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DXC Technology Co. (DXC)

Q4 2022 Earnings Call

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CORPORATE PARTICIPANTS

John Sweeney
Vice President-Investor Relations, DXC Technology Co.

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

OTHER PARTICIPANTS

Ashwin Vassant Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Bradley Clark
Analyst, BMO Capital Markets Corp.

Bryan C. Bergin
Analyst, Cowen & Co. LLC

Lisa D. Ellis
Analyst, MoffettNathanson LLC

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Darrin Peller
Analyst, Wolfe Research LLC

Rod Bourgeois
Analyst, DeepDive Equity Research, LLC

Jason Kupferberg
Analyst, Bank of America Merrill Lynch

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the DXC Technology's Fourth Quarter Fiscal Year 2022 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

John Sweeney, Vice President of Investor Relations, you may begin your conference.

John Sweeney

Vice President-Investor Relations, DXC Technology Co.

Thank you, and good afternoon, everybody. I'm pleased that you're joining us for DXC Technology's fourth quarter and full year 2022 earnings call. Our speakers on the call today will be Mike Salvino, our President and CEO; and Ken Sharp, our EVP and CFO. This call is being webcast at dxc.com Investor Relations, and 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 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 and in the webcast slides.

Certain comments we make on the call will be forward-looking. These statements are subject to known and uncertain 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 Annual Report on Form 10-K and other SEC

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

Michael J. Salvino

President, Chief Executive Officer & Director, DXC Technology Co.

Thanks, John. I appreciate everyone joining the call today, and I hope you and your families are doing well. Today's agenda will begin with an update on the progress we have made in driving our transformation journey. There is no doubt that DXC is in a better place. Next, I will update you on Ukraine and Russia. Ken will then discuss our Q4 results and FY 2023 guidance. And finally, I will make some closing remarks before opening the call up for questions.

I'm pleased with what we've accomplished in FY 2022. The next two slides show quantitatively and qualitatively the progress we have made that has put DXC in a dramatically better place. Beginning with the numbers, we narrowed the total organic revenue decline by 620 basis points. Our growth strategy has two parts: consistently grow GBS and shrink the negative declines in GIS. We have achieved the first part of our growth strategy by consistently growing GBS for four consecutive quarters in FY 2022. While we did shrink the organic revenue declines in GIS, we expected better results, which we plan to achieve in FY 2023.

Concerning adjusted EBIT margins, we delivered a 230-basis-point increase, and our non-GAAP diluted EPS was up $0.44. The highlight of the year was our free cash flow performance. We drove $743 million in free cash flow. This is a $1.4 billion improvement compared to FY 2021 and is a clear indication that we have built a team that can execute.

Now let me turn to our qualitative results, discussing each of the five steps of our transformation journey. The first step is to inspire and take care of our colleagues, which was highlighted by how well we've taken care of our people through COVID and now conflict created by Russia's invasion of Ukraine.

Concerning our customers, we continue to increase our NPS score, which is now at 31 and above the industry best practice range of 20 to 30.

Optimize cost is the next step. We made good progress in portfolio shaping by divesting businesses that did not fit our strategy, and we drove out costs across the organization. Our cost takeout activities will accelerate for the GIS business in FY 2023.

The fourth step is seize the market, where our book-to-bill numbers continue to show that we can in the IT industry. Our trailing 12-month book-to-bill of 1.1 is a great result.

And finally, in terms of our financial foundation, Ken's team has done a great job executing three initiatives: improving our free cash flow; refinancing our debt; and remediating the material weakness. All three of these items have put DXC in a stronger financial position.

We continue to stand with the people of Ukraine, and our thoughts are focused on a rapid resolution of the conflict. While Russia's invasion of Ukraine has been a tragedy, this has not and will not have a significant impact on our business.

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Let me take you through how we've delivered on the commitments we made on March 4. First, we've done a great job caring for our people in the region. I would like to thank our DXC colleagues across the organization for coming together to deliver excellence for our customers and colleagues. Our transformation journey starts with our people, and we are honored by the commitment, dedication, and caring we have seen from our people in the region and throughout the company over the past few months.

In terms of our 4,000 colleagues in the Ukraine, we have successfully moved many of them to Western Ukraine, Poland and Romania. And I would like to highlight their productivity has been above 85% since the conflict began. By the end of June, we will also have successfully relocated our non-domestic and corporate Russian employees out of Russia.

Our second commitment was to exit Russia. In April, we exited the Russian market and successfully took care of our customers and colleagues of that business. This action fulfilled DXC's commitment to exit the region and will reduce our revenues by approximately $140 million per year. Our solid execution of these commitments has enabled us to have strong customer retention, has made our business better, and position us to effectively deal with the conflict as it continues.

As we move into FY 2023, our leadership team knows what we need to do within GBS and GIS. This clarity gives me confidence that the momentum created in FY 2022 will continue in FY 2023. GBS is a business that we've consistently grown and is comprised of a set of digital offerings that are high value for our customers and for DXC. This business is highlighted by our engineering offering, which enables DXC to help our customers grow.

In fact, a number of our customers refer to us as their growth partner. We use deep engineering skills to create products, services, and experience that make our customers more relevant and vital to their customers. An example is our relationship with one of the world's largest automotive manufacturers. Car buyers want a digital experience that will help them minimize disruption to their vehicles, and we all know cars are full of sensors that produce all sorts of data. Our engineering teams use this data to provide diagnostics and preemptive failure analysis. Overall, this lowers maintenance, improves the car's performance, and leads to a better driver experience.

The engineering offering is just one example, but you can see why we're excited about the future of GBS. It's a business that's differentiated, is high value for our customers in DXC and now represents roughly 47% of the total revenues of DXC.

GIS is comprised of a set of offerings where the work is mission-critical, making this business high value for our customers. Based on the financial performance of this business, it is currently lower value for us.

In FY 2023, our top priority is improving the financial performance of GIS. The focus of this attention will be on driving organic revenue growth in Modern Workplace and driving margin improvement for cloud infrastructure/ITO. From Modern Workplace, we expect to see the fruits of last year's labor drive improve organic revenue in FY 2023. We anticipate that Q4 will be the low watermark in organic revenue declines. And by the end of FY 2023, Modern Workplace is expected to turn positive.

For cloud infrastructure/ITO, we are committed to taking out cost to increase margin, which will be done by fixing contracts, reducing contractor and real estate costs, and optimizing the assets of our data centers. Finally, we will continue to portfolio shape, to run a company that has higher value to our customers and DXC.

Now let me turn the call over to Ken.

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Kenneth P. Sharp

Chief Financial Officer & Executive Vice President, DXC Technology Co.

Thank you, Mike. Turning to our progress on our transformation journey. There is no doubt we are in a much better place.

Our Q4 organic revenue declined 2.8%, impacted by 75 basis points due to Russia's invasion of Ukraine. Adjusted EBIT margin of 8.5%, year-over-year, our margin expanded 100 basis points.

Margins were impacted by 40 basis points related to taking care of our Ukraine and Russian colleagues and exiting our Russian business. Our trailing 12-month book-to-bill is 1.11. Non-GAAP diluted earnings per share of $0.84, up $0.10 compared to prior year.

Moving to our income statement on slide 11. During the fourth quarter, gross margin was lower by 210 basis points due to accelerated hiring and higher utility costs in Europe. SG&A as a percentage of sales was down 180 basis points as our business optimization efforts yielded results.

Other income increased due to a gain on sale of assets. In total, adjusted EBIT margin expanded 100 basis points. Interest benefited from our debt retirement and refinancing. Q4 was $4 million higher than anticipated due to unwinding a legacy financial structure.

Adjusted EPS is up 13.5%, boosted by increased EBIT margin, lower interest, and a lower share count. Our EPS for Q4 came in below our guidance by $0.14 due to three items aggregating $0.17; $0.04 Russian invasion of Ukraine, $0.06 increased European utility costs, and $0.07 higher tax rate. For FY 2023, we expect additional costs related to taking care of our colleagues in exiting Russia of $50 million, and our tax rate will be back to a normalized level of 25%.

Turning to our segment results, a key part of Mike's strategy is to continue to improve the business mix and ultimately move GBS to be a larger portion of the business. For the quarter, our GBS mix improved 160 basis points to 47.2%. GBS continues with its fourth consecutive quarter of organic growth of 3.4%. GBS growth was impacted by about 150 basis points due to Russian invasion of Ukraine. Our GBS profit margin was 14.5%, down 130 basis points year-over-year. GBS margins were impacted by about 100 basis points due to Russia's invasion of Ukraine.

GIS organic revenue declined 8%. GIS profit margin was 5.9%, an improvement of 180 basis points benefiting from operational improvements, as well as a gain on the sale of assets. We continue to work plans to move the GIS margin forward.

As Mike articulated, our growth strategy has two parts: first, consistently grow GBS, which we feel good about; second, moderate the GIS organic revenue declines. We see early success with our IT Outsourcing business. Our GBS and GIS businesses are each comprised of three offerings.

Turning to our GBS offerings, Analytics and Engineering continued its strong organic growth, up 19.7%. Applications decreased 0.6% due to timing. We expect Applications to return to growth in Q1. BPS generated $112 million of revenue, down 12.8%.

Moving to our GIS offerings, Cloud and Infrastructure and Security (sic) [Cloud and Security] was down 6.9% with a book-to-bill of 1.04. It's great to see that our IT Outsourcing declines moderated in the low single digits for two consecutive quarters, with a decline of 2.1%. Modern Workplace was down 19.6% due to a difficult compare, as

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the prior-year quarter included a higher than normal level of resale of approximately $60 million, or 930 basis points of growth rate. We believe the fourth quarter represents the low watermark for Modern Workplace based on our investments in the business and its ability to win in the market.

For FY 2023, we plan to make three updates to how we operate and report our offerings. First, we will bring our insurance and banking software assets and related business process outsourcing together; second, combine our cloud infrastructure with our ITO infrastructure business; and third, Security will be standalone.

Slide 14, debt was reduced to our target debt level and remained there the entire year. Interest is down significantly, and restructuring and TSI expense were reduced by $565 million. We also reduced operating lease payments by $132 million. Lastly, capital expenditures and capital lease originations as a percentage of revenue was 7% in FY 2022, down from roughly 10% in FY 2020 and presents a significant opportunity to improve cash generation as we look forward.

Slide 15 demonstrates how our progress translates into improved cash flow. Our performance in the last three quarters of FY 2022 provides a solid platform to build off of in FY 2023, and ultimately gives us confidence as we work towards delivering our longer-term guidance of $1.5 billion in free cash flow. I should note this cash improvement has come while we've been reducing capital leases and related financing payments that sit outside of free cash flow. Cash flow from operations in the quarter totaled an inflow of $271 million. Free cash flow for the quarter was $93 million. For the full year, we delivered $743 million of free cash flow, exceeding our initial guidance of $500 million.

As Mike mentioned earlier, our financial foundation is in a much better place. We achieved a lot in the year, improving transparency into our performance, strengthening our balance sheet, significantly improving free cash flow, reducing restructuring and TSI expense, and executing on our capital allocation program. Now that our financial foundation is much improved, we will pivot to providing more details on our business optimization efforts, particularly focused on improving GIS margins led by our Chief Operating Officer, Chris Drumgoole.

Turning to chart 18, let me expand a bit on what Mike discussed earlier, that improving GIS economics is a top priority. Let's think about our business optimization in two parts: first, improving disciplined execution with a focus on driving higher-quality revenues; and second, optimizing costs that will allow us to expand margins.

On disciplined execution, this starts with putting disciplined processes, metrics, and incentives in place to ensure our team is committed to signing profitable new business with favorable economic terms. We are moving away from leveraging our balance sheet to sell work that does not yield quality revenue with appropriate margins and cash flow. We are actively solutioning underperforming relationships and reviewing our contracts to ensure we can provide a high level of service, but also make a proper return to allow us to invest in our business.

Cost optimization, there is clearly a lot of opportunity in front of us, whether it is addressing our underutilized data centers and office buildings, software agreements, contractors, delivery standardization, or offshore mix. We feel that we have enough levers to improve the GIS margin to circa 10%. We believe more than ever, we can make these changes as the competitive landscape has improved.

Moving to capital allocation on slide 19, we returned $634 million to our shareholders, repurchasing 18.8 million shares, or over 7% of our outstanding shares. We expect to repurchase an additional $770 million, or about 10% of our outstanding shares, over the next three quarters. We continue to believe our stock is undervalued.

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As a reminder, when our debt is at our target debt level, we expect to deploy any cash over $2.5 billion. Additionally, we expect to generate $500 million of cash from our disclosed portfolio shaping initiative. Related to portfolio shaping, we are committed to ensuring we have the right portfolio to drive organic growth. We will continually assess our portfolio, with specific focus on GIS, to ensure our portfolio is aligned to our strategy and value creation to reduce complexity and allow management more time to focus on the critical parts of the business.

Moving to governance, Mike and I are committed to improving our corporate governance. To be clear, our low governance score is not and will not be our brand. In that vein, we are pleased the legacy material weakness is remediated. As part of our efforts to pass say on pay, we have proactively engaged many of our shareholders, obtained their feedback, and used their feedback to reshape our pay practices. You can see the improvements we committed to make that will be fully detailed in our proxy.

Turning to our FY 2023 guidance, revenue of $14.9 billion to $15.05 billion, two key items we are addressing in our revenue guidance. Foreign currency is expected to be a headwind of 4.6%, or almost $800 million, based on the strengthening US dollar. Divestitures that are announced and closed lower revenue by approximately 2%, or about $300 million. We have additional divestitures in process, including Fondsdepot Bank, and we'll update you accordingly.

Organic revenue growth of minus 1% to minus 2%, which is a combination of continued growth in GBS and moderating declines in GIS; adjusted EBIT margin of 8.5% to 9%. Our margin guidance takes into consideration $100 million decline in our non-cash pension income for FY 2023, and a $50 million of costs associated with taking care of our colleagues in Ukraine and Russia as we reposition our business to put it in a better place and exit Russia. The non-cash pension income is due to expected returns on our pension assets, exceeding pension costs, as several of our pension plans are overfunded. We are focused on locking down these plans and further de-risking our balance sheet.

Non-GAAP diluted earnings per share, $3.85 to $4.15, or a 15% growth at the midpoint; free cash flow, $800 million.

Our guidance for the first quarter of FY 2023: revenue of $3.7 billion to $3.75 billion; foreign currency is estimated to be 6%, or about $250 million headwind. Divestitures are expected to reduce revenue by about $100 million; organic revenue decline of 1.5% to 2.5%; adjusted EBIT margin in the range of 7.5% to 8%, due to the lower non-cash pension income of $25 million, and a cost to reposition our Ukraine and Russia business; non-GAAP diluted earnings per share of $0.80 to $0.85; free cash flow of minus $100 million due to seasonally high level of cash payments in Q1.

We are reaffirming our guidance for FY 2024. This reflects our strong progress on our transformation journey and our belief in the company's capability to execute over the next two fiscal years.

As we think about our FY 2024 goals, it's important to realize how far we've come, as we've improved the transparency of the financials and the investability of DXC. We improved year-over-year cash generation by $1.4 billion. We tackled the issues that negatively impacted our ability to generate and hang on to cash. And we are in the process of reshaping our portfolio to drive higher value for our customers in DXC, so that we can grow organically and generate cash flow.

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As we close on FY 2022, let me point out two key points that demonstrate we are in a better place. First, GBS never grew before FY 2022, and has now grown four consecutive quarters. Second, GIS is no longer declining double-digits. We will bring this positive momentum into FY 2023, which sets us up well for FY 2024.

With that, I'll turn the call back to Mike for his final thoughts.

Michael J. Salvino

President, Chief Executive Officer & Director, DXC Technology Co.

Thanks, Ken. I agree that DXC is in a better place. In FY 2022, we made excellent progress on our transformation journey, driving our financial performance, and building a strong financial foundation. While Russia's invasion of Ukraine is a tragedy, our team has done a tremendous job taking care of our colleagues. Our Analytics and Engineering business will emerge in a far better place. It is more resilient, has a more diversified global delivery platform, and has lower geopolitical risk. While this situation is unfortunate, we have been able to manage it well, and it has not and will not have a significant impact on our business.

Over the last 2.5 years, it is clear that we have put DXC in a far better place, and I'm excited to embark on FY 2023. My leadership team has clarity on the actions that we need to accomplish on our portfolio and how to improve its trajectory. We fully expect our momentum to continue and deliver longer term.

And with that, operator, please open the call up for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Ashwin Shirvaikar. Your line is open.

Michael J. Salvino

President, Chief Executive Officer & Director, DXC Technology Co.

A

Ashwin, it's Mike. How are you doing?

Ashwin Vassant Shirvaikar

Analyst, Citigroup Global Markets, Inc.

Q

Hey, I'm good, thank you. Sorry, I was on mute. Figured I'd learn that after two years. I guess my first question is with regards to the mention of contracts that you said need improvement or improved performance. So, is that different than when you first got there? There were problem contracts. Could you kind of help us with that? And if there are any problem contracts again, how come would be the question, and what gets you out?

Michael J. Salvino

President, Chief Executive Officer & Director, DXC Technology Co.

A

Okay. So Ashwin, this got nothing to do with us fixing those original problem contracts. What I said was our team has tremendous clarity now. This is the first time since I've been here that my management team – the majority of them have been in the seat for over a year. So, they are now running their teams, their strategies, their policies, their procedures. And the clarity that we have on what we literally need to do to the GIS business has never been better. So we're raising the bar on what good looks like here at DXC.

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So when I think about fixing some of the contracts, look, we're just not going to run contracts, where we don't make the appropriate margin. And if we're not getting COLA, we will go get COLA. So, we're taking a click up on managing this business. There's not a ton of these contracts. But clearly, we've got basically a laser focus on making sure these things get fixed.

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.
A

Yeah, maybe, Ashwin, just to jump in real quick, too, I think that when we had problem contracts previously, it was around the customer relationship side. And I think Mike and his team did a phenomenal job improving that. When we talk about underperforming contracts, it's just where we think we can actually generate better margins. We have happy customers. And I think we believe that we ought to have the right margins to be able to ensure that we're investing in our business and our workforce, and that's our focus, and we think this is just additive as we move the business forward and create a sustainable business.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

But Ashwin, you know in this market, there's two things you look at. You make sure that you're getting paid for the scope that you do, and then the second thing is the margin. And when I look at page 12, the GIS business, we've been floating around, call it, 5.5% to 6%. We're going to continue to go fix that and take the appropriate measures to make sure we're on the right track. But there is – we are not in the problem contract category at all. We've got – that's why I gave you the NPS score. There's no chance that our NPS score would be 31 if we had a bunch of clients not liking our delivery.

Ashwin Vassant Shirvaikar
Analyst, Citigroup Global Markets, Inc.
Q

Right, right. It sounds, based on what you said, that there are – just given the environment with wage inflation and timing of pricing and things like that, these are things that you're fixing as you go along. That's what it sounds like. The other question, just some clarity with regards to – you mentioned pensions, and there's a potential upside EPS opportunity with the pensions. Could you kind of walk through perhaps what's on the table, perhaps size that? I know – I might have missed the sizing of it.

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.
A

Yeah. So Ashwin, our pension income generally runs greater than our pension expense. So we have a GAAP, and it's non-cash, but a GAAP profit. It was running somewhere around $300 million last year, and it'll be down to $200 million this year. And there's a couple reasons, right? One is the interest rates have certainly crept up. I think that impacts everybody that has a defined benefit plan. And we've also been, I think, relatively thoughtful with our pension surpluses. We've started to move into, I would argue, maybe a little bit more conservative investments. And we're looking to see if we can lock down those pensions and maybe wind them down certainly [ph] in all (00:31:34) within the rules. And while the participants do well with that, I'm certainly trying to figure out how to unlock some of that potential surplus that we have in these plans.

Ashwin Vassant Shirvaikar
Analyst, Citigroup Global Markets, Inc.
Q

Understood. Thank you.

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Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

Thanks, Ashwin.

Operator: Your next question comes from the line of Bryan Bergin with Cowen. Your line is open.

Bryan C. Bergin
Analyst, Cowen & Co. LLC
Q

Hey, good afternoon, guys. Just first off, a clarification on the outlook in the fiscal 2023, can you give us any sense on the [ph] divestitures (00:32:08) and the portfolio shaping? Was there any margin or free cash flow assumption or impact that you can quantify there?

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.
A

Yeah. I'd look at the margin impact to be roughly about what our business runs at. So, I wouldn't say it's accretive on a margin side, but arguably, a little bit maybe right around the 8.5% to 9% range we're at.

Bryan C. Bergin
Analyst, Cowen & Co. LLC
Q

Okay. And free cash flow, nothing to call out specifically on the divestiture piece, just to clarify that?

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.
A

No, I think we're good on the free cash flow piece. I mean – at this point.

Bryan C. Bergin
Analyst, Cowen & Co. LLC
Q

Okay. Okay, Ken. So then when we look at that $800 million number, you obviously did a lot of proactive measures in fiscal 2022. Do you have anything chunky in there that you're undertaking as well?

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.
A

We try to make sure we leave a bit of room on the free cash flow, so we can deal with some of the legacy stuff that pops up from time to time. So I would say we've tried to be thoughtful with that in general.

Bryan C. Bergin
Analyst, Cowen & Co. LLC
Q

Okay. Thanks. And then just last one for you, just on the macro. So if you just put Russia and Ukraine aside, can you give us a sense on what you're hearing from clients? Just any notable change you've seen in client decision-making in recent weeks, and how you thought about, when you built the fiscal 2023 outlook, what kind of economic environment did you kind of build in there?

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

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I mean, we looked at it like this. The first thing that the big indicators are book-to-bill, and the book-to-bill we just delivered was 1.2. So, we're not seeing the headwinds. I've heard a lot about Europe and so forth, and we have not seen that yet.

And like I commented, Bryan, we really – the way I look at it is we have two different businesses. We have GBS that we've consistently grown. And that business is highlighted by Analytics and Engineering that we grew almost 20%, and that is the business where we had to deal with the Ukraine-Russian situation. So that 19.7% is a very good number, and we've seen an ability to pass on price increases in this environment.

So then you turn to GIS. And I've been in the outsourcing business for 30-plus years. This business is an annuity stream. So in downturns, this thing holds up. And it holds up because we've got long-term contracts that are protected by COLA clauses. And then the thing I will tell you is in the GIS environment, we have now become the safe pair of hands. That competitive landscape has changed in terms of the providers of mission-critical systems. And we've got some good demand, let's just put it, coming our way as it relates to the GIS business.

Now when I look at margin, if we keep going in terms of inflation and the economic headwinds, look, we put into this expanded margin salary increases, some more costs for Ukraine and Russia that I think is conservative, utility cost inflation adjustments, and then the appropriate investments in the business. One of the things that you will see us do is invest in the insurance business that has been a really nice nugget for us that we're going to lean into pretty heavily.

And then the last thing I would look at is people, Bryan. So am I losing people and can we attract good people? And our attrition numbers are definitely right in the middle of the industry averages. But the key signal for me was as we had to scale up a number of the centers and our global delivery network to deal with Russia and Ukraine, we could attract good people. Otherwise, we wouldn't have effectively dealt with the Ukraine-Russian situation.

So, I would tell you, our viewpoint was steady as we go. I don't think we are overly aggressive or overly unoptimistic around what we're trying to get done. Did I give you enough color on how we saw 2023?

Bryan C. Bergin
Analyst, Cowen & Co. LLC

Q

Yeah, that was great. Thanks for all the color. Appreciate it.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

Josh, next question.

Operator: Your next question comes from the line of Bryan Keane with Deutsche Bank. Your line is open.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, guys. How are you doing? Mike, let me ask the GIS question a little bit differently. I know it was weaker than expected. And I guess in the history of DXC, it's probably been typically weaker than expected. So slide 18, you have a plan to improve it. Why is this plan going to work when many plans haven't worked to improve GIS?

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

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Bryan, I've been at this now for 2.5 years, and what I can tell you is I've got the team in place to finally do it. So, let me just take you back to the strategy. Strategy number one was to make sure we were delivering for those customers, and we clearly are with the NPS score. The second thing then was to make sure that we continue to build the relationship. So we could have open-minded conversations if we wanted to change the scope, move the scope, and so forth.

The third thing is this, we're really honing into things that we think we should adjust. Like for instance, I don't think on our balance sheet should be the purchase of computers, or quite frankly, the purchase of software. Clients can go directly to those folks that doesn't need to flow through us. That's deal shaping 101.

Then when you also look at some of the contracts, I continue to go back to the margin. There's plenty of stuff that we can do, and what we need to do is be proactive with the clients and tell them what we're doing. There may be some dollars that we need to give them to decrease contractors, to deal with data centers, to literally move people around the world, but now we can start being proactive. You can't do any of this, Bryan, when we're literally not delivering, okay? And then you can see the fact that I've got the right team in place.

The second thing is, I mentioned, I think, in my last answer, the competitive environment has changed, okay? DXC is being looked at now totally different because of the investment that we've made in GIS, and that's not hard dollars. That's people. That's relationships. That's us making sure that these IT estates don't tip over. People are now coming to us to say, hey, let us run your – think about having us look at running their contracts. So I kind of like the competitive environment. So that's on the revenue side.

On the cost side, like I said, we've been preparing for this. I think slide 18 maps out what we're going to do. The thing we haven't touched yet is we've had teams built now for the last year looking at contractors and looking at real estate. Ken and his team did a nice job with real estate. They took out roughly $93 million in costs. The next thing that we're going to tackle is the data centers, which you all know, we've been a little long on data center capacity for a while, and we're going to tackle that in 2023.

So that's sort of a long-winded way of answering your question, but this is something that we've been preparing for for a while. It's part of the strategy, love the fact of where GBS is. GBS can't go backwards. We got to continue to grow that. The second part of the growth strategy was meant to fix GIS, which is what we're going to do.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. No, that's helpful. And just as a follow-up, Ken, on the guidance, it looks like fiscal year 2023 may be a little lighter due to some of the call-outs, especially the unfortunate Ukraine-Russian situation. But fiscal year 2024 didn't change. So you're going to grow margins at least 100 basis points in fiscal year 2024 over 2023 and a couple hundred basis points in revenue. So can you just talk about the jump from fiscal year 2023 to 2024? It looks like a sizable jump, but maybe there are some one-timers in there and some improvements that help that jump.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

No, Bryan, let me take that question. So if you look at what we've delivered on page 5, over the past 12 months, you look at the 620 basis point improvement in organic revenue, you look at the 230 basis point improvement in adjusted EBIT, you look at what we've done in free cash flow, we basically have to deliver the same results over the next 24 months. We never said this thing was going to be a straight line. We definitely like the trajectory we're on, and I would keep coming back to what gives me confidence around 2024, management team in place, okay?

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This is a team now that literally has got their hands around, like I said, the team, the strategy, their policies, and procedure has never been clearer. So that's a key point. And literally the math that's pretty simple to do is you take page 5, you see where we landed with 2022. If you say that we'll continue, this team will continue to execute, which we've done to date, you'll see that not only will we deliver on the FY 2024 guidance, we'll usually be on the upper end. Hopefully that gives you some color in the way we looked at it.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah, thanks, guys. Thanks so much for taking the questions.

Operator: Your next question comes from the line of Rod Bourgeois with DeepDive. Your line is open.

Rod Bourgeois
Analyst, DeepDive Equity Research, LLC

Q

Okay, guys. Hey, I want to start with a question about portfolio shaping. You mentioned portfolio shaping in your comments on GIS. I was hoping you could talk about your criteria for portfolio shaping, and give us your thoughts on how portfolio refinements would enhance DXC's overall value.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

All right. So hi, Rod, thanks for the question. Our criteria is, let's just talk about four, because when we look at Fixnetix, Japan Systems, the German banks, the Israel business, they all go through the same process. So the first thing is now that we've got control of this business, and you've seen the progress we've made in 2022, now it's our turn to really sort out businesses that will literally get us to high value.

So what do I mean by that? I mean, the GBS business that you can see on slide 13, that's all digital stuff. The engineering work we do, again, with my background, that's second to none. So that's high value for DXC and high value for our customers. So, when something isn't high value, that's the first trigger that we want to look at, all right, so that we'll start looking at that business.

The second one is complexity. You know since I've sat in the seat over 2.5 years, I've been trying to drive down the complexity of the things we have to manage. So if we can decrease the complexity and increase our management focus towards the businesses that matter, that's what we'll do.

Third is we look at FY 2024 a lot. And if we can help accelerate getting to those targets by divesting a business, we will.

And then the last one is a good valuation. I think you would think that we would be in remiss if we didn't look at the sum of the parts of DXC. And if we can see the sum of the parts and we can unlock significant value on one of those parts with divesting something for a good valuation, then we'll do it.

So simply put, if it gets DXC to higher value, check; if we can reduce complexity, check; if we can accelerate, get into the FY 2024 numbers, check; and if it's a good valuation, we'll consider it.

And that's what we've done, Rod. That's what we did with Fixnetix, Japan Systems, the German banks, and so forth. So hopefully that gives you a little bit more detail on how we think about it.

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Rod Bourgeois
Analyst, DeepDive Equity Research, LLC

Q

Got it. And the guidance for Workplace revenues, it's pretty encouraging. You're guiding to the ability to get to positive growth by the end of the fiscal year. What are the levers that are giving you the confidence in getting workplace revenues heading in that direction?

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

Two levers. The first one is, I've been saying for the last year, we took the exact same approach. We did to basically fix ITO, which probably in other calls didn't mean much. But now when you look at ITO, that thing has gone from minus 9% at the beginning of the year to a stable, call it, minus 2%.

When we see the investment we made in Modern Workplace, and we see all the work we've done over the last year, that gives us a lot of confidence that not only is the fourth quarter the low watermark, but the thing is going to pop because just like ITO, Rod, Modern Workplace has very chunky contracts. The revenue comes on in large pieces.

So as what we've been doing over the last six months is starting to convert some of the new business that we've sold. I know for many of you, the book-to-bill hasn't converted quick enough. But for us, we know exactly when that revenue is coming on, and we can see pretty clearly to Modern Workplace in FY 2023 going positive.

Rod Bourgeois
Analyst, DeepDive Equity Research, LLC

Q

Got it. Thanks.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

Thanks, Rod.

John Sweeney
Vice President-Investor Relations, DXC Technology Co.

A

Josh, next question.

Operator: Your next question comes from the line of Keith Bachman with BMO. Your line is open.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

Hi, Keith.

Bradley Clark
Analyst, BMO Capital Markets Corp.

Q

Hi. This is Brad Clark on for Keith. Thanks for taking the question. I wanted to visit the pricing comment you made and the ability to pass on some price increases. Can you just dive a little bit deeper into the pricing environment? What do the conversations look like with customers? Where have you seen more openness, I guess, to have that conversation with some customers and others? Thank you.

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Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

Okay. Thanks for the question. So, look, the price increase is usually in the Analytics and Engineering space, and the conversation is pretty simple. After we've created a certain amount of value in terms of doing a quick pilot and so forth, the conversation goes to, all right, well, what's the value we're going to create moving forward? And as we look at the value that we're going to create moving forward and staffing that team up, people know how critical these engineers are to get. That's why we think we've got a unique position in the engineering space, because we can continue to create and recruit these engineers to get the work done.

So because they're in such demand, because everybody talks about it quite a bit, there has been an uptick in terms of us being able to give a little price increase to a number of the customers just because if they don't use all the resources, those resources can be quickly moved to other projects. So that's basically the conversation. I've been thrilled about it because we've been leaning in. Our bench gets cleared pretty quick. And when you've got that low of a bench, you better get as much money as we can for those folks.

John Sweeney
Vice President-Investor Relations, DXC Technology Co.

A

Josh, next question.

Operator: Your next question comes from the line of Lisa Ellis with MoffettNathanson. Your line is open.

Lisa D. Ellis
Analyst, MoffettNathanson LLC

Q

Hey, good afternoon, guys, and thanks for taking my question. First one for me was on the trailing 12-month book-to-bill. You highlighted that's running at 1.11. That's a really strong number. But then the FY 2023 revenue guide is down 1% to 2% on an organic basis. Can you just help us bridge those two factors a bit? Like what are the other kind of levers or drivers underneath there? Is there like weakness in the backlog? Or is there an FX impact? I'm just reconcile those two numbers. Thank you.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.

A

No FX impact, Lisa. That is literally us bringing on large chunks of work. I forget the call -- or the question that was above to say, oh, looks like FY 2023 to 2024 is a jump. Well, it's not a jump if you're literally taking six months, nine months to convert some large contracts, okay?

So -- and look, a lot of our revenue is project-based. That's the stuff that converts quickly, but the outsourcing deals don't convert overnight. And you know those take anywhere between six and nine months to convert. You can tell by my comments where they're being converted. So the reason why that guide is that guide is because the revenue should come on in the back portion of FY 2023.

Lisa D. Ellis
Analyst, MoffettNathanson LLC

Q

Got it. Okay. Yes. Super helpful. So there's like a duration kind of impact in there on the ITO side. Second question, just looking at slide 9 on the actions for improving GIS. I was -- good list of actions. I was kind of maybe expecting or hoping to see some investments in actually helping clients with the cloud migration work that they're doing that's affecting this business, right, as many of your clients might be modernizing or migrating some of

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these workloads into the cloud. Is that a piece of this? And can you just give us a little bit of an update on kind of how much doing with clients now that, like you said, you've improved the relationships tremendously with these clients over the last couple of years?

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

Yes. I mean, Lisa, it's definitely in there. When I look at the cloud infrastructure and ITO, it's not only just on-prem stuff, but there's a ton of cloud work that we do. And that's one of the things that Ken highlighted. As we get into Q1, we're going to detail out even more GBS and GIS to say, okay, the GIS stuff that we're talking about here is cloud infrastructure. But that's definitely in there. And the code there on optimizing the assets of our data centers, that's what you're poking on. And that's clearly what we're going to go after now.

But when you think about the journey we've been on, the first thing was get the contracts under control, start delivering for the contracts, start taking some cost out. And now the point that we're in is we can really look at not only the real estate, but also these data centers that we're running and the assets that are in them. Should they move to the cloud? Should they stay on-prem? How do we balance that? And then how do we balance that when we've got a data center that's not fully utilized? So that's what that optimizing the assets of the data center means.

Lisa D. Ellis
Analyst, MoffettNathanson LLC
Q

Got it. Helpful. Thank you.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

Clarity. That's what you should take away. I mean, like I said, this is the first time the team has been in place. I mean, I know I've talked to you guys a lot about, hey, I've hired this person or that person. That's great. So that means we've got good talent. But now that good talent has stayed and are really starting to drive what we're trying to do here. So now hopefully that gives you enough color, Lisa.

Lisa D. Ellis
Analyst, MoffettNathanson LLC
Q

Yes. Very helpful. Thank you.

John Sweeney
Vice President-Investor Relations, DXC Technology Co.
A

Josh, next question?

Operator: Your next question comes from the line of Darrin Peller with Wolfe Research. Your line is open.

Darrin Peller
Analyst, Wolfe Research LLC
Q

Hey, guys. Thanks. My first question is just -- I mean, looking at some of these metrics on the GBS side, the growth rates were very strong in those key areas that we called out earlier, which, again, I mean, if that's sustainable, probably should lift -- the rising tide to lift the whole ship here at some point. I think it's just a question of like you were alluding to earlier, the GIS business inflecting.

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And so with that in mind, can you remind us a bit more about the types of contracts coming into the GIS side that your booking business in -- what exactly is it in terms of what kind of work are you booking? And like what's resonating now? And sort of follow-up to Lisa's question a little bit as well as, I think, Bryan's, what's resonating now that you're going to see in big contracts coming later in the fiscal year that's really going to drive that path?

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

So the bottom line is the first one is Modern Workplace. When you look at those contracts, McDaniel has done a great job. We kept showing you all the book-to-bill, all right, the book-to-bill at 1.12 for trailing 12 months. That's a good indicator that he's built up a backlog that we then have to go in and think about it. I mean, a lot of these clients have 50,000, 100, 000 people. That takes a while to bring that revenue on. And then think, right, when we lost it and we started looking at these negative numbers, that's what was going out the door, right, that revenue. So, the first one is Modern Workplace. And like I said, those are our large contracts.

The second one that I keep talking about is the competitive environment within ITO. So that's literally modernizing ITO work, okay? So that means I'm going in. I'm updating servers. I'm updating networks that can be both on-prem and also cloud. And I'm not going to get into more detail on the competitive environment. Let's just say it is nice to hear that DXC is a safe pair of hands, financially safe, good team, good client references. You guys do your own channel checks. You know what you're hearing. So there's work to be had out there. And you know what, we're going to go get it, and we're going to go get it at the right price. So that's our attitude there.

Darrin Peller
Analyst, Wolfe Research LLC
Q

Okay, okay. Can I just add one follow-up...

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

I want to come back, Darrin...

Darrin Peller
Analyst, Wolfe Research LLC
Q

Okay.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

No, Darrin, hang on, one thing, because you did make a point on GBS. When you literally look at our business, the other thing that hopefully everybody sees now is GBS is almost half of our business. Ken mentioned 47.2% or something like that, that has not been the case. So we, throughout this transformation journey, we have grown a business that is, what, $7.6 billion now of digital stuff that we can compete with anybody that's high value. So we got to keep that business growing. I couldn't be more pleased about that. We do a couple more things to GIS, and I like the future of DXC.

Darrin Peller
Analyst, Wolfe Research LLC
Q

That's great.

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Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

Sorry about that.

Darrin Peller
Analyst, Wolfe Research LLC
Q

And just one quick follow-up – no, I appreciate it. Very quickly on the financials, just on the free cash, obviously you've made a huge amount progress, Ken and team. And just when we think about the bridge now from, I think, you're saying $800 million or so into, I think it says $1.5 billion for 2024, which was reiterated. It just seems like you've done a lot already. I guess I'm curious what the next step would be to really bridge that.

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.
A

You're talking about bridge into FY 2024. Look, just one of these things...

Darrin Peller
Analyst, Wolfe Research LLC
Q

Yeah. Exactly.

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.
A

Yes. Sorry. This is one of the things we certainly have been in the details of the business. And when you think about it, right, the progress, the $1.4 billion change, we certainly beat our guide for this year pretty significantly, which is a great result.

When I kind of think of 2023 to 2024, we've got some restructuring and TSI expense that basically impact cash flow, that'll go down. So think a couple hundred million dollars there. We're very focused on CapEx, uses of cash. The business has been running 6%, 7% CapEx. So I think there's certainly some knobs to turn there.

You heard Mike talk about passing through software and those kind of things. We definitely need to get more thoughtful with how we deploy capital. So I think there is a pretty big focus there as well. Margin improvement we can touch on, just working capital as well.

And then our bank actually consumed a little bit of cash this year, which we don't expect it to consume going forward because it won't be in the portfolio. So when the deposits go up and down, it actually has a negative impact on cash flow, which sounds odd, but that's, I guess, how the bank accounting works. So I think that'll ultimately be out of the portfolio. So I think we're pretty comfortable on our bridge to $1.5 billion. We think we've got a lot of levers, and we'll just keep working at them, and that's what we did just last year.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

Darrin, the key is -- I'll let Ken keep 14 and 15 in the deck, which is a lot of detail, all right, around what our opportunities are. There's literally eight things that we look at, right, on a quarterly basis, starting with restructuring and TSI. I couldn't be more pleased around our commitment from taking that to over $1 billion to now roughly $300 million and continue to drive that down.

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But it literally has all the pieces Ken talks about, whether it's the leases, whether it's the interest expense, it's our way of making sure that we're very fiscally smart about keeping the cash with us and then doing something good with it like the capital allocation. So very -- I know it's a team effort, but Ken has done a nice job with our new finance team driving that home.

Kenneth P. Sharp
Chief Financial Officer & Executive Vice President, DXC Technology Co.
A

Yes. Maybe even just touch on something Mike said, the capital leases, which if you think about when we started our journey, they were burning around $900 million. I think we guided this year to $500 million. That all sits outside of free cash flow. And to Mike's point about hanging on to more cash, the $1.5 billion becomes even more meaningful with that number ticking down. So we think that's just a great result as well.

Darrin Peller
Analyst, Wolfe Research LLC
Q

Great. Thanks again.

John Sweeney
Vice President-Investor Relations, DXC Technology Co.
A

Darrin, thanks. Josh, I know we're at the top of the hour, but let's take one more question if we can.

Operator: Certainly. [Operator Instructions] There are no further questions. I'll turn the call back to Mike Salvino for closing remarks.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

Josh, thanks so much.

Operator: Sorry. I think we do have a question. Sorry.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

Okay. Perfect.

Operator: My apologies. We do have a question from Jason Kupferberg for Bank of America. His line is open.

Jason Kupferberg
Analyst, Bank of America Merrill Lynch
Q

Thanks, guys. I'll be real quick. I know you're trying to wrap up. But I'm just wondering, do you expect to exit this fiscal year at breakeven organic revenue growth? And I'm just curious just given all the commentary around pricing, is there an assumption of positive net pricing in the revenue growth outlook for this year? Thank you.

Michael J. Salvino
President, Chief Executive Officer & Director, DXC Technology Co.
A

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No. So, Jason, on the pricing, we didn't put that into the revenue growth. I mean, like I said, we've been at this now for 2.5 years. We're looking at the rhythm of the business and shown the trajectory. What I would do is come back to the comment that I said, right?

This thing was never going to be a straight line. I like the momentum that we have. We literally have to deliver over the next two years what we just got done doing -- just got done delivering. So, I mean, I think we've got a good guide for 2023. I can definitely see 2024 in our sites and got a lot of confidence in terms of us getting there.

Michael J. Salvino

President, Chief Executive Officer & Director, DXC Technology Co.

So, Jason, thanks. Sorry, you were held up a little bit. So look, in closing, first of all, I appreciate everyone joining the call. I just want to leave you with, I couldn't be more pleased about our team and the momentum that we've achieved in 2022 and definitely looking forward with our team of carrying that momentum into FY 2023 and ultimately achieving our longer-term goals.

So with that, hopefully everybody has a nice holiday weekend. And, Josh, please close the call.

Operator: This concludes today's conference call. Thank you for joining. You may now disconnect.

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