

11 - 01 - 2023

DXC Technology Services, LLC

Q2 Earnings Call

DXC Technology Services, LLC

Q2 Earnings Call

CORPORATE SPEAKERS:

Michael Salvino

DXC Technology Services, LLC; Chairman, President and Chief Executive Officer

Robert Del Bene

DXC Technology Services, LLC; Executive Vice President and Chief Financial Officer

PARTICIPANTS:

Zachary Ajzenman

Cowen; Vice President

Gates Schwarzmann

Citi; Analyst

James Friedman

Susquehanna International Group, LLP; Senior FinTech and IT Services Research Analyst

Rod Bourgeois

DeepDives Equity Research, LLC; Head of Research

Bradley Clark

BMO Capital Markets; Senior Equity Research Associate, Software & IT Services

PRESENTATION:

Operator^ Thank you. Good afternoon, everybody. I'm pleased that you're joining us for DXC Technology's second quarter Fiscal Year 2024 Earnings Call. Our speakers on the call today will be Mike Salvino, Chairman, President and CEO; and Rob Del Bene, our EVP and CFO. The call is being webcast at DXC's Investor Relations website.

The webcast includes slides that will accompany this discussion today. Today's presentation includes certain non-GAAP financial measures, which we believe provide useful information to our investors.

In accordance with the SEC rules, we provide reconciliation to measures of the respective and most directly comparable non-GAAP measures. These reconciliations can be found in the tables included in today's earnings release and in the webcast slides. Certain comments we make on the call will be forward-looking.

These statements are subject to known risks and uncertainties, which could cause actual results to differ materially from those expressed on the call. A discussion of these risks and uncertainties is included in our quarterly report on Form 10-Q and other SEC filings.

DXC Technology Services, LLC

Q2 Earnings Call

I'd now like to remind our listeners that DXC Technology assumes no obligation to update the information presented on this call, except as required by law. With that, I'd like to introduce DXC Technology's Chairman, President and CEO, Mike Salvino. Mike?

Michael Salvino^ Thanks, John. I appreciate everyone joining the call today. I hope you and your families are doing well. Today's agenda will begin with an update on our overall business performance. Next, I will update you on our performance of our GBS and GIS businesses. Rob will then discuss our financial results in detail and our guidance. And finally, I will make some closing remarks before opening the call up for questions. We are pleased with our financial performance in Q2.

As our leadership team continues to strengthen and execute on our offering based operating model. Organic revenue for Q2, was minus 3.6%, above our guidance and consistent with our Q1 performance.

Our GBS business performed better than we expected at 2.4% organic revenue growth, and GIS showed progress going from organic revenue of minus 9.9% in Q1 to minus 9.1% in Q2.

Our EBIT margin was 7.3%, which is better than our guidance and quarter-on-quarter was an 80 basis point improvement due to both GBS and GIS margins improving.

EPS was \$0.70 at the high end of our guidance and book-to-bill was 0.81 on our trailing 12-month book-to-bill is now 1.02. Free cash flow was \$91 million, which was an increase over the minus \$75 million we delivered in Q1.

This execution shows that we are beginning to see the benefits of our new offering based operating model where we are now running global offerings with the goal of driving revenue growth and expanding margins, EPS and free cash flow. The Q2 results clearly showed we achieved all four goals when compared to Q1 performance.

As you have heard consistently from us over the last several quarters, our management team is laser-focused on transitioning DXC from stability to higher performance. That work started with reinforcing our financial foundation and customer relationships and moved on to ensuring we have the right talent in the right places to execute on our growth and expansion goals.

With the moves that we have made over the last several months, I now believe we absolutely have that team in place. In Q2, we added two more senior executives to our leadership team to strengthen our ability to run our offering based operating model and consistently deliver on our financial commitments.

DXC Technology Services, LLC

Q2 Earnings Call

Howard, Andrew and Rob marked three senior executives with significant senior management experience and expertise in critical parts of our business, that have joined us to play key roles for DXC alongside the other talented members of our senior leadership team.

Howard will be running our Applications offering and be accountable for our AI strategy Andrew will be running our modern workplace offering, and obviously Rob is our new CFO, who has been making a huge impact in driving our financial performance.

Howard has joined us from IBM. He is an IT services expert with proven experience in creating growth strategies and executing against them as we did at IBM with their cloud business. Prior to IBM, Howard was the CTO of Bank of America, which gives him a unique perspective of what customers want in an IT service provider. Howard is the perfect choice to lead our Applications offering.

Andrew joins us after working for some of the largest and well-respected brands in the technology industry. Most recently, he was the Chief Digital Officer at Microsoft, where he was our customer for the Modern Workplace services we provide to them. Prior to Microsoft, I worked with Andrew at Accenture, where he was the CIO and delivered innovative digital services to a very demanding workforce. His ability to run global P&Ls and deliver these services makes him the perfect choice to run our global Modern Workplace offering.

Howard and Andrew, combined with Chris, who runs ITO, gives us three former CXOs of Fortune 500 companies, leading almost 70% of our revenue. These three bring deep customer and industry relationships to DXC and the ability to attract top talent to help us deliver on our financial targets.

Now turning to our GBS business. GBS grew organically for the tenth consecutive quarter in Q2 and now accounts for 49.7% of our total revenue. As we have stated repeatedly, consistently growing this high-value business and having it become the majority revenue source of DXC, is important to our overall growth strategy.

As you can see from the results this quarter, we are delivering on that goal. The 2.4% organic revenue growth was moderately ahead of our growth expectations for the quarter due to the stronger performance across all three offerings. Also, I was pleased to see us expand margins from 11.3% in Q1 to 12.5% in Q2.

Our insurance offering has benefited the most from our new operating model because it's been in the model the longest.

Our insurance offering delivers a SaaS model to our customers, and we are the world's largest provider of Insurance Software & BPS solutions to the industry. Under our new model, Ray can now focus on selling these capabilities to existing customers and delivering services more

DXC Technology Services, LLC

Q2 Earnings Call

efficiently. His team has done an outstanding job of beginning the modernization process of our insurance software products, positioning our insurance offering for further growth.

This is just one example of how our right model and right leader approach is clearly making a positive impact and starting to generate solid financial performance. I believe that kind of production across DXC is only beginning. Another key attribute of our growth strategy is selling our GBS offerings to our GIS customers.

On a yearly basis, we generate roughly \$370 million in revenue by selling analytics and engineering to our GIS customers, and this is growing 11% in FY '24 so far. The new operating model is allowing Michael and his team to continue having success in a very tough market.

Another example of us having the right model and the right leader is our Applications offering, which generates roughly \$1.2 billion of revenue by selling to GIS customers but it is not growing in FY '24 so far. Facing this as one of Howard's highest initial priorities, as we have charged him with responding to the AI demand and getting our customer base ready to accept this technology.

Moving now to our GIS business, where this quarter, we moderately moved it in the right direction, shrinking the decline in revenue from minus 9.9% in Q1 to minus 9.1% in Q2, while margin increased from 5.2% in Q1 to 5.8% in Q2. Like GBS, all three offerings performed better than our expectations. Let me highlight the progress we have made in the quarter to continue fixing our ITO business.

We have discussed moving to an infrastructure-light model. As part of this effort and as we've communicated on prior calls, we plan on selling facilities.

Chris and Rob are making progress on this initiative with plans to sell facilities in the back end of the year. Executing on this will allow us to sell underutilized assets, making us more efficient overall and helping us fix the margin of the GBS business moving forward.

We recently have signed a deal to become the partner of choice for AWS. This partnership incentivizes us and our customers to move their systems that are essential to their operations to the cloud.

We plan to use this deal to move some of our customers that are using a data center that is on-prem and suboptimized to the cloud to improve the cost economics for our customers and ourselves. Now let me turn the call over to Rob to discuss the details of our financials.

Robert Del Bene^ Thank you, Mike. Before I get into the numbers, I would like to say the team has made good progress with the implementation of the offering based operating model with improved execution and expect us to build on this performance going forward.

DXC Technology Services, LLC

Q2 Earnings Call

I'll now provide you with a quick rundown of our 2Q performance. Organic revenue was down 3.6%, which came in above our organic revenue guidance range and in line with first quarter's performance.

Of the 3.6% year-to-year decline, 160 basis points came from a reduced level of low-margin resale revenues, which was in line with our expectations. Adjusted EBIT margin came in at 7.3%, also above our guidance range. The margin increased 80 basis points sequentially and was down 20 basis points on a year-to-year basis.

Within this number, there is a significant reduction of 60 basis points from the pension income contribution on a year-to-year basis.

So without the pension income, our non-GAAP EBIT margin moved from 6.3% in 2Q '23 to 6.7%. Non-GAAP EPS was \$0.70 at the high end of our guidance range, down \$0.05 year-to-year and up \$0.07 sequentially. SG&A was well managed in the quarter with spending in line with our expectations. Free cash flow for the quarter was \$91 million, benefiting from our continued focus on working capital management and a lower level of CapEx.

In the quarter, our book-to-bill was 0.81, and the trailing 12 months is now 1.02. The level of bookings through the first half of the year is similar to the first half of fiscal '23 and the 0.81 is factored into our annual guidance. Looking forward, based on our pipelines, we expect book-to-bill to improve in the second half of the fiscal year.

Moving to our key financial metrics. Our second quarter gross margin of 23.4% was up 120 basis points year-over-year and 230 basis points sequentially, benefiting from our cost reduction initiatives. SG&A was 9.4% of revenues, up 60 basis points year-over-year. Depreciation and amortization was down \$7 million compared to the prior year.

Other income decreased \$28 million year-to-year, driven primarily by a \$25 million decline in non-cash pension income.

Taking this all together, adjusted EBIT margin was down 20 basis points year-over-year. Excluding pension income in both periods, the EBIT margin would have been up about 40 basis points year-to-year.

Net interest expense increased \$9 million year-over-year to \$25 million, primarily due to a higher level of variable interest expense on short-term debt. Non-GAAP EPS was down \$0.05 compared to the prior year, driven by a \$0.03 decline from higher interest expense, a \$0.06 reduction from a higher tax rate and a \$0.06 reduction due to lower pension income. These increases were partially offset by a \$0.09 improvement due to lower share count driven by our ongoing share repurchase activity. Now turning to our segment results.

DXC Technology Services, LLC

Q2 Earnings Call

Our business mix continues to trend to our higher-margin GBS segment. As a percentage of total revenue, GBS is now very close to 50% of revenues.

We anticipate that this trend will continue and that shortly, the GBS segment will be the majority of our revenue. GBS grew 2.4% organically and posted the tenth consecutive quarter of organic growth, which reflects the deep industry-based customer value delivered by the GBS teams. The GBS profit margin declined 20 basis points year-over-year, with the decrease driven by the impact of lower pension income. Turning to GIS.

Organic revenue declined 9.1% with a modest reduction of the decline sequentially. GIS profit margin decreased 40 basis points year-over-year, again driven by the reductions in pension income.

Now let's take a closer look at our offerings. Analytics and engineering revenue performance was up 5.3% below the first quarter growth rate. We are seeing a moderating level of demand, as customers are more cautious due to the current macroeconomic environment.

Applications revenue declined 80 basis points, similar to first quarter performance. While our Applications performance has been stable, we are expecting to see improving book-to-bill performance in the second half of the year based on the opportunities we see in our enterprise Applications business in public sector and in banking.

Insurance Software & BPS continued to grow with revenue up 5.2% and insurance SaaS component of the portfolio accelerated to high single-digit growth. The insurance platform and deep industry EPS skills of our team is resonating in the market. Security declined 1.8% year-to-year.

Cloud infrastructure and IT outsourcing revenues declined 9.8% year-to-year organically. The year-to-year performance continues to be impacted by two primary factors that I outlined in the first quarter earnings call, the impact of which were anticipated in our 2Q guide. The first is declined from contracts that were terminated some time ago and continue to wind down. The second factor is the decline in resale revenues, which drove 41% of our second quarter decrease in cloud and ITO.

The Modern Workplace business declined 9% year-to-year. And as with ITO, the business performed as expected in our 2Q guide.

Our expectation is that the sequential performance in revenue will stabilize through the second half of this year. Turning to financial foundation metrics. Debt levels decreased modestly in the first quarter to \$4.5 billion.

DXC Technology Services, LLC

Q2 Earnings Call

Restructuring and TSI expense increased to \$38 million, with the increase entirely due to the restructuring of facility leases part of our effort to rightsize our facility footprint. We are tightly managing restructuring, and we'll continue to evaluate opportunities to streamline our operations.

Operating lease payments and related expenses were \$91 million, down \$17 million year-to-year, reflecting continued management of our real estate commitments. In the quarter, capital expenditures were \$157 million, down \$38 million year-to-year. Finance lease originations were \$24 million, flat year-to-year.

As a percentage of revenue, capital expenditures and lease originations declined to 5.3% of revenues, as we tightly manage our capital and leasing commitments. As I mentioned earlier, free cash flow for the quarter was \$91 million, bringing our first half total to \$16 million, slightly better than last year's performance.

We have several large drivers of cash expenditures in the first half of the year such as bonus payments, payments to suppliers for annual renewals of software and related maintenance and cash taxes.

These cash outflows will be significantly lower in the second half of the fiscal year and combined with a higher adjusted EBIT and continued progress on working capital efficiency, we are maintaining our free cash flow goal of \$800 million. Turning to capital deployment. We made continued progress on our \$1 billion share repurchase program for fiscal year 2024.

Year-to-date, DXC has repurchased about 10% of our shares outstanding. This is in addition to the 7.4% of shares that we repurchased in fiscal year '22 and 10.6% in fiscal year '23. It is important to note that in aggregate, our \$1 billion share repurchase program will be funded through free cash flow and our asset sale program. And just to note, there's approximately \$500 million remaining for the second half of the fiscal year. Turning now to third quarter.

We expect Q3 organic revenue to decline from minus 4% to minus 5%, reflecting the weaker demand environment. Adjusted EBIT margin of 7% to 7.5% and non-GAAP diluted EPS of \$0.75 to \$0.80. Turning to our full year guidance.

We are reaffirming our organic revenue growth from negative 3% to negative 4%, our adjusted EBIT margin of 7% to 7.5% and EPS from \$3.15 to \$3.40.

We are also maintaining our free cash flow guidance of \$800 million. We have increased the tax rate. Our non-GAAP EPS guidance reflects a tax rate of 30%, up from our previous expectation of 29%.

We are making progress on our \$250 million asset sale program, which is a planned source of

DXC Technology Services, LLC

Q2 Earnings Call

cash in fiscal year '24. In 2Q, we realized \$61 million bringing our year-to-date asset sale total to \$65 million.

We have a portfolio of assets that will enable us to achieve a \$250 million objective and expect to execute by the end of the fiscal year.

These cash-generating transactions could result in a non-cash loss that is not factored into our guidance and as we have more clarity on the specific assets and timing, we'll provide an update in 4Q guidance. With that, let me turn the call back to Mike for his final thoughts.

Michael Salvino^ Thanks, Rob, and let me leave you with a few key takeaways. We are starting to see the benefits of our new operating model and our financial performance, and we are focused intently on making sure this continues.

We believe we now have the right model and the right leaders to run the global offerings for the three businesses where we need to make the most improvement.

Having three ex-CXOs now running Applications, ITO and Modern Workplace is a big win for us because they have deep relationships with existing CIOs that will prove impactful for us.

Our goal for DXC is to grow revenue and expand margins, EPS and free cash flow. Quarter-on-quarter, we made positive progress on each. Concerning revenue growth we grew GBS for the tenth straight quarter. We moderately slowed the decline in GIS.

We also continue to sell our GBS offerings to GIS customers. With the addition of Howard driving our Applications offering, we expect to do even more.

And we continue to make our high-value GBS business a larger part of our overall revenue, now at 49.7%. While making that progress on revenue, we expanded margin 8 basis points, EPS \$0.07 and free cash flow turned positive as we delivered \$91 million in the quarter.

I am pleased with our financial execution for the quarter. Expect that this execution will continue, and I look forward to updating you on our Q3 progress in February. Operator, please open the call up for questions.

Operator^ (Operator Instructions) Our first question comes from the line of Bryan Bergin with Cowen.

Zachary Ajzenman^ This is Zach Ajzenman on for Bryan. First question on the demand and outlook. So the trailing 12-month bookings remains above one, but the quarterly book-to-bill was below one for the second consecutive quarter.

DXC Technology Services, LLC

Q2 Earnings Call

So in this context, we're just looking to dig into what gives you confidence for the revenue affirmation for fiscal '24, which implies a 4Q revenue acceleration? And perhaps you can give some context around individual stack layer assumptions that underpin this 4Q revenue improvement.

Michael Salvino^ Okay. So Zach, the first of all, the bookings in the first half of the year was factored in our guidance when we gave you guidance last quarter. I would tell you the key takeaway from this earnings report is our ability to convert the pipeline to revenues. It's significantly improved.

We talked about project work that we saw on the back end of the year, that clearly has accelerated by us beating our revenue number. So and basically, what we're seeing is this shows that our operating model is really starting to work.

We talked about that last quarter that our detailed leaders need to get side-by-side, shoulder-to-shoulder with our customers and start driving the project stuff, and that's what we've done.

We think we can continue.

So what we see in our bookings, our bookings have always been lumpy. If you look at last year, if you look at the year before, they are lumpy.

We're focused now on replenishing the project work. And as I look forward, based on our pipeline, we expect book-to-bill to improve, particularly in the area of GBS.

So that hopefully gives you the color you're looking for. Next question -- do you have another question?

Zachary Ajzenman^ Yes.

On free cash flow, I just wanted to dig into the factors that are giving you confidence here and being able to achieve that \$800 million outlook that was affirmed.

Robert Del Bene^ Yes. Sure, Zach. This is Rob Del Bene.

As I mentioned in my remarks, there are several factors that hit free cash flow in the first half of the year that won't be repeated in the second half.

So the first is bonus payments.

They are always skewed to the first half of the year.

DXC Technology Services, LLC

Q2 Earnings Call

I could give you a rundown of the numbers in more detail.

Our impact in 1Q was \$130 million due to the bonus payments.

We have vendor payments that are normally skewed to the first half of the year, primarily for software and maintenance annual renewals and our projections are that, the second half of the year will be significantly lower due to the SKU into the first half of those annual payments in the range of \$450 million.

So those two factors alone are \$580 million.

The cash taxes are projected to be lower in the second half of the year as well in the \$80 million range.

The remainder, we're confident we'll come from second half EBIT being better than first half and continued working capital improvements.

We have -- we've identified specifically where we think we will make those improvements.

So that's the pretty detailed bridge to get to the \$800 million.

Michael Salvino^ All right, Zack. Thanks so much. (Jessica), next question.

Operator^ Your next question comes from the line of Gates Schwarzmans with Citi.

Gates Schwarzmans^ This is Gates Schwarzmans calling in for Ashwin. You went through the free cash flow bridge. You also had noted that you repurchased a quarter to share since early 2022. Is that the main use of cash going forward?

Or are there any M&A opportunities or other uses like further restructuring that might take precedence.

Michael Salvino^ Look, we basically -- when you look at our capital allocation, we have 1A, 1B, 1C.

So 1A is -- will be the buyback. 1 billion will be our debt, which I think we've continually made sure that we stayed at investment-grade profile or better. Then 1C will be our investments. If you go look at our SG&A for this quarter, we've made investments around our brand.

We've also made some investments in some outside help to evaluate some of our SG&A costs.

Then the third thing we'll do is I highlighted for you the uptick in our insurance business in terms

DXC Technology Services, LLC

Q2 Earnings Call

of us modernizing our software that's positioning that offering for growth.

So that's how I'd answer that question.

Gates Schwarzmann^ And for a follow-up question...

Michael Salvino^ Do you have another question?

Gates Schwarzmann^ Yes. I have one follow-up. I would like to ask if it's possible to walk through the offerings get an idea of nondiscretionary revenue in the base versus what clients can push out, asking this because as we see the sequential track record lately, some of the items we thought were safer like cloud and IT has stepped down while some that we thought were more prone to cost cutting like analytics and Applications have done better than expected.

Michael Salvino^ So look, what I would tell you is we'll break the two -- your question into the two pieces, GBS and GIS.

So on GBS, we see our GBS business continuing to grow, but at a lower rate due to A&E, we believe, is in a tough market.

We think Michael has done a nice job selling out application or Analytics and Engineering onto our GIS customers.

But we are seeing that slow a little bit. I don't think that's any new news to anybody.

Applications has continued to be flat.

With addition to Howard, we think he can definitely improve on that.

But right now, we're keeping it flat.

Then the final thing is we've been pretty bullish around insurance. Just in terms of what Ray is doing in the market and so forth.

So we continue to see growth there.

If you then turn the page to GIS, we think that basically, the GIS business we'll maintain what it's doing today. Both Chris with ITO and Andrew are very focused on positioning both of those businesses for future success.

I gave you some details around what Chris is doing with ITO.

DXC Technology Services, LLC

Q2 Earnings Call

So I would highlight those two things again being he's working with Rob to take our underutilized assets, the facilities and put them -- make sure that we can sell them because the longer we hang on to them, the less value that they have, all right?

So we're pushing hard to make sure that happens this year. The second thing is AWS, and we're pretty happy about that to say the least.

I say that because for years now, we have not gotten our fair share of the cloud business.

With AWS, with us being that partner of choice, that clearly puts us into the cloud migration and the cloud operations business that, like I said, traditionally, we have not participated as well as we wanted to.

When you look at the cloud industry right now, what we see is, they're focused on the essential systems that run customer operations.

That's our ITO business.

When somebody like AWS gives you that partner of choice credential, that's a big deal.

What they see is they see a firm like us that has great customer relationships that are trusted because this essential stuff is not easy to run, and they also know that we can make the migration work successfully.

And the tidbit I'll give you is we're expecting AWS, when I say they'll incentivize us and work with us, they're going to train roughly 15,000 of our women and men on AWS to make that happen.

So that's quite a bit of scale.

So that's what we see. Hopefully, that gives you what you need.

Operator^ Your next question comes from the line of James Friedman with Susquehanna.

James Friedman^ So you've had some impressive accomplishments in especially the free cash flow and the free cash flow per share.

I was wondering if you could kind of unpack how you're achieving that, Rob, because it really stands out on both the numerator and denominator.

Robert Del Bene^ Yes.

DXC Technology Services, LLC

Q2 Earnings Call

One of the -- there are several -- as you would imagine, there are several factors that contribute to the free cash flow performance. It starts with the value delivered by the teams and the offerings that we have, the profitability of those offerings. Another big contributor is a significant cost reduction activities that the teams have embarked on.

And last year, they were very successful in achieving the cost reduction goals this year. We're on track with our cost reduction goals, and that will continue.

The third area of emphasis has been on management of capital outlays and management of longer-term commitments like leases.

We are very focused on -- in that -- on both and we've been successful in steadily driving the commitments down over time.

Now that's not to say if we had great opportunities we wouldn't deploy capital.

But the management system has been very tight.

Then there's just continued emphasis on the working capital metrics and driving those numbers down.

So those are the four main elements of what we think has delivered the progress on free cash flow.

Operator^ Your next question comes from the line of Rod Bourgeois with DeepDives.

Rod Bourgeois^ Okay. I want to talk about the cyclical demand trends and how they've affected your business here. When you reported three months ago and updated guidance, your project-based revenues were weak, and that was the case for the industry at large. I think at that time, you would assume that project-based revenues we're positioned for some improvement in the second half of the fiscal year.

I think some of that was due to your new operating model showing some benefits.

So I just wanted to see if you could share how those project-based revenues are tracking for the second half. Do you see improvement there?

And also maybe do you have other sources of revenue upside to offset projects if the projects were to remain weak due to the cyclical challenges?

Michael Salvino^ So Rod, I'll tackle the second one first. Certainly, we do. I mean we're running an outsourcing business.

DXC Technology Services, LLC

Q2 Earnings Call

So basically, that's still our bread and butter. And converting that stuff from backlog is, quite frankly, something you talk quite a bit about, right, in the industry, meaning taking your pipeline and converting it to revenue.

So the reason why we went to this operating model, all right, and I call it basically right model with right leaders, is the fact of can you take the pipeline and convert it to revenue. Now the quickest is the project stuff.

What we're seeing in terms of the industry is we're seeing Analytics and Engineering in a tougher market, all right?

But that's being picked up by insurance, that software business doing better than we expected.

Then I would say that applications has a chance, all right, with the -- with Howard's leadership, what we see in the industry.

One of the comments I made, he's charged with getting clients ready for AI. That doesn't mean that he's implementing AI. That means that clients need to get ready for AI. All right?

You got to get ready with your data, you got to get ready for your applications. You got to understand the bias in your data and so forth, and that's good work for us.

So I look at applications in the back half, we think it's flat, but Howard could potentially do a little bit better.

When you look at GIS, we see the cloud infrastructure stuff. I'm very encouraged with how Chris has positioned that business now with the relationship with AWS and also what he's doing on the margin.

Then look, I have full confidence in Andrew because the best part about Andrew is he used to be our client. And he knows what we do well. He knows where we need to improve. He knows how to sell the stuff, and that's basically what he did at Accenture.

So when I look at the demand, the demand should be getting better in GBS, all right?

I don't see that demand is going to change much in GIS, it will be lumpy, but that's what we see, Rod. Do you have another question?

Rod Bourgeois^ Yes. I do.

So thanks to Rob for outlining the free cash flow drivers to get you to the \$800 million target.

DXC Technology Services, LLC

Q2 Earnings Call

That's clearly the key metric here. I want to ask another question about free cash flow kind of from a different angle. Clearly, the industry is experiencing the cyclical challenges, and that's impacting your project-based revenues this year.

If you weren't seeing cyclical challenges in your project-based revenues this year, would you then be in a position for free cash flow north of \$800 million?

In other words, I'm trying to get a take on to what extent the cyclical demand challenges are impairing your free cash flow power this year?

Robert Del Bene^ Yes. There's -- I mean the way I'd answer that is we're adjusting our capacity based on demand.

So there's always some leverage with more demand and more revenue, right?

There's always operating leverage as a result.

So the higher the demand over time, the higher the free cash flow.

But the way I'd answer it is, for this year, in particular, we're managing our structure going forward and operating within the envelope of demand that we see on the table, right, and in our pipelines.

Michael Salvino^ So Rod, the other thing I would add to Rob's comments is we keep overlooking the operating model.

So it takes most companies a year or 2 to get these operating models right.

We now are starting to see the benefits of it because after last quarter, right, every transformation hit some bumps.

But I couldn't be more proud of the execution of our team this quarter.

What that means, is we're getting to a lower level of detail than DXC has ever seen with our customers.

And that detail not only produces new project work. It also makes us have the ability to manage our margins a lot better to generate more free cash flow.

So when I talk about the right model, right leader approach, to me, that's the catalyst that we're giving to the market at this point in time.

DXC Technology Services, LLC

Q2 Earnings Call

You're starting to see a team really starting to deliver now. Versus being able to -- and having a consistency around hitting our financial performance.

So we don't have much more on the free cash flow. We're happy with where it is and where it's going to be, and we'll go forward from there.

So, (Jessica), next question.

Operator^ (Operator Instructions) And your next question comes from Brad Clark with Bank of Montreal.

Bradley Clark^ Two part question. First, you've mentioned cost reduction as a gradual free cash flow, and it's been a focus for some time during this economic cycle and to DXC in general. How much room do you see left in cost reduction activities to get a deal looking forward and if an economy start to improve, how much would that mean a focus?

Then the second part is on Modern Workplace. It sounds like this is mostly an execution-based improvement rather than a demand-based improvement. With the new leadership in position and with it being with the business, what are going to be some of the focus is to improve execution?

And sort of how long does that take to play out?

Michael Salvino^ Okay.

So Brad, first, I'll take your cost point. Look, there's always 4 levers that we're focused on. I think we've drained the details on us focusing on facilities, all right, that will change our fixed cost over time, all right?

And that will play out through the rest of this year.

Second is the increase in margin this quarter was solely due to the reduction of contractors and us continuing to optimize our staff to the revenue we have, and that's not going to change, all right?

I was very pleased on the execution. And again I'll give that benefit to our new operating model. with our 6 leaders now running these global offerings.

Then the final one is onshore offshore.

So that's one we got to continue to focus on.

DXC Technology Services, LLC

Q2 Earnings Call

The onshore ticked up a little bit.

So we need to go back and look at that.

But there's more room there, and we certainly haven't said we're done yet.

So I like the opportunity we have there, whether the environment is good or bad, all right?

On Modern Workplace. Modern Workplace, there is demand, all right?

Let's make no bones about that. The demand environment is there. Everybody hasn't gone back to being in offices full time.

So being virtual is still a big piece of what's going on in the market, and we think we've got a great solution.

So from an execution standpoint, my expectation is, one, you will see Andrew knock down a few more deals that we weren't able to get in past quarters.

The second thing you'll see him do, all right, is look at the value proposition because the value proposition isn't just maintaining PCs and so forth, it's also helping with the employee experience.

That's what I know Andrew is good at.

That's what he did in the past stops at Accenture and Microsoft, and we expect that he's going to show the market how to do that.

Then finally is the cost piece. Meaning, I think we've done well on the cost, but I think there's more that we can do.

So those would be the three things he's focused on, and I do think he's going to make some good improvement. I think that business is close.

So that's why we're leaning into it. (Jessica), next question.

Operator^ That's currently all the questions that we have in the queue.

So at this point, I will turn the call back over to Mike for closing remarks.

Michael Salvino^ (Jessica), thanks so much, and I appreciate everybody joining the call today.

DXC Technology Services, LLC

Q2 Earnings Call

We obviously are pretty excited about our execution.

Our execution was aligned with our expectations and in some cases, even better. I think my team is making great progress on our new operating model, and you're starting to see that show up in the financial benefits.

As we've stabilized our business now and the numbers are now moving again in the right direction.

I think the catalysts from our standpoint that we're focused on is the right model and the right leaders to drive our financial performance and I expect this performance to continue. With time, the operating model on our team does nothing but get better, which means consistent financial performance from DXC.

So with that, I look forward to updating you on our Q3 performance in February, and have a nice evening.

Operator^ Ladies and gentlemen. that concludes today's call. Thank you for joining. You may now disconnect.