signaling. It doesn't mean we don't have plans in place to try to recapture the bulk of that, we do. But when you see a slightly different trend than what you saw, it's important to the investors to call that out. So yes, are we confident about that? Yes, we are.

Operator

Our next question comes from Rayna Kumar with Evercore ISI.

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

So you cut your EPS guide by $0.75 at the midpoint. Can you just break out how much of that is from incremental FX headwind, deal closing delays, larger declines in your legacy IT services business and then the slower cost takeout versus what you initially planned?

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

Paul, do you want to take that?

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

Yes. I would say the -- if you look at it from an EPS perspective, right, the revenue probably is somewhere around $0.25-plus of the impact of that. And the rest of it is a combination again of the mix change that we're seeing with the traditional being a little softer than we had anticipated. But digital is picking up, but the differential has an impact. And also the cost, that got pushed out, in a sense, things that we did not execute as fast as we had anticipated, particularly in the complex markets. And that will just really be with us through the second quarter, but we expect to catch up in the third and fourth quarters. So that -- the combination, in a sense, it was happening fast -- too fast, in a sense, in certain markets that we couldn't take the costs fast enough. So net-net, I think it's about $0.75. And it's broken down, as I mentioned, $0.25-plus from revenue, the rest from the costs.

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

Great. That's really helpful. And then can you just talk about maybe like on a quarterly basis, your expectations for just revenue growth on a constant currency basis?

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

We will -- right now, I think we reflected the currency from where it is now. I think we said it was about $150 million to $200 million impact for the full year, right? There was some impact on the revenue side, right? And right now, we would expect relatively slight -- flat, I would say, for Q2. And for the full year, we gave you the expectations of a pickup in the second half of the year. We expect to have about a couple of hundred million dollars of pickup in Q3 and then a similar amount in Q4, right? And then we would -- as I mentioned, the margins would be impacted in Q2 by about 1 point, but then we all expect to see quite a rapid acceleration of our margin improvement in the second half of the year as our cost takeout action starts to materialize in the third quarter and carry through into the fourth quarter.

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

That's very helpful. And just one housekeeping question for me. What was the acquisition -- the revenue contribution from Luxoft in the quarter?

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

$45 million.

Operator

Our next question comes from Jim Schneider with Goldman Sachs.

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

I was wondering if you could maybe help us, Mike, understand the dynamics. Clearly, the faster transition to cloud is one thing. Could you maybe give us an update on what you're hearing from clients who you gave kind of -- on the outsourcing business and the rate at which they are booking digital revenues? And talk about your level of confidence that those revenues are actually going to materialize throughout the year as you expected.

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

Yes. That is pretty much working just as we had discussed before. Again, when I step back and I look at this, the Digital revenue is clearly accelerating above the level that I thought. So just exclude Luxoft for a second, it was up 31%. That's about the fastest growth rate we've had in Digital revenue. And some of that is attributable to some of the deals we did. As I said, some of those deals that we did, we saw that impact in the first quarter, okay? So my confidence level on that part of the strategy is very high because we're seeing that absolutely flow through.

And if I look at the pipeline as I look out for the balance of the year in Digital, very strong. And that's before we even throw Luxoft into the equation.

So from a strategy standpoint and a plan standpoint, that is working. Where we had some new news was the acceleration of the movement to cloud and the impact that is having on our traditional ITO business. And then our ability to respond to that in the first quarter from a cost standpoint, we were not able to respond quickly enough.

The other factor I mentioned is Bionix. I'm really pleased with the progress we're making in Bionix, but that now is becoming much more client by client. And many clients are -- want to see that improvement from Bionix before we actually exit the people. And that's fine. That makes good sense. But that does delay some of the -- delay some of the cost takeout in the first quarter, and that then has an impact on the full year.

So that's fundamentally what's going on here. The digital strategy is working. As a matter of fact, it's accelerating. But at same time, we're seeing an acceleration of that impact, particularly on the infrastructure business.

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

I would add to what Mike has said. The pipeline, as he mentioned, on the Digital is growing 80% on a year-over-year basis, about 18% sequentially. So that's a strong one. But also the pipeline on the traditional business is also holding up right now. And so we see actually opportunities as customers are coming to us, so -- that had in-sourced their environment and asking for modernization opportunities in discussions with us, which...

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

I'd say the composition of the pipeline is much more geared towards not just standard outsourcing but much more modernization of the current IT estate and then the move to digital.

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

That's helpful. And then maybe just a little bit more color on the deterioration in the traditional business. Can you maybe talk about over how broad a client base or how many clients that deterioration is that you're seeing? Is it kind of relegated to a few clients? Is it broader than that? And I guess, to the earlier question, what's your level of confidence you won't see that from additional clients in the next couple of quarters?

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

Yes. Well, we look at our top 200 or 300 clients, which is what I look at. And across that, I'm not going to name any specific client, but we are seeing an acceleration of this move to a cloud infrastructure. It is somewhat industry-specific. So some of the industries that we are more exposed to, like consumer packaged goods, for example, is migrating more rapidly to the cloud than let's say, financial services or insurance. So it's not so much that there's new clients that we're seeing this in. We're just seeing a slightly more rapid adoption of the cloud infrastructure in the top 200 or 300 clients that we have.

Now that's being offset -- it's being offset by some of this digital revenue that we talked about. And then what we -- now that we have what I'd call shored up most of our large contracts and renewed most of those large contracts, we don't have a lot of those on the horizon this year, we're being more aggressive in targeting now more new clients from an IT modernization standpoint.

That's what we're now seeing in the pipeline. As a matter of fact, we've got probably a stronger pipeline on traditional IT modernization than we've had in years as we begin to make that shift to driving much more of a sort of aggressive, offensive play around IT modernization.

Operator

Our next question comes from Edward Caso with Wells Fargo.

Edward Stephen Caso - *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

I was wondering if you could talk a little bit about the competitive dynamics in the market. Are you seeing any shifting in, say, the last 6, 9 months? And I guess I'm particularly thinking about IBM here, if they're emerging more as a competitor.

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

No. I -- we were -- particularly in the digital world, we are competing more frequently with an Accenture for example, particularly in some of the areas like our enterprise cloud apps business. Think about that as SAP and the upgrade to S/4HANA. So we are running into some of those players more often, and we're having quite a bit of success with that. On traditional, more traditional outsourcing things, we see the same competitors we've seen. We haven't really seen any difference in that. I would say there's quite a bit of price competition. There's certainly pricing pressure around some of those traditional outsourcing and IT modernization programs. But many of our competitors are seeing the same, exactly the same dynamics in their infrastructure business that we are seeing. There's not significant differences there. So I wouldn't say there's been any significant change from a competitive posture over the last 3 or 4 months.

Edward Stephen Caso - *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

Historically, you've given us a multiyear view, a 3-year view. Is -- can you update any of that now that you've got Luxoft in-house?

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

No, we're not going to update that today. I think at some point in time, it will be important to sit down, do another analyst meeting and go through what those longer-term models look like. But right now, we're sort of focused on recovering some of the shortfalls that we had in the first quarter and building a plan to get where we need to get to here on a full year basis. But long term, there's no changes to that model.

Operator

Our next question comes from Ashwin Shirvaikar with Citi.

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

My first question is it seems that based on the information you provided in these questions, you should be able to exit the year approaching breakeven overall. So I first wanted to confirm that possibility. But then as we break out GIS, GBS, are we in a situation where it's primarily you can get a little bit of growth from GBS, but GIS is in a much longer multiyear situation because of these accelerated cloud migrations, pricing, productivity, things like that? Could you break that down a bit for us?

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

Yes. I would say your comment is well taken in the sense that as we exit the year, we would have recovered quite a bit of that revenue shortfall that would have happened particularly in Q2. From our original expectations, we're maybe off maybe by about $100 million to $150 million from our original exit rate.

That being said also, you're absolutely right. I think the GBS business will be a little bit closer to its original target because that's where we have a whole lot of our digital assets. And -- but the GIS will have a little bit longer road ahead just because of the trends that Mike was -- indicated will take longer to moderate. And as we get new deals, in a sense, that we have in the pipeline, this will also -- hopefully, we'll do better than -- over time.

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

But I just think the trend here is quite straightforward. We're seeing an accelerated shift to the cloud. That is clearly impacting our ITO business. That's being offset by some of the things we're doing by participating with them in many of their digital projects, integrating those digital projects into the existing IT infrastructure. So there's nothing different here from a strategy standpoint other than it has accelerated a little bit. And now we've got to make some adjustments both from a cost standpoint and going out and attracting newer -- new clients beyond our current installed base in this IT modernization space. That's the fundamental message here.

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

Got it. Understood. And I see that you haven't changed the free cash flow conversion, but there will be correspondingly lower FCF based on the guide down. The question is does that affect the magnitude or timing of your capital return plans? And how does that -- I mean, can you kind of go through capital allocation a bit?

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

No. I think we have still -- we -- it will not make a significant -- have any significant impact on our capital return. We look at it much more opportunistically against all the other opportunities that we see for tuck-in acquisitions, for example, or investments that we're making in the business. But -- and we're still, as I said, 90% or more of free cash flow for the remainder -- for the full year, even though we started the year at a lower point than -- but we just -- again, there were more timing issues than something more fundamental.

Operator

Our next question comes from Jason Kupferberg with Bank of America Merrill Lynch.

Jason Alan Kupferberg - *BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst*

So obviously the pace of change in the business just seems to be accelerating on a couple of different fronts as you outlined, Mike. Does that speak to the need to evolve some of the internal forecasting processes you guys use? I mean it just seems like there was some pretty significant change in just 2, 2.5 months relative to when you reported your Q4. So I'm just wondering if you guys are contemplating any changes in terms of how you formulate your forward guidance as you think ahead.

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

Yes. I think the runoff and things like that, we've got a really pretty good handle on. I think for me, what I -- what we need to do a little better job, and I'm going to qualify this because it's really not that easy to do, is some of the volume metrics. So again, the way our contracts are set up, you get paid based on volumes. It's a little difficult to forecast too far out what's going to happen with those volumes. And they do fluctuate month to month, and they certainly fluctuate quarter to quarter.

Now we're going to try to do a better job of understanding that and forecasting it. But I got to tell you, there are some limits as to how you can forecast those volumes. This has not been a huge issue in the past because the volumes were quite stable. But what we're seeing with this accelerated shift to the clouds, some of those volumes are shifting around. And that is now something we're going to have to get a better handle on and forecast. If we get enough data points, you'll be able to calculate with a little more precision. But that's the fundamental new news for me and what was different from what I saw coming out of last year.

Jason Alan Kupferberg - *BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst*

Okay. Okay. Paul, just one for you as we're tinkering with the model here. It looks like the adjusted EBIT margin outlook for the full year of fiscal '20 is coming down by maybe 1 point or so. So I just wanted to see if you can validate that. I know you talked directionally about a better second half obviously, but just so that we have the models calibrated properly on that line.

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

Yes. I think the way I -- from where we gave you some directions before, by 1 point to 1.5 points.

Jason Alan Kupferberg - *BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst*

Okay. And then just very quickly...

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

That's for the full year. Excuse me, that's for the full year.

Jason Alan Kupferberg - *BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst*

Yes, for the full year. Yes, yes, understood. And then you talked about some deals that slipped out of Q1. Did those already close in Q2?

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

No. A couple of them -- I'll be very honest, there's a couple of them I decided not to do. And typically at the end of the quarter, you get into an equation of -- there was one, for example, I think it was roughly $400 million, roughly. I won't name the name. But at end of the quarter, okay, if you give us a bigger discount, we'll sign it. I decided not to do it. I'm just not going to take -- I'm not going to give up that profit for the sake of a book-to-bill number over a week or 2-week transition period. So we'll get that closed, and we'll get it closed in the second quarter. But that was an example of just something we were unwilling to do to get that done before the June 30 deadline. So there's probably at least $400 million, $500 million that fell into that general category. And there were just some deals that we just couldn't get across, has to do with pricing or giving away profit, it's just we couldn't get them done, yes. And we do expect to get them closed in the second, or some may go as far as the third quarter.

Operator

Our next question comes from Arvind Ramnani from KeyBanc.

Arvind Anil Ramnani - *KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst*

So just a couple of questions. When you think of all the strategic options you have, are you able to outline what may fall sort of within your control sort of given your current financials versus what you may need to really kind of get help externally?

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

Well, yes. I mean there's all kinds of strategic options. As I have said before, all options are on the table. We've got a strategy. We're executing that strategy. Yes, there was some new news here, particularly around the acceleration on the infrastructure business. Does that change the strategy? No. Does it change some of the options that are available? No. Could that change some of the timing to think about some of those? Yes, it could.

So I just -- I don't think any -- from a strategic options standpoint, I don't really fundamentally see any change. All those options have always been on the table.

Arvind Anil Ramnani - *KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst*

Great. Great. And from an investor perspective, I think sort of pretty vocal, sentiment has been weak for some time now. But can you maybe help outline the mood at DXC. It may be different in different types of businesses. Like what's the mood internally? And secondly, what's the message either to existing employees or recruits?

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

Well, I think the messaging is very similar to the messaging we have for you. It doesn't change, okay? Because it's the facts. It's the truth.

Now if you go into different parts of the world, it is slightly different. I've said this before. You go to Asia, you go to Australia, where we've largely got through this transformation of -- where the digital revenue streams are more than offsetting some of the traditional, well, that's a much more upbeat mood. If you go to our digital transformation centers where people are totally focused on these digital projects, it's a different world. You go into an account where you've got a significant amount of runoff and you're taking costs out, well, it's not nearly as positive. So it differs based on where you are, and it differs on where you -- where the business is in that transition. But we're seeing good opportunities to attract people. We've hired -- I think last year, we hired 25,000 people. We're continuing to hire particularly in the digital business. And most people see the opportunity that we're communicating here around helping our clients not only modernize their existing IT infrastructure, but being able to help them on these digital projects and then integrating that into the existing IT infrastructure.

Operator

Our next question comes from Rod Bourgeois with DeepDive Equity Research.

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

You've sort of answered the same questions over and over. So let me answer -- ask a question from a different angle here.

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

I thought you were going to answer for me, Rod. That's good.

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

Right. No. I mean you're clearly seeing volumes at your clients shift more rapidly to the cloud. My question is, is that spend as it shifts going completely away from DXC? Or is this more of a case where over time, that spend is still available to you, you can recover that spend, but at a lag effect? I mean you mentioned last quarter that you're pursuing these deals where you give clients upfront savings, but then you get a commitment to make up the spend gap over time by shifting into digital scope. So I'd like your take on whether this accelerated cloud shift is an outright negative. Or is it more of a situation where you're taking a hit now, but with the benefit later of a shift into more of a digital business mix, which is kind of the long-term goal that you're trying to accomplish? So how much of it is a negative versus an opportunity? Can you give us the balance on that right now?

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

Yes. I think on balance, it's much more positive. I do think there's a delay, but we're seeing that because the increase that we're seeing in our cloud infrastructure business is increasing. It was up again, I think, 36% in first quarter. So it's much more of a lag effect. We're also doing other things where some of the revenue associated with the actual cloud is beginning to be captured as part of the contract. That is a lag effect as well. So I view it much more as a lag effect than just a negative. As a matter of fact, I go through this all the time. Our top 2 or 3 -- roughly our top 250 accounts where we've got about $14 billion of revenue, I go through every one of those accounts. Where are we? What's the runoff? What's the digital pipeline look like? But there is a timing issue as you pointed out. You are 100% correct.

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

Okay. And a couple of quick ones related to that. Can you quantify -- on these deals where you're giving clients proactively, you're giving them upfront savings, that's clearly affecting your revenues this year because of that lag effect. Can you quantify how much revenue impact that's having this year? Is there a number you can give us on that?

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

I can't. I can't give you an accurate number on that right now. What I can -- what I -- I'll be able to do that a little bit more retrospectively. For example in x account, I know what we've given, okay? I also know what that current forecast is. I know what the digital pipeline is. I know what's the revenue associated with that is. But -- I want to see that materialize. And then we'll be able to look back and make some judgments as to whether that's something we ought to continue, something we shouldn't continue. But right now, I don't see any major change in what we have communicated up to this point in time.

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

Okay. And then one other quick one, as the -- in your -- particularly in your GIS business, as the volumes move to the cloud and you shift your scope to more digital services, is that a positive margin event? Or is it neutral or negative? What's the margin mix that's happening -- mix shift that's happening as you shift into more digital in your GIS business?

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

I think, Rod, near term, it's a little bit more negative just because you have 2 things, transformation project early on don't have the same margins as you could imagine from the environment that we were managing in the traditional side. So there is a differential in margin early on. We also have to take cost action also to deal with some of the stranded asset in the old environment. So net-net, it puts more pressure on the cost side near term. And therefore, the margin are more pressured near term. But over time, then you get the efficiency...

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

Because as those costs come out, the margins -- actually, there's an opportunity to expand those margins. It's really tough when these volumes go away. I mean you don't need as much many servers, you don't need as much storage, you don't need as much of this and that. That stuff doesn't move out in 60 days. It just doesn't work that way. It takes time to do that. But yes, as those costs come out, then that gives you a great opportunity for margin expansion on the new digital business.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. We thank you for your participation. You may now disconnect your phone lines, and we hope you have a great day.