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DXC.N - Q4 2020 DXC Technology Co Earnings Call

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OVERVIEW:

Co. reported 4Q20 GAAP revenue of \$4.8b, non-GAAP income before taxes from continuing operations of \$292m and non-GAAP EPS of \$1.20.



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PRESENTATION

Operator

Good day, and welcome to the DXC conference call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Shailesh Murali. Please go ahead, sir.

Shailesh Murali - DXC Technology Company - Head of M&A and IR

Thank you, and good afternoon, everyone. I'm pleased that you're joining us for DXC's Fourth Quarter and Full Year Fiscal 2020 Earnings Call.

Our speakers on today's call will be Mike Salvino, our President and Chief Executive Officer; and Paul Saleh, our Chief Financial Officer. This call is being webcast dxc.com/investorrelations, and the webcast includes slides that will accompany the discussion today. After the call, we will post these slides on the Investor Relations section of our website.

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 will 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 the actual results to differ materially from those expressed on the call. A discussion of these risks and uncertainties is included in our annual report on Form 10-K and other SEC filings. I would like to remind our listeners that DXC Technology assumes no obligation to update the information presented on the call except as required by law.

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

Michael J. Salvino - DXC Technology Company - CEO, President & Director

Thank you, Shailesh, and I appreciate everyone joining us today. This is the first time we've connected since the COVID crisis, and I hope you and your families are staying well.



I'm going to start today's call by sharing some big-picture context about what we've accomplished since the last time we spoke. I will then discuss feedback we have been receiving from our customers who are recognizing our outstanding operational performance during the COVID-19 crisis. Before I hand the call over to Paul, I will also provide an update on our transformation journey. Paul will then share our financials, including an update on the actions we have taken to strengthen our liquidity and enhance our financial flexibility. Then I'll make some closing remarks before opening the call up for questions.

I am pleased with the quarter. We have been making good progress with our customers. Since I started in September, we have been focused on improving customer delivery and building stronger customer relationships, and we have done both this quarter.

On customer delivery, we have now fixed 35 of the 40 challenged accounts. Of the remaining 5, 2 have decided to leave us, and we are still working the other 3. Investing to fix these accounts was something I highlighted during my first earnings call, and I'm happy to report this is pretty much behind us.

The investment is also paying off as we now have sold \$2.1 billion in TCV over the last 2 quarters to these accounts. The work consists of renewals and new work. Some of this new work was previously put on hold, and some of the work is in new areas like analytics and engineering. New work is the best evidence to describe a turnaround.

On building stronger customer relationships, we have significantly increased our focus on our top 200 accounts. During this quarter, I have personally checked in with these customers numerous times, making sure I gave them an update on how DXC was doing, assuring them we were focused on delivering and asking them to please let me know if they ever see any issues. As unfortunate as the COVID-19 crisis is, and I don't want to minimize that point, the crisis has caused customers to see heightened needs for our capabilities, specifically having reliable and secure on-prem IT infrastructure and workplace and mobility services. The customer feedback has been overwhelmingly positive for the way we have delivered, and I could not be more proud of how our team at DXC has delivered. Clearly, the investment we have been making in our people in the business over the past 7 months was the right thing to do. It allowed us to fully support our customers when they needed us most. And customers remember when you deliver in tough times.

We have pulled together a slide with a sampling of quotes that captures some of the stories concerning how we've delivered for our customers. The IT challenges that our customers have faced during the crisis have highlighted the criticality of our distinctive workplace and mobility services; our on-prem IT infrastructure and cloud capabilities; and finally, our ability to innovate and execute in a very demanding environment.

Let me bring a couple of these quotes to life. For a major defense contractor, we delivered 1,200 fully imaged computers for their employees in one week. Also, in one day, we fielded a 200% surge in service desk calls to enable half of their employees to work from home. In addition, we delivered a dashboard showing their devices across their 119 locations, which delighted the customer.

For a leading health tech company, we anticipated a surge in service desk calls from the employees working from home, and we built a chat bot in 30 hours to reduce the call volume by 12% on the first day. The customer was thrilled, as you'll see in the quote. They highlighted our proactiveness, out-of-the-box thinking, speed and collaboration. And I want to highlight for you all, this is the new DXC at work.

I want to thank our 137,000 women and men who deliver every day for our customers. They've done a phenomenal job taking care of themselves, their families and our customers during the COVID-19 crisis. Over 99% of our people are enabled to work virtually. This 99% number is industry-leading, which is expected, because we've got the #1 workplace and mobility business in the industry, but nonetheless, it was great to see us deliver for our customers.

The actions we have taken to improve customer delivery and focus on our people have enabled us to meet and exceed our customers' expectations during this challenging time. And I also want to take a moment and thank our customers for reaching out and recognizing the outstanding performance of our people.

Our strategy to position DXC for growth has always been based on taking care of our customers and the people who do the detailed work. The financial payoff from this strategy will materialize over time, but I am very encouraged about our progress. As we discussed in the last couple of

earnings calls, DXC's main fundamental challenge has been revenue runoff from existing contracts. With everything we've been doing for our existing customers, we should be able to stem future revenue runoff. I say this because over the last 7 months, we've done a lot of work to secure our customers, improve delivery and study our customers' IT states.

Here's the key finding from all this work. Our revenue run-off was not caused by cloud trends, prompting customers to move away from DXC. Instead, this run-off was due to suboptimal customer delivery and weakening customer relationships. As a result, we lost roughly \$1 billion of revenue in FY '20 and expect to lose a similar amount in FY '21 from price-downs and terminations decisions made by customers in the last 12 to 18 months. For FY '21, the impact will be more pronounced in the first half of the year. The good news is that this fundamental problem is absolutely within our control and fixable. In fact, we're making good progress on bringing the new DXC to our customers, which should help stem future revenue run-off.

Now I'd like to turn to our people. We continue to hire talented people to serve our customers, both at the account level and within delivery. My focus has been to reward our people who are closest to our customers. You might have heard we announced pay increases for our people that are delivering the detailed work. The first phase of these increases were done in January, and the final phase will be done in August. The health and safety of our people has always been and remains a top priority for me as we navigate the COVID-19 crisis. I'm personally keeping our people informed of the evolving situation through town halls and e-mails on a regular basis.

My leadership team has done a fantastic job throughout this quarter. We are meeting daily to ensure that we are supporting our people and our customers by acting on the information from our COVID-19 command center. This center works around the clock to monitor the evolving situation. It guides our actions to help reduce the spread of the virus, ensures our people can work safely on critical on-site roles and enables our people to work from home securely.

Now let me turn to our transformation journey, which consists of 3 initiatives focused on our customers, cost optimization and the market. All of these initiatives will help us build the foundation for growth. Now I've already given you a lot of context on our first initiative, which focused on customer delivery and building stronger customer relationships, but I want to spend time clarifying our cost optimization and seize the market initiatives. Being well on our way to securing our customer base and taking care of our people, it's now time to focus on the second initiative, which is to optimize the cost. Our cost optimization will be initially focused on simplifying our management layers and taking the appropriate steps to rightsize our cost structure to our revenue. What I have learned by doing countless customer calls and account reviews is that we have too many people between our customers and the people doing the detailed work. This causes complexity and confusion. It also erodes profitability and shareholder value.

By eliminating unnecessary layers, our people will be able to deliver for our customers faster, drive meaningful revenue growth and help deepen customer relationships. This is why we are accelerating our cost optimization initiative. We expect to eliminate about \$700 million of cost on an annualized basis, with about \$550 million coming this year. We expect roughly 4,500 people or 3.5% of our workforce to be impacted. I also want to highlight a reminder that I communicated to our people 4 weeks ago that along with these actions, we will continue to run our business. This means we will continue to hire and exit people at all levels as we see the needs and the performance of the business changing. This cost optimization initiative will allow us to better serve our customers and help us seize the market, which is our third initiative.

The current environment has reaffirmed that what we do at DXC is incredibly relevant. We see this demand as a revival of the on-prem IT estate market, and this is an opportunity that is unique to us. I've mentioned before that we were going to tap into the strategic advisory capabilities of Virtual Clarity, a DXC company that we acquired this past year to provide greater insights to us concerning how our customers are considering moving their existing on-prem IT estate to the cloud. We have worked with 95 of our top customers who represent nearly half of our key accounts to assess their current IT estate and the expected evolution of these estates to the cloud over the next 2 years.

The data shows our customers aspire to move 20% of their current on-prem IT estate to the cloud over the next 2 years. However, after careful analysis and considering the technical feasibility, risk and business case, along with the ability to execute, this number drops to 5%.

In addition, we found these customers wanting to modernize over 60% of their on-prem IT estate and do not plan to touch the remaining on-premise estate in the next 2 years. This also highlights the criticality of the IT estates that we run for our customers and the thoughtfulness concerning how



they will move the next pieces of these estates to the cloud. These on-prem IT infrastructure capabilities have always been essential. But now they're both essential and top-of-mind for our customers. I want to underscore here that reliable and secure work-from-home capabilities have become a must-have for our customers.

The work-from-home trend is becoming a demand game changer for our IT infrastructure and Workplace and Mobility businesses, and we are eager to capitalize on these opportunities. You will hear from Paul that we are currently in the market with the Workplace and Mobility business. But given the importance of working from home to our customers, we are reevaluating retaining the business to capitalize on this strong demand. It is now time for us to focus on cross-selling our services to our customers that we have worked so hard to take care of, which is exactly what we are doing.

We are in the market right now cross-selling to our top 200 accounts. We have spoken to 90% of them concerning our Workplace and Mobility offering, our ITO and cloud capabilities and our analytics and engineering offering. All of these actions have enabled us to increase our qualified pipeline by 23% over the last couple of months.

I am looking forward to working with our teams and customers to seize this market opportunity that this third initiative has created and convert this cross-selling pipeline into new revenue for DXC.

Now let me please turn the call over to Paul.

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

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

In the current quarter, we had restructuring costs of \$4 million on a pretax basis or \$0.01 per diluted share. Also in the quarter, we had \$92 million on a pretax basis or \$0.28 per diluted share for transaction, separation and integration-related costs, primarily from external spend associated with assets under strategic review. In the fourth quarter, amortization of acquired intangibles was \$148 million on a pretax basis or \$0.45 per diluted share. Also in the quarter, we recorded a \$3.9 billion noncash goodwill impairment charge or \$15 per diluted share. Also in the quarter, our annual remeasurement of pension assets and liabilities resulted in an accounting gain of \$244 million. As of year-end, we had pension assets of \$11.1 billion and pension liabilities of \$10.2 billion for an overfunded position of \$940 million.

Excluding the impact of these special items, non-GAAP income before taxes from continuing operations was \$292 million for the quarter, and our non-GAAP EPS was \$1.20, driven by a tax benefit from the release of a valuation allowance in a key foreign jurisdiction as well as the benefit from other tax planning initiatives.

For the full year, restructuring, transaction, separation and integration costs amounted to \$570 million on a pretax basis or \$1.78 per diluted share. For the full year, amortization of acquired intangibles was \$583 million on a pretax basis or \$1.73 per diluted share. Our full year non-GAAP earnings also include the impact of goodwill impairment losses in Q2 as well as the gain on HPE arbitration award. So for the full year, our non-GAAP income before taxes from continuing operations, which also includes the gain on the HPE arbitration award, was \$1.84 billion, and our non-GAAP EPS was \$5.58.

I will now move to our fourth quarter and full year results in more detail. As always, all revenue comparisons I will discuss will be in constant currency.

GAAP revenue in the fourth quarter was \$4.8 billion despite a stronger dollar during the quarter. Currency was a headwind of about \$40 million for the quarter sequentially and \$101 million headwind compared with the prior year. Our full quarter revenue -- fourth quarter revenue represents a sequential decline of 3.3% in constant currency. The revenue decline reflects the impact of prior terminations, run-offs and price concessions as well as a \$49 million in onetime headwind from the resolution of certain customer disputes in the quarter. Adjusted EBIT in the quarter was \$352 million. Adjusted EBIT margin was 7.3%, and our non-GAAP EPS was \$1.20.

In the quarter, 2 items were particularly noteworthy as they impacted our income from continuing operations in our EPS. First, the resolution of certain customer disputes impacted non-GAAP income before taxes from continuing operations by \$73 million and our non-GAAP EPS by \$0.21. On the other hand, EPS in the quarter benefited from a low tax rate as a result of the release of a valuation allowance in a key foreign jurisdiction and the benefit from other tax planning initiatives. Normalizing for a tax rate of 27% and excluding the charge associated with the resolution of those customer disputes, EPS in the quarter would have been \$1.07.

In the fourth quarter, bookings were \$4.4 billion for a book-to-bill of 0.9x. For the full year, GAAP revenue was \$19.6 billion, including a year-over-year currency headwind of \$445 million. For fiscal '20, adjusted EBIT was \$2.06 billion. Our adjusted EBIT margin was 10.5%, and our non-GAAP EPS was \$5.58. For the full year, bookings were \$17.7 billion for a book-to-bill of 0.9x.

Turning now to our segment results. I'll start with the GBS segment, which includes the following layers of our enterprise technology staff, application and industry IP as well as analytics and engineering, which now includes data analytics, advisory and the engineering services of Luxoft. The GBS segment from now also includes the U.S. state and local health and human services business and the horizontal BPS business, which both are under strategic review.

GBS revenue was \$2.3 billion in the fourth quarter, down 1.5% sequentially. Adjusting for the impact of the resolution of certain customer disputes, revenue was flat sequentially. Year-over-year, GBS revenue was up 7.3%, primarily due to the contribution from the Luxoft acquisition. In the fourth quarter, GBS segment profit was \$223 million, and profit margin was 9.7%. Adjusting for the impact of customer dispute resolutions, the profit margin would have been 12%. GBS bookings for the quarter were \$2.2 billion for a book-to-bill of 0.9x, primarily due to a slippage of a one large deal that we expect to sign in the current quarter. For the full year, GBS revenue was \$9.1 billion. Segment profit was \$1.3 billion. Margin was 14.3%, and our bookings were \$9 billion for a book-to-bill of 1x.

Turning now to our GIS segment. Our GIS segment consists of the ITO layer of the enterprise technology stack and our cloud and security business. It also includes our Workplace and Mobility business, which is under strategic review.

GIS segment revenue was \$2.5 billion in the fourth quarter, down 4.9% sequentially and 16.9% on a year-over-year basis. The decline year-over-year is due to the run-off and termination of certain accounts as well as the decision from a few customers to in-source services. GIS segment profit in the fourth quarter was \$192 million, and profit margin was 7.7%. Sequentially, GIS profit margin was down 100 basis points, primarily from the impact of revenue run-off.

GIS bookings for the quarter was \$2.2 billion for a book-to-bill of 0.9x. And for the full year, GIS revenue was \$10.5 billion. Segment profit was \$1 billion. Margin was 9.6%, and bookings were \$8.7 billion for a book-to-bill of 0.8x.

Now let me comment on the performance of the layers of the enterprise technology stack. ITO revenue was down 7.1% sequentially and 20.6% year-over-year. This layer of the stack has been impacted by terminations and price-downs due to actions that were taken in the last 12 to 18 months. Book-to-bill was 1x in the quarter, which is an early indication that the effort to secure and stabilize our customers is starting to pay off. And for the full year, revenue was \$5.5 billion.

Cloud and security revenue was up 3.1% sequentially and up 7% year-over-year. The revenue increase in this layer of the stack was driven by continued demand for IT modernization solutions. Book-to-bill was 1.1x in the quarter. And for the full year, cloud and security revenue was \$2 billion.

Moving up the stack, the application and industry IP layer was up 0.6% sequentially and flat year-over-year. We're seeing solid demand for our enterprise cloud application business. Book-to-bill for this layer of the stack was 0.8x in the quarter as customers pulled back on project work and new application deployment due to COVID-19 as well as the slippage of one of the large deal I just referenced. For the full year, revenue was \$5.5 billion, down 2.1% year-over-year.

In the analytics and engineering layer of the stack, revenue was down 6% sequentially, primarily from softness in the automotive sector and some project delays in banking. Book-to-bill in the quarter was 1.3x. Revenue for this player of the stack was \$1.8 billion, pro forma for the full year contribution of Luxoft.

Now let me turn to the 3 businesses under strategic reviews. Overall, these 3 businesses generated \$5 billion in revenue for the year. As you all know, we announced the sale of our U.S. state and local health and human services business to Veritas Capital for \$5 billion in cash. This business continues to perform very well. Our teams are diligently working through separation activities. And we now expect this transaction to close earlier than expected and most likely by the end of our second quarter. We're in active discussions with interested parties for the horizontal BPS and Workplace and Mobility businesses. Our horizontal BPS is performing well despite challenges from COVID-19.

For our Workplace and Mobility business, we're seeing strong demand in the current environment as a number of customers are looking to enable their employees to work remotely. Our pipeline has increased by \$1 billion since the beginning of our fiscal year. As Mike mentioned, Workplace and Mobility has become an area of strategic importance for our customers in the current environment. So we're also reevaluating the value-creation potential of retaining this business, while at the same time, we continue to pursue discussions with interested parties.

Turning to other financial highlights. Adjusted free cash flow in the fourth quarter was \$131 million or 43% of adjusted net income. We generated solid free cash flow despite 2 large cash outflows, including payment for our annual 401(k) match and a contract settlement that we expect to recover from insurance coverage in the current fiscal year. And for the full year, adjusted free cash flow was \$1.34 billion or 92% of adjusted net income. Our capital expenditures, including the payment of capital leases, was \$368 million in the quarter or 7.6% of revenue. For the full year, CapEx was \$1.38 billion or 7% of revenue.

During the quarter, we paid \$53 million in dividends. And for the -- during the whole fiscal year, we returned \$950 million of capital to our shareholders in the form of \$214 million in dividends and \$736 million in share repurchases.

Cash at the end of the quarter was \$3.7 billion. Our total debt was \$9.9 billion, including capitalized leases for a net debt to total capitalization ratio of 41.6%.

Now I'd like to turn to our liquidity and the actions we've taken to enhance our financial flexibility. As we've stated, one of our key strategic priorities is to maintain a strong financial position consistent with an investment-grade credit profile. In the last couple of months, we've taken a number of steps to strengthen our liquidity and financial position. We drew down on our \$4 billion revolving credit facilities in 2 steps: \$1.5 billion in March and \$2.5 billion in April. We were able to build out our cash position during an uncertain economic environment, and we used our credit facilities to pay down commercial paper. We subsequently accessed the capital markets and raised \$1 billion in bonds via 2 senior notes with an aggregate principal balance of \$500 million each due in 2023 and in 2025. The proceeds were used to pay down bank debt and extend our maturity profile.

As of April 30, we had over \$5.5 billion of cash on our balance sheet. We also had \$10.2 billion in debt and \$2 billion in capital leases. \$6.2 billion of our debt, consisting of term loans and drawn revolver, is subject to financial covenants. We recently modified our covenants from a 3x gross debt-to-EBITDA to 3x net debt-to-EBITDA for the next 12 months, which further enhances our flexibility. Our net debt-to-EBITDA at the end of fiscal '20 was 1.6x and less than 1 turn on a pro forma basis for the sale of the U.S. State and Local Health and Human Services business. After 12 months, this covenant will step down to \$2.25 billion net debt-to-EBITDA.

We also completed the extension of about \$1 billion of euro term loans by 12 months, further improving our debt maturity profile, and so as a result, we now have less than \$600 million of debt maturing in the next 24 months. As previously communicated, we intend to use the proceeds from the sale of our State and Local Health and Human services business to pay down our debt.

Lastly, in this uncertain environment, we're also taking the prudent step of suspending our dividend. This decision aligns with our investment-grade financial policy. The pause in the dividend will give our Board an opportunity to reevaluate the appropriate dividend payout, following the completion of our strategic alternatives.



So in summary, we're taking steps to ensure that the company is well positioned financially and is able to withstand potential further market dislocations. Importantly, these steps underscore our commitment to maintaining a strong financial position consistent with an investment-grade credit profile, but it also gives us the flexibility to execute our transformation journey.

As stated previously, fiscal '21 is a transition year for DXC. We are executing on a number of initiatives as part of our transformation journey. We're securing our customers, optimizing cost and executing on strategic alternatives while enhancing our liquidity and our financial position. We're working on all of these initiatives concurrently, but the added uncertainty from COVID-19 makes it very challenging to have a clear line of sight on the timing and the full impact of these actions on our financial results. We're, therefore, suspending our fiscal '21 guidance until we have better visibility into the COVID situation and we've progressed further along on these initiatives.

We expect the impact of our transformation journey on COVID-19 to be more pronounced in the first half of the fiscal year. For the current quarter, the revenue loss due to price concessions in previously terminated business, combined with the impact of COVID-19 on our project work, could result in revenue decline of 8% to 10% sequentially, but we expect that revenue to stabilize sequentially thereafter. Our first quarter EPS will be a low point for the quarter. It reflects the more pronounced impact of the revenue decline in Q1 as well as the impact of additional investments in the business and a higher level of interest expense in the quarter.

Additionally, Q1 EPS only includes minimal contribution from the cost-optimization actions we're undertaking. The benefit of those cost-optimization initiatives of \$550 million for fiscal '21 or \$1.60 per share will accelerate throughout the year beginning in the second quarter. Now the interest expense in the first quarter is also not indicative of the annualized level for the remainder of the year, particularly when you factor in the paydown of debt from the proceeds of the sale of the U.S. State and Local Health and Human Services business.

And with that, I will now turn the call to Mike for his closing remarks.

Michael J. Salvino - DXC Technology Company - CEO, President & Director

Thank you, Paul, and I just wanted to take a moment to recognize all the great work that you and your team have done to position us for success during the COVID-19 crisis.

I am pleased with the progress we are making on our strategic initiatives, which should allow us to have a stronger balance sheet, enabling us to execute our transformation. As part of our ongoing strategy, we will continue to assess the competitive position of our business portfolio and develop plans to unlock future value, either organically or inorganically.

In summary, we are making good progress on our transformation journey. We are fixing our delivery and customer relationships that will stem the revenue run-off that has impacted us in FY '20 and FY '21. We are executing our cost-optimization plans to better serve our customers by eliminating complexity and confusion. And finally, we are seizing the market opportunity where the criticality of the IT estate is top-of-mind for customers, which is highlighting our expertise. This allows us to cross-sell our capabilities across the enterprise technology stack. All of these points will create the foundation that will position DXC for growth.

Now before opening the call up for questions, I just want to wish you and your families all the best during this time, and please stay healthy.

Todd, please open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)



We'll take our first question from Darrin Peller with Wolfe Research.

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

All right. Glad to hear you're all doing well and safe. Mike, can you give us a deeper understanding of the conversations you're having with clients, the responses that you're getting back from these clients? They really recognized, I guess, the renewed focus DXC is getting on the ITO business. And then overall, would you say you think these conversations are getting will -- has helped you conservatively capture what you're seeing in that \$1 billion impact in '21?

Michael J. Salvino - *DXC Technology Company - CEO, President & Director*

Darrin, thanks. The -- look, the bottom line is I think we're making great progress. That's why we put together the customer quote slide. And what they're basically seeing is if you think about the environment right now, basically almost overnight, people had to start working from home. And the CEOs and CIOs that I'm talking to are saying, "All right, look, what do I do with my existing estate because now I've got my entire workforce hitting up against that estate pretty much every day?"

So when I start talking about the IT estate again and say, "Hey, it's become relevant," is I think we've all experienced some level of, call it whatever, slow times or what have you against what you're trying to do from a virtual standpoint. So that's top of mind for the senior level folks. How do I make sure I can bring my entire workforce together to communicate virtually? So those are the conversations.

And then the key thing for us is the fact that it was an outpouring of, "Look, you guys really showed up. I really appreciate what you've done." And it wasn't just showing up, Darrin, with normal-type things, but it was finishing transitions that was important. It was thinking innovatively, and it was making sure that we went above and beyond the call of duty to get them where they need to be.

So that's why I highlighted for you all that, look, the plan was always to go cross-sell these customers. That's why I focused on the customers to begin with. And what this has enabled us to do is look at those customers now and say, "All right, what else can we be doing?" And then I wanted to highlight that, look, I have been having discussions with analysts for a while now about the cloud, and I'm very, very supportive of the cloud. But when I analyzed our IT estate and the criticality of that, that isn't just going to move to the cloud quickly. I've been saying that all along, Darrin, all right?

And the fact of the matter is now I'm sitting there going, "We have the facts." Because we use Virtual Clarity. We made the investment in Virtual Clarity, and we got to the over 60% number, and now we got to go tackle that opportunity. And some of it is in that \$2.1 billion that I mentioned, and some of that is in the 23% qualified pipeline uptick over the last couple of months.

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

Okay. And just a follow-up on the comment you made around the impact of what you're seeing on pricing and other factors. I mean, it sounds like you've done a pretty good bottoms-up analysis across your client base now, so we should feel pretty good about your conservatism there or really how comprehensive that review was around that \$1 billion.

Michael J. Salvino - *DXC Technology Company - CEO, President & Director*

Yes. I mean, look, we -- I've taken my time, okay? And the plan we've got set, I think, is at a very detailed level, and hence, the reason why I highlighted again the Virtual Clarity stuff, all right? And the fact that we are -- I know -- and the fact that, Darrin, I also highlighted for you all from a very transparent standpoint the 40 challenged accounts, okay? And the fact that in 7 months we stabilized the majority of those accounts and delivered in the COVID-19 environment, that's special. We've got a good team here. We're doing good stuff, okay?

Operator

We'll take our next question from Ashwin Shirvaikar of Citibank.

Ashwin Vasant Shirvaikar - Citigroup Inc, Research Division - Former Director

Mike, I want to take up on your last comment, where 35 of 40 problem clients resolved, 2 of them are leaving. I mean, as a problem, this is behind you. I wanted to understand a couple of things.

One is, if I could figure out where I would see maybe the base financial impact of this. The amount that mentioned was, I think, \$73 million in quarter seemed relatively small impact. Is there ongoing impact of pricing concessions? Is there ongoing impact on cash flow or terms, easier comps that you had to give? Where would I see the impact of that ongoing?

Michael J. Salvino - DXC Technology Company - CEO, President & Director

Ashwin, are you talking about the \$2.1 billion of new work? Are you talking about the \$1 billion of revenue runoff? What exactly -- help me understand that a little bit more.

Ashwin Vasant Shirvaikar - Citigroup Inc, Research Division - Former Director

The combination of that and then taking that down to, are we going to be faced with sort of a structurally lower margin because you might have given significant price concessions to resolve these problems? Get a little bit into the solution. What was the solution? How did you fix these things so quickly so that we can understand what the ongoing impact is?

Michael J. Salvino - DXC Technology Company - CEO, President & Director

Okay. Well, here's the 3 things that we did, right? I mean, first of all, moving forward, obviously, we've got significant pricing discipline. So we're not doing that anymore.

The second thing is, like I had mentioned, right out of the shoot, I started investing in those customers to get the delivery sound, all right? Because I didn't want to have any other discussions about revenue run-off, and now those discussions, right, are over. Paul mentioned that the majority of that revenue run-off will be in the first half of FY '21.

And then the last thing is the -- the last thing that we did around there is one, we secured our delivery operations, okay? And we've put in place various mechanisms to make sure that not only were we delivering, but Ashwin, I'm calling these customers on a regular basis. I'm sitting in weekly meetings. I am having dialogues with these customers to make sure I hear not only what they're saying, but I'm also pushing on them a little bit when I hear what our competitors potentially are saying about us, all right? And I'm giving them the facts around what we're doing at DXC. That's why when I thanked Paul about the liquidity process and the financial flexibility, all right, that we've got over the next 24 months, we've got the runway to go make this thing happen.

Ashwin Vasant Shirvaikar - Citigroup Inc, Research Division - Former Director

Understood. Understood. And you said an important thing. You kind of said it wasn't the secular impact of cloud. It was really suboptimal delivery, the way things were being done. Is it possible to kind of do an attribution analysis of sorts to kind of figure out -- you've had terminations, price-downs, so optimal delivery. Cloud is something of an impact. Maybe it's incorporated in the price-downs. There's a short-term impact here from COVID. As we think of growth going forward, how should we think of that in terms of all these factors?



Michael J. Salvino - DXC Technology Company - CEO, President & Director

Well, look, in terms of growth moving forward, right, before I give any other guidance, I want to get further down my transformation journey. But the -- what I will tell you is this, right, when I think about what we're doing with these customers, it was really important for us to show up and deliver for them, okay? And when you show up and deliver for a customer, the immediate thing that happens is -- I have one of our largest customers tell me 2 weeks ago after delivering, "You're going to get the first shot at the new work, okay?"

And what I have seen in the analysis, Ashwin, is the fact that at a detailed level, right, what we're doing is making sure that we understand and listening to the voice of the customer, and then we're starting to cross-sell what's happening. And the environment just helped us because outsourcing always does better in a down market, and our clients want cost savings. So not only are we coming to the table, but they're coming to the table.

Paul, would you have anything else to add on Ashwin's comments about numbers or what have you?

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

No, Mike, I think we're seeing it across the board. This cross-sell that you're talking about, certainly, I mentioned \$1 billion in new pipeline that just really got generated by the workplace business. The ability -- and also to build actually on what you just said, Mike, because I think it's important, Ashwin, to note. I think I should have made it clearer during our -- my presentation, and I think it was on one of the slides that our business is actually quite resilient in economic uncertainties. If you think about it, 30% of our business is only exposed to project work.

So we have the opportunity, Ashwin, Mike has mentioned, of stabilizing the customer and securing them to come back and just really meet their core need. And their core need right now has shifted to make sure that their on-prem ITO environment is resilient and secure. And so that gives us really a great opportunity to showcase the rest of our product -- of our offering across the enterprise technology stack.

Michael J. Salvino - DXC Technology Company - CEO, President & Director

So Ashwin, just to close on that, the bottom line is this. I've been saying since I showed up here, all right, that I have a hard time believing everything is just moving to the cloud because when I analyze these accounts and the critical nature, I mean, people have described us as being at the heartbeat of our clients. People have described us as being as part of the fabric of what they do. That stuff is going to thoughtfully move to the cloud. And oh, by the way, when it does move to the cloud, they still need our capabilities. All the knowledge, everything that we do on-prem is needed in the cloud, except for walking into a data center.

So look, getting back out there in the market, Ashwin, and having those discussions with clients, and then knowing we care is -- it's turned the tone. So when I say a new DXC is showing up, that's what we're doing.

Operator

We'll take our next question from James Faucette with Morgan Stanley.

James Eugene Faucette - Morgan Stanley, Research Division - Executive Director

Great. I wanted to ask about -- as you look at the cost run-offs and the progress you're making with your customers, and as you referenced, the new DXC, how confident are you that the revenue run-offs will kind of end in fiscal year '21? And what do you need to see happen from this point for that to be the case so that you can kind of get yourself back into a firm footing and headed in the positive direction you want to be going from a financials perspective?

Michael J. Salvino - DXC Technology Company - CEO, President & Director

Okay. So 4 things. The first one is we need to continue to deliver for these customers, right, because that's going to stem any future revenue run-off. Second is we got to continue to build trust. And we got a huge opportunity to build trust in the COVID-19 environment, all right? And I don't want to minimize COVID-19 -- but like I said, right, I take it very seriously, but we had a heck of an opportunity to deliver for our customers. So now, the key thing is what additional new work is potentially out there. And that's just in the existing environment every day. Upgrade -- updating a network, updating a server, putting in patches, right, we need to be doing that.

The third thing is the cross-selling, and the cross-selling is meaningful because now we've got an open door based on those relationships that they trust us. And then the last thing is we want to continue, obviously, to optimize our cost. I wasn't kidding about me doing the analysis about the detailed people doing the work, right, and the number of layers between them and the customer. And getting that more simplified and streamlined that's going to help us in that environment. So I see those 4 things, James.

Operator

We'll take our next question from Bryan Bergin with Cowen.

Bryan C. Bergin - Cowen and Company, LLC, Research Division - MD & Analyst

I wanted to ask on the cost optimization plan. So how much of that \$550 million is a net cost savings versus reinvestment that you may plan to make? And then Paul, just as it relates to the \$700 million, too, as we think about the following fiscal year?

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

The cost optimization of \$550 million is all going to be net incremental to the bottom line. And as I mentioned, not much of it was in the first quarter, so we're going to see it accelerate throughout the quarter. You'll see it starting to show up in the second quarter. And I think from a timing perspective, some of these initiatives that you can imagine in complex countries, as we begin to execute them and we're way on our way now to getting the work done, will have basically a carry-on effect in fiscal '22. That's the difference between the \$700-plus million that we're going after and the \$550 million. So that will add further to the run rate actually as we exit fiscal '22.

And we're not just done with that. This is just really a part of the plan of continuing to optimize costs. There are other opportunities that we're looking at. We're looking at, for example, our real estate footprint, for example, in this new redefined work environment. We're also looking at contractor costs or further opportunity within the pyramid of how we serve our customers. All of these things are still things that are going to be top-of-mind for us as we progress through the year and we start to look to fiscal '22.

Bryan C. Bergin - Cowen and Company, LLC, Research Division - MD & Analyst

Okay. Is there a -- as we think about cash flow then, how should we think about conversion here and really just absolute cash flow generation levels? Understanding you've given yourself more flexibility in financials, but from a cash generation perspective, anything changed in the model going forward?

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

Well, it's hard to give you, again, guidance at this point in time. One thing that I can tell you that a lot of people worry about the fact that maybe customers will defer payment in this environment of COVID, for example. And another interesting statistics is that only about 80 -- 15, 1-5, 15% of our revenue comes from industry that have been really high-risk exposed to COVID, like the airline, for example, or the hospitality sector or some



of the consumer goods players -- or retail. And then the rest of it is 85% of our business is in industries -- come from industries or customers in industries that are moderate to lower risk. So that's a good sign for us.

Right now, our cash flow has been very solid. You can see from the data that I gave you as of April 30 that we continue to generate solid cash flow. And I mentioned that we are over \$5.5 billion of cash at the end of April. And so we're just watching the market carefully, managing our working capital, being very prudent in our cost -- or in our spend. So I can't give you a precise number in terms of netting -- how much of the cash flow as a percent of net income. But in due time, as we get a little bit more clarity, I'll be able to give you that.

Operator

We'll take our next question from Rod Bourgeois with DeepDive Equity Research.

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

So I have a question on revenues and then a follow-up about the cost takeout plan. So first, on the revenues, your commentary has conveyed enthusiasm about the progress you're making with clients. On the other hand, it's hard to see the benefits from that progress in looking at the near-term financials and the outlook for the June quarter, which, of course, we understand is affected by COVID and the contract run-offs that seemingly were started into motion in earlier periods.

But with that as the backdrop, I want to ask, particularly, Mike, what are the metrics you're looking at concerning DXC's turnaround? And can you also comment on how those metrics are making you think the worst should be over on the revenue run-off as of the first half of fiscal '21?

Michael J. Salvino - DXC Technology Company - CEO, President & Director

Okay. So the 3 metrics, Rod, that I would lay out is, first of all, the customer delivery and the relationships because that is going to stem the revenue runoff. And being conservative, I can't predict everything that every single one of these customers is going to do, but I'll tell you, I have gone out of my way to make sure that they've seen the, what I call new DXC showing up, all right? So the first one is the delivery and am I hearing any problems that are out there. And I've made myself personally available along with the leadership team. So that's the first thing.

Second thing is we're obviously very serious about the second initiative, which is optimize cost, all right, because there's too many people between the folks doing the work and the customers, all right? So we need to make sure we get that cleaned up. I think that will continue to help us deliver. I just -- I look at also some basic things in that bucket, too, right, around just the operational performance. I mean, our P1s are down. Our service -- SLA penalties are down. That's all metrics that I'm looking at.

And then the final thing, I gave you all a glimpse as to the campaigns we're running, all right? And we're at the front end of it because I'm on my team every day about the cross-selling. The fact that we're at 90%, I mean, I would have liked to have been a little bit better on that, right? But the 23% uptick, now what I'll be measuring is the conversion of that qualified pipe.

So it's those 3 things. It's the customer delivery and the relationship, all right? The second one is the optimized cost, and then the third is the cross-selling, Rod.

Operator

This concludes today's question-and-answer session. We appreciate your participation.



Michael J. Salvino - DXC Technology Company - CEO, President & Director

Todd, hang on. Hang on. Rod had another piece of that question. Are you guys still there?

Operator

Rod, you're back in line.

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

Great. Thank you. Thanks for letting me...

Michael J. Salvino - DXC Technology Company - CEO, President & Director

Rod, sorry about that.

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

No problem. So listen, in the past, we've seen firms pursue cost takeout, and then sometimes there's a revenue trade-off. So my question is, how do you take out substantial costs without sort of stymieing the progress on the customer service improvements that you're seeing and also just laying a better groundwork for growth? It sounds like you see ways to take out costs that may actually make things smoother with clients, but it'd be great if you could explain more about how to avoid trade-offs on growth as you pursue the cost takeout.

Michael J. Salvino - DXC Technology Company - CEO, President & Director

Okay. Thanks, Rod. The -- and again, sorry about cutting you off. The -- look, the first one is you got to overcommunicate with the customers. So my third message during this quarter, I highlighted exactly what we were doing in layering to our top 200 accounts. So I've proactively communicated with them. And then when I've had the virtual meetings or the conversations, I've reiterated what we're doing. So it's not a surprise, okay?

I've also given them some examples, right? And the examples, Rod, came from the second piece, which was the detailed analysis. I kept saying, right, over the last 7 months, I'm going to go review these accounts. I'm going to go review these accounts. Well, we went and did the work. And we identified, right, the layers. And when you identify the layers, you can actually give the customer some examples of, "Have you seen so and so? Have they shown up and made an impact?" And when they recognize that, all right, "Well, that's part of our management structure, but that person really isn't showing up every day," they get the concept, all right?

And then the last thing is you got to continue to take care of the people that are doing the work. So that's why I wanted to make sure that I highlighted for you all that we gave them raises, all right? The folks that are coming in today that are doing the detailed work, we've locked those folks down. We started in January and then we'll be done -- we started in January in India to get ahead of the industry in terms of salary increases, and then we will finish with the rest of the world in August.

So it's really doing those 3 things: proactively talking or communicating to the customer, second is the detailed analysis, then 3 is taking care of the people.

So Todd, with that -- thanks, Rod. Todd, sorry, I interrupted you. You can probably close the call now.



Operator

Thank you, sir. Again, we appreciate your participation, ladies and gentlemen. This concludes today's call. You may now disconnect.

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