

NYSE:UIS Q3 2025 Earnings Call Transcript

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Operator | Conference Operator:

Good day and welcome to the Unisys Corporation Third Quarter 2025 Financial Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then one on your telephone keypad. To withdraw your question, please press star then two. Please note this event is being recorded. I would now like to turn the conference over to Michaela Paworski, Vice President of Investor Relations. Please go ahead.

Michaela Paworski | Vice President of Investor Relations:

Thank you, Operator. Good morning, everyone. Thank you for joining us. Yesterday afternoon, Unisys released its third quarter 2025 financial results. Joining me to discuss those results are Mike Thompson, our CEO and President, and Deb McCann, our CFO. As a reminder, today's call contains estimates and other forward-looking statements within the meaning of the securities laws. We caution listeners that current expectations, assumptions, and beliefs forming the basis of these statements include factors beyond our ability to control or precisely estimate. This could cause results to differ materially from expectations. These items can be found in the forward-looking statement section of yesterday's earnings release furnished on Form 8K and in our most recent Forms 10K and 10Q filed with the SEC. We do not assume any obligation to review or revise any forward-looking statements in light of future events. We will also refer to certain non-GAAP financial measures, such as non-GAAP operating profit or adjusted EBITDA, that exclude certain items, such as post-retirement expense, cost reduction activities, and other expenses the company believes are not indicative of its ongoing operations, as they may be unusual or non-recurring. We believe these measures provide a more complete understanding of our financial performance. However, they are not intended to be a substitute for GAAP. Reconciliations for non-GAAP measures are provided within the presentation. Slides for today's call are available on our investor website. And with that, I'd like to turn the call over to Mike.

Mike Thompson | CEO and President:

Thank you, Michaela. And good morning, and thank you for joining us to discuss the company's third quarter 2025 financial results. We continue to demonstrate our steady focus on improving delivery and operational efficiency which is helping us successfully navigate the macroeconomic uncertainty in the market and other headwinds impacting revenue. We remain on track to meet or exceed the midpoint of the improved non-GAAP operating profit margin guidance of 8% to 9% provided last quarter, as we expect to generate \$110 million of free pension, free cash flow for the full year. We're on track to meet our increased L&S expectations of \$430 million for the current year, \$40 million above our original expectations, supported by strong retention and consumption trends in our high-value software ecosystem. These trends have now helped generate upside in each of the past three years, and we're increasing our projection for out years to approximately \$400 million of average annual L&S revenue for the three years of 2026 through 2028. The quarter also reflects our commitment to executing the pension strategy we laid out and the realization of the benefits we said we would achieve. We said we would remove substantially all market volatility from our aggregate U.S. pension contributions, and those have remained stable. Our pension debt has come down with our quarterly contributions, and we executed an annuity purchase in September to remove more than \$300 million of U.S. pension liabilities, over half of our stated \$600 million target by the end of 2026. While

revenue was light relative to the color provided last quarter, much of this was related to timing, including a shift of a large license and support renewal, which closed early in the fourth quarter. Timing on XLNS hardware pass-through also contributed to the quarterly miss on top line. Additionally, market dynamics affecting the PC cycle and IT budgets continue to cause clients to pause or delay project initiation, slow the pace of transition for some new business, and limit market penetration of newly introduced solutions. Some of the early signs of improvement we've seen at the U.S. state and local clients lost some steam as concerns about federal funding returned leading up to the ongoing U.S. government shutdown. Our revised full-year outlook reflects some additional revenue timing elements, including a shift in expected fourth-quarter revenue recognition from upfront to overtime, which will generate future revenue. We could see some of the headwinds that challenged XLNS growth this year persists for a few quarters, so we're acting quickly to adjust our approach to mitigate those impacts. At the same time, feedback from clients, partners, and industry analysts have only increased our confidence in the positioning of our solutions and our ability to establish baseline XLNS growth over time. Meanwhile, we're still delivering on profit dollars and free cash flow priorities. The most important elements required to achieve that success are the continued execution of our L&S solution, which we continue to outperform, and the efficiency gains in XL&S delivery, where we're stepping up our efforts. We have already made significant improvement in our XL&S gross margin and have identified incremental opportunities within workforce optimization and the application of AI-driven productivity solutions. Looking at all these factors, we believe we're on a path to improving our growth profile over time, continuing to enhance profit, chip away at the pension deficit and liabilities, and ultimately fully remove our U.S. pension liabilities. Looking at client signings, third quarter total contract value increased 15% year over year, driven by a strong quarter in XL&S renewals. New business TCV of 124 million was in line with the solid levels of new business in the second quarter. Year-to-date, our new business signings are slightly positive relative to 2024, which was a strong year for new business signings, some of which are still building up their full revenue run rates and are showing expansion opportunities. The pricing environment remains competitive, which is not unusual. Clients want to share in the AI cost savings, and in some cases their expectations may be unrealistic. We've also seen some competitors undercutting on price based on aggressive assumptions for the size and pace of future AI-related efficiencies, and we think that they're taking on a high degree of risk in those cases. We are seeing these dynamics on a handful of renewals, and in certain cases have been willing to accept certain attrition, especially at clients prioritizing cost over value, and offering limited potential for us to expand in higher-value solutions. We continue to take a disciplined approach aligned to our priorities of profit dollars and cash flow, and we believe clients are beginning to adjust their expectations as they're gaining knowledge on how the use of the emerging technology applies to their ecosystems, which allows us to build competitive advantages in our portfolios. We have large new business opportunities within our extensive existing client base, and many of our third quarter wins highlight our ability to expand those relationships. In many cases, our wins reflect a close alignment between solution development and our clients' efficiency priorities. For example, in digital workplace solutions, we signed a renewal with a global industrial manufacturing client that included significant new scope to transform and streamline IT support. As part of this engagement, we will transition existing service desk to our next-generation service experience accelerator, and we'll also deploy virtual tech cafes and migrate IT service management capabilities to a new platform to streamline IT support without sacrificing quality. This engagement also includes new scope in CA&I solutions, such as automating network operations monitoring to both improve process and reduce costs. In cloud application and infrastructure solutions, we've signed an expansion deal expected to drive significant cost savings for a public sector client in Australia. Leveraging our deep multi-cloud expertise, we proactively identified an opportunity to optimize their hybrid infrastructure by eliminating a high-cost platform, resulting in migration project work and ongoing managed services revenue for us and millions of dollars of annual cost savings for our clients. During the quarter, we renewed one of our largest public sector infrastructure managed services contracts, a seven-year extension to manage data center environments for a large U.S. state government. We also introduced a new cyber vault solution to protect critical infrastructure used by all of the state's cabinet-level agencies spanning revenue, public health, transportation, and more. The enterprise computing solutions, we signed a new scope contract with a large European financial services clients to consolidate some core systems onto one of our platforms. We will provide transformation services through our proven migration factory to accomplish this project and help our

client execute their simplification and rationalization program. Our deep expertise in financial services sector has been a key driver of new business in ECS segments. And in the third quarter, that also included a noteworthy new logo win for our modern core banking industry solution with a financial institution in Latin America. Branch banking remains an important channel in the region, and we've developed a differentiated offering that integrates branch and digital banking with central core banking technology, incorporating capabilities from our recent partnership with Thought Machine. Our innovative end-to-end offering will consolidate legacy systems for customer management, deposits, loans, accounting, treasury, and compliance into a single, secure, scalable solution that will become the backbone of our clients' financial operations. I now want to discuss our solution portfolio, including some trends we're seeing in client demand and where we're focusing our investment, innovation, and partnership efforts. We allocate a significant portion of our capital expenditures to our ClearPass Forward solution in the ECS segment, which we discussed in more detail in an investor education session earlier this quarter, a recording of which is available on our investor website. A core element of our ClearPath Forward 2050 strategy is the continued evolution of our operating systems and surrounding ecosystem of products, industry solutions, and modernization services. We are continually expanding several dimensions of ClearPath Forward, including speed, security, and resilience, to maintain strong value proposition that has allowed us to retain clients for decades and support increasing consumption. In the third quarter, we released updates to one of our ClearPath Forward operating systems, expanding cloud compatibility, and made significant post-quantum cryptography security algorithm enhancements. Looking at our industry solutions portfolio, in travel and transportation, we completed the integration of our in-transit system to our cargo portal, which means our platform now allows detailed tracking across the cargo journey in accordance with international air transport association standards. In banking and financial services, we're seeing client interest in quantum enhanced fraud detection for financial transactions, a topic on which members of our ECS team recently published research accepted by the International Conference on Quantum Artificial Intelligence following a rigorous peer review. In DWS and CA&I, we continue to invest in our AI-driven portfolio that's based on technology-led delivery models. This is beginning to allow us to show up in the market with higher value offerings at better price points, making us more competitive in the markets. This puts pressure on the top-line growth but allows for reduced cost of delivery and better margin profile. In digital workplace solutions, we're already seeing this in the uptake of our service experience accelerator. During the quarter, we rolled out this solution to additional clients and continue to see roughly 40% deflections away from human support to automated support handled by our agentic AI agents. Data from early client adopters also indicates an improvement in the end user experience. In a service where marginal change has meaning, we're seeing a substantial 28% increase in user engagement and a 24% decrease in abandonment on average. Our knowledge management capabilities are identifying gaps in approximately 10% of support tickets and addressing them with automated content generation, to improve accuracy of the training data and the effectiveness of our agentic AI agents. In field services, we've invested in Salesforce's AgentForce technology, which leverages agentic AI to automate scheduling, rescheduling, and pre and post work summaries, while continuously learning and making autonomous decisions to improve and optimize dispatch efficiency over time. During the quarter, Unisys became an authorized Apple product reseller, adding MacBooks and iPads to our existing device subscription service, which provides comprehensive lifecycle management with intelligent device refresh and a flexible, predictable cost model. This partnership enables client decision-making based on the user's needs rather than supplier limitations. In cloud applications and infrastructure solutions, our application factory has taken shape and yielding a growing pipeline of new opportunities. Application development is a bright spot within public sector, with clients remaining interested in modernizing inefficient platforms, including for criminal justice information, identity access management, and licensing and permitting. We also continue to cross-sell and up-sell new opportunities for our CA&I solutions at existing enterprise computing solution clients, primarily related to ClearPath Forward clients seeking to modernize their application layer and expand digital capabilities. We're also making a push to cross-sell CA&I solutions into our base of ECS clients in the financial services and public sectors that use our business process solutions, where we believe our workflow and process knowledge combined with industry expertise is a unique combination. In both DWS and CNI, we continue to view the market of mid-sized enterprises, those with \$1 billion to \$5 billion of annual revenue, as a relatively untapped market opportunity where we have all the ingredients to effectively compete and source significant

new revenue. These clients typically value personalized service, which they're not receiving from larger providers and have less organizational complexity allowing them to establish their relationship with us at a higher level and more quickly. Given our digital workplace solutions are market-leading, even for the largest enterprises, we see the mid-market commercial sector as a larger opportunity to build leadership and differentiation, particularly within our CA&I solutions. A top priority heading into year-end is defining more clearly a set of CA&I solutions tailored for this segment of the market, and with a streamlined and repeatable sales motion. This involves solidifying preferred partners and building more standard architectural solutions and delivery frameworks, just as we've done in IT service management with Freshworks and EasyVista and in licensing and permitting with Clarity. We are already enhancing our cybersecurity portfolio in this manner, an area where our pipeline is growing and where we're seeing strong secular growth tailwinds in market demand. We're leaning in with partners like Dell and Microsoft to develop end-to-end security managed service playbooks, integrating security tooling, standardized solution frameworks, and repeatable sales motions. We've also begun designing a standard architecture for Unisys intelligent operation specific to mid-size enterprises that can also incorporate private AI clouds. Running AI workloads exclusively in public cloud environments is very expensive and cost prohibitive for mid-market clients. We're exploring potential technology partners with OEM, data centers, and GPU as a service providers so we can offer our clients alternate private AI frameworks with Unisys service wrappers to bring down those costs. Before turning the call over to Deb, I want to provide an update on the industry recognition, including the growing acknowledgement in higher growth areas of the market. In the third quarter, we received a new leader ranking in cloud services for mid-market enterprises. We were also recognized for the first time or appear in new reports in cybersecurity, agentic AI services, and AI-driven application development. This was in addition to maintain leader positions in a number of updated reports put out in multi-cloud, digital workplace, and generative AI services. These recognitions come from highly respected firms such as Avasant, Everest, IDC, and ISG, and give credence to our strategic focus on application development, AI services, and penetration of the mid-market. The majority of the clients and prospects rely on industry experts in some manner when choosing IT service providers. So our steady rise in many quarters should open up new business opportunities in areas of the market we want to penetrate to support XLNS growth and our new solutions. Finally, I want to mention that Unisys was named to Time Magazine's 2025 list of world best companies for the first time, recognizing us amongst global organizations that exemplify excellence in today's corporate landscape. Our investments in upscaling and development opportunities for our employees is an important component of that excellence. and supports a stable workforce maintaining our low voluntary attrition, which was 11.7% on a trailing 12-month basis. With that, I'll turn the call over to Deb to go through our financials in more detail.

Deb McCann | Chief Financial Officer:

Thank you, Mike, and good morning, everyone. As a reminder, my discussion today will reference slides from the supplemental presentation posted on our website. I will discuss total revenue growth, both as reported and in constant currency, and segment growth in constant currency only. I will also provide information excluding license and support or XLNS to allow investors to assess the progress we are making outside the portion of ECS where revenue and profit recognition is tied to license renewal timing, which can be uneven between quarters. To echo Mike's comments, we remain in a good position to achieve our increased profitability and free cash flow outlooks to maintain our strong liquidity position. And we took another step forward on the journey to removing our U.S. pensions with the annuity purchase we executed in September. While we have faced some XLNS revenue headwinds, our license and support cash engine is being powered by our base of high-quality clients who continue to commit to and increase consumption on our platforms. At the same time, we are fine-tuning our strategy to ensure we capitalize on the advantages offered by technology like agentic and generative AI and quantum encryption to expand the scope of our efficiency initiatives and deliver innovation that advances our clients' efficiency goals. Looking at our results in more detail, you can see on slide four that third quarter revenue was \$469 million, a decline of 7.4% year over year, or 9% in constant currency. We had an approximate \$12 million impact from the shift in timing on a license

and support renewal that closed just outside the quarter, which will benefit L&S fourth quarter revenue. Excluding license and support, Third quarter revenue was \$377 million, down 3.9% or 5.8% in constant currency. This was below our expectation of \$390 million we shared with you last quarter due to foreign exchange movement and dynamics I will cover now as I discuss constant currency segment revenue. Digital workplace solutions revenue was \$125 million in the quarter, down 5.8% year over year. Year-to-date, DWS revenue is down 2.9%. The third quarter decline was driven in part by the shift of low-margin hardware revenue, some into the fourth quarter and some into 2026. Volumes in some of our traditional PC field services were also lighter than we expected, and a pickup and PC refresh activity was dampened by Microsoft's extension of security support for the significant number of devices still running on Windows 10. Third quarter cloud applications and infrastructure solutions revenue was \$180 million, a 6.8% decline compared to the prior year period. This segment has our highest public sector exposure, where activity levels have already been suppressed, and the uncertainty around federal funding heading into the government shutdown caused incremental slowing. That impact continues to be primarily concentrated at U.S. state and local governments, though we were pleased to secure meaningful renewal TCV with some of these clients at an improved margin. Year-to-date, CA&I revenue is down 5% due to volumes in the public sector. Enterprise Computing Solutions revenue was \$133 million in the third quarter, a 13.9% year-over-year decline due to the cadence of L&S renewal signings, which have a higher fourth quarter concentration than last year. Within the segment, L&S revenue was \$83 million compared to \$105 million in the prior year quarter. Specialized services and next-generation compute solutions revenue grew 1.7%, benefiting from new business and application services we are delivering for clients in both travel and transportation and financial services. Trailing 12-month signings of approximately \$2 billion translate to a book-to-bill, of 1.1 times for both the total company and our XLMS solutions. And we exited the quarter with a backlog of \$2.8 billion flat year over year. As Mike touched on, the complexity and pace of negotiations have continued to elongate cycles on some renewals in DWS and CA&I. Moving to slide six, third quarter growth profit was \$117 million, a 25.5% growth margin down from 29.2% a year ago. as a result of the cadence of L&S renewals. Ex-L&S gross profit was \$70 million, and ex-L&S gross margin was 18.6%, up 70 basis points year over year, largely due to lower cost reduction charges in the quarter. Excluding that benefit, we continued to make incremental gains in delivery efficiency to maintain profitability despite revenue decline. Our investments in workforce optimization are helping us hone in on incremental opportunities to improve delivery, and we plan to act quickly to capitalize on those. I will now touch briefly on segment gross profit. DWS gross margin was 16.2% in the third quarter, essentially flat year over year. As Mike discussed, we are leaning heavily into technology to automate delivery. DA&I gross margin was 19.6% in the third quarter, relatively flat year on year. We were pleased to maintain profitability especially given the higher margin profile of CA&I solutions being impacted by public sector uncertainty. Segment margins continue to benefit from automation and optimizing workforce and labor markets, as well as synergies we are achieving from centralizing application capabilities. ECS growth margin was 46.2% in the third quarter, down from 58.2% a year ago, which was due to the timing of L&S renewals and NICs from integrated system sales. As a reminder, our L&S solutions have a fairly fixed cost base, and the very high concentration of license renewals is expected to drive a significant sequential increase in fourth quarter ECS growth margin. Moving to slide seven, third quarter gap operating loss is \$34 million, which included a \$55 million non-cash goodwill impairment in the DWS segment related to the near-term industry dynamics challenging volumes, and the pace of client signings. Non-GAAP operating profit was \$25 million, a 5.4% non-GAAP operating margin, which is in line with our expectations for mid-single digits. SG&A in the third quarter declined slightly year over year and is down 8% year to date, driven by our initiatives to streamline corporate functions, real estate, and technology. We are pushing to accelerate the remaining cost takeouts and increase our overall rationalization programs to maximize savings in 2026. We had a third quarter net loss of \$309 million, which included an approximate \$228 million one-time non-cash pension expense related to the annuity purchase transaction in the quarter. As we previously discussed, this is an important element of our pension removal strategy. The quarter also included a \$4 million foreign exchange loss. As we mentioned last quarter, we ended our hedging program on intercompany loans which removed the cash impact of the hedge settlements, but increases P&L FX volatility, impacting GAAP net income. Adjusted net income was negative \$6 million, or a loss of 8 cents per share. Turning to slide 8, capital expenditures totaled approximately \$18 million in the third quarter and \$59 million year-to-date, relatively flat

year-over-year. A significant portion of capital expenditures relates to relatively steady levels, of solution development for our L&S platforms while we maintain a capital-light strategy in our ex-L&S solutions. Pre-pension, pre-cash flow, which is free cash flow prior to pension and post-retirement contributions, was \$51 million in the third quarter and \$15 million year-to-date. We generated \$20 million of free cash flow in the third quarter and improvement from \$14 million in the prior year period. During the quarter, we made \$30 million of contributions to our global pension plans and received a \$25 million one-time payment related to a favorable legal settlement in the fourth quarter of 2024. Moving to slide nine, cash balances were \$322 million as of September 30th, compared to \$377 million at year end, reflecting our use of \$50 million cash on hand as part of our \$250 million discretionary pension contribution. Our liquidity position is strong, with no major debt maturity until 2031, and our recently renewed \$125 million asset-backed revolver remains undrawn. Our net leverage ratio is 1.8 times and 3.7 times, including pension deficit. We expect lower net leverage at year-end, given the strong profit contribution we expect from L&S renewals and expect leverage to gradually come down over time as we contribute to our pensions, though not in a straight line. I will now provide an update on our global pension plans. Each year end, we provide detailed estimated projections for expected global cash pension contributions and gap deficit relative to our quarterly updates. These projections change based on factors including funding regulations and actuarial assumptions. The deficit is also impacted by our planned contributions some of which go directly towards deficit reduction. After the upside senior notes issuance in June and one-time \$250 million contribution, the pro forma 2024 year-end U.S. pension deficit was approximately \$500 million. As of September 30th, we estimate the deficit to be approximately \$470 million. We are forecasting approximately \$360 million of remaining cash contributions our global pension plans in aggregate through 2029, which includes approximately \$24 million of pension contributions in the fourth quarter, including both U.S. and international. Of the \$360 million of contributions we are forecasting through 2029, approximately \$230 million are associated with our U.S.-qualified defined benefit plans, relatively unchanged from last quarter. As we discussed on last quarter's call and during our dedicated pension investor education event, the historical pension contribution volatility that was primarily in our U.S.-qualified defined benefit plans was substantially removed by increasing fixed income allocations of plan assets to match duration of plan liabilities. As a result, our contributions through 2029 are not expected to fluctuate more than 3% in aggregate per annum, providing a high degree of certainty as to our future funding requirements. During the quarter, we completed an annuity purchase that removed approximately \$320 million of pension liabilities, more than half of the \$600 million we aim to remove before the end of next year. This involves transferring \$320 million of liabilities and a similar amount of plan assets to a third-party insurer. Annuity purchases reduce ongoing maintenance costs and allow us to remove liabilities at lower premiums than would be paid on a full takeout. I will now discuss our full year financial guidance and additional color provided on slide 10. For the full year, we now expect constant currency growth of negative 4% to negative 3%, which equates to a reported revenue decline of 3.6% to 2.6%, which continues to assume full year license and support revenue of approximately \$430 million. This implies fourth quarter revenue of approximately \$570 million, which assumes \$185 million to \$190 million of L&S revenue. We expect to come in at or above the midpoint of our upwardly revised non-GAAP operating margin guidance range of 8% to 9%, implying fourth quarter non-GAAP operating margin in the mid-teens due to the concentration of L&S revenue we expect. We are pleased that this translates to non-GAAP operating profit that is slightly above our original full-year guidance. This stems from the strength and stability in our ClearPass Forward software ecosystem, as well as diligent execution to enhance delivery and operational efficiency and foreign exchange favorability. We will continue to act with agility to remove additional costs where needed to align with revenue levels in certain areas of the business. We continue to expect to generate approximately \$110 million of pre-pension free cash flow. This reflects full-year assumptions listed on slide 10. As a reminder, pre-pension free cash flow is difficult to predict with precision, as the exact timing of some larger L&S collections and how those fall around year end could shift collections between fourth quarter and first quarter of 2026. Operator, please open the line for questions.

Operator | Conference Operator:

We will now begin the question and answer session. To ask a question, you may press star, then 1 on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then 2. At this time, we will pause momentarily to assemble a roster. And our first question will come from Rod Borges of Deep Dive Equity Research. Please go ahead.

Rod Borges | Analyst, Deep Dive Equity Research:

Okay, great. Thank you. I could ask a long-winded question on AI, but I'll make it short-winded. How are you seeing AI's impact overall on your P&L?

Mike Thompson | CEO and President:

Hey, Rod, it's Mike. Thanks so much for joining in the question. Really appreciate it. Although short-winded question may be a long-winded answer, that's As you would expect, lots of impacts in regard to the application of AI. In general, what I would say to you is that the impact of our transformation of our delivery model, which allows us to continue to deliver our solutions in a more, I'll say, cost-friendly way or reducing our delivery costs, certainly helps our margin profile, and we've seen a lot of green shoots in that regard. As I mentioned in some of my prepared remarks, and Deb did as well, there's a knock-on impact, a top line for that, right? So, typically, the AI component of a lower delivery cost means that, you know, our clients are seeing some of the benefit of that, and we share some of that savings with our clients, but it makes us, you know, obviously a lot more profitable and allows us to be a lot more competitive from a pricing perspective. So, you know, we think that's the right way to approach that in regards to the new solution uptake. And then, you know, obviously as we continue to grow and add new logos to the mix, the application of those new logos certainly have an uplift that is much more top line and bottom line accretive because we've already baked that into our models. We're seeing, as you know, within our L&S business, increases in our consumption rate. We think that's pretty much driven by the application of AI across the board, right? So this whole data abstraction layer and AI compute layer, we're seeing some nice improvements in our HPC business. So, you know, clearly that clear path forward consumption, we've increased that guidance, as you know, and we're actually talking about the increase of the out years, 26 through 28. I think we started that dialogue a couple years back thinking that would be about 360 million per annum, and now we're talking about 400 million on average per annum for that three years. So significant uptick in L&S related to consumption that we think is AI related. Certainly AI in our delivery efficiency and hitting those real strategic objectives of increasing our profitability and our delivery. And, you know, in some of those cases too, Rod, by the way, it's not only about just margin improvement in those accounts. You know, we're looking at expansion and new scope and kind of growing those accounts in a bigger way through the application of this kind of technology-led delivery. And, you know, so the scale is one part of it, but certainly the volume is the other part. So, So, you know, we're obviously, you know, huge believers. We've talked for a while that we think this is, you know, exponentially helping us to continue to compete in greater and greater scale with some of our competitors. And, you know, we've got it essentially sprinkled in throughout our delivery, whether that's in intelligent operations embedded in just AI management and orchestration of compute, within CA&I, whether it's embedded in ECS from a ClearPath Forward delivery and navigation, and whether it's in field services and or service desk inside of DWS. All of our solutions essentially have that baked in and continue to grow in that manner.

Rod Borges | Analyst, Deep Dive Equity Research:

Okay. And then I guess as an extension of that and applying it to the results for the quarter, despite the revenue shortfall, you seem on track to meet your margin and free cash flow targets. So I'd like to ask, what's enabling the margin performance to come through, even though revenues are coming in less than planned?

Mike Thompson | CEO and President:

Yeah, great question, Rod. Thanks for that. Well, look, the first and most obvious is the increase in L&S, right? So that's obviously a higher profit component, and we're seeing a step up in that which is giving us margin pull through. The second and probably less obvious is there are plenty of green shoots embedded in XLNS for our new solutions, right? We've had quite a bit of renewal activity this year. It's probably an unusually high renewal activity coming through in the year. And being able to sign those accounts with our new solutions at a better margin profile. And in a lot of cases, being able to expand either expansion of the work that we're doing or add new scope to those renewals are also benefiting us from a margin profile. So I think what you're really seeing here on the top line is you're seeing some reduction or accretion in top line related to either contracts that have attrited off or the slowness of some of the PC cycle or some hardware shifting. But all three of those are lower margin accreted off. And what we're adding is higher margin, you know, addition. So right now the top line is suffering a little bit from the accretion being a little higher than the addition. But, you know, we feel like that's the right path from our perspective. And, you know, we've tried our best here to fully deliver, you know, what the risk is for the remainder of the year for the, you know, the impacts that we've been seeing over time. Whether that's the PC refresh cycle, whether that's, you know, slow down in the adoption of Microsoft 10 to 11, or whether that's just the uptake in project work in public sector due to, you know, the prevailing issues there in the U.S. with the government shutdown and others. So a little bit of a balance, but in general, you know, it's allowed us and I think proves our margin continued improvement in our new solution delivery. I mean, just as a reminder, over the course of the last three years, we've improved that gross margin in XLNS by almost 600 basis points, and we continue to see opportunity to continue to see that expansion, regardless, really, on what's going on in the top line.

Deb McCann | Chief Financial Officer:

And also, Rod, this is Deb, just to add, we have also increased some of the SG&A savings we talked about. At Investor Day, we're accelerating some of those. Some of those were through 2026. We've accelerated some of those. into 25, and we're, you know, ramping up our efforts overall on rationalizing our cost base.

Mike Thompson | CEO and President:

Yeah, look, I think Deb mentioned, too, in her prepared remarks around, you know, kind of the variability of that workforce. So clearly we're going to take, you know, some level of action to make sure that we continue the margin improvement that we've been seeing over the last couple years.

Rod Borges | Analyst, Deep Dive Equity Research:

All right, and just a final quick one here as inputs to the model link. Can you give your view on the pace of your delivery improvement going forward and how that would impact Q4 cost reduction charges specifically? Thanks.

Mike Thompson | CEO and President:

Yeah, thanks, Rod. So, look, I mean, we've always been and continue to refine our delivery costs, and so there's some level of kind of BAU cost reduction that you normally see. I would expect that you'll see some of that increment in Q4 costs, and the cadence probably be a little higher in Q4 just to kind of mirror the variability in the workforce. I don't think it's going to be like a crazy significant increase in that, but there certainly will be actions taken to mitigate the exposure that we've seen on top line or some of the, you know, de-risking efforts that we're going to do to maintain the margin profile.

Rod Borges | Analyst, Deep Dive Equity Research:

Got it. Thank you.

Mike Thompson | CEO and President:

Thanks, Rob.

Operator | Conference Operator:

The next question comes from Mayank Tandon of Needleman Company. Please go ahead.

Brandon | Analyst, Needham & Company (on behalf of Mayank Tandon):

This is Brandon on for Mayank. Thanks for taking my question. I guess I just was wondering, what are you guys seeing on the demand front in cloud spending, particularly on the AI front? I know you guys mentioned, like, increased competition, but I guess what are you guys doing to navigate those increased competition dynamics that you guys are seeing?

Mike Thompson | CEO and President:

Hey, Brad, and thanks for the question and thanks for participation in the call. Look, the demand is certainly there. I will tell you, I was just on the road, frankly, in Europe and met with a whole host of clients and just had what we call a CIO and CTO forum and had a big discussion with, you know, 20-some-odd potential clients and existing clients in that forum. So, you know, clearly the demand is there for the application I think what we're bumping up against is the application of that technology into an ecosystem that is very sensitive, right? There are many attributes that need to be addressed, security being one of the primaries involved with that. So there's money there certainly to be spent. The demand is there. We continue to get validation from clients and industry analysts that our solutions are there and what they want. And, you know, as I mentioned, the competition continues to be, you know, fairly aggressive in that. So, you know, we've got to really make sure, you know, from a defensive posture that education is key and really having those dialogues around what that output looks like and why, you know, our client centricity model and being, I'll think, a little bit pragmatic in how it gets adopted, where it gets adopted, and the time of adoption is really important. So there's an equal amount of hype as there is an equal amount of, you know, practicality in the adoption of these AI models, right? And I think from our perspective, we're taking a tack to really try to be very conscious around setting the right expectations with our clients, not promising things we can't deliver, And in some cases where those expectations aren't met, then, you know, then we have to attrit that potential, you know, client opportunity because, you know, we're not looking for a race to the bottom here. We're really talking about adding value and experience to our clients. And, you know, one of the stats I like to use when having discussions with our clients and potential clients is, you know, for our top 50, On average, we've serviced those clients for, you know, roughly 20 years. You don't have that level of experience with a client base because you're looking at a short-term adoption of a technology. We really like to think our technology is state-of-the-art, and we want to talk about the future and how we get our clients to the future. So the demand is certainly there. Our solutions certainly meet that demand. And, you know, the key is really about client education. and setting an adoption roadmap.

Brandon | Analyst, Needham & Company (on behalf of Mayank Tandon):

Okay, thank you. That's super helpful. And then I know you guys, last quarter, you guys touched on the public sector, I think specifically for the cloud business. So I was wondering if you guys, you guys mentioned the call a little bit, but any update on that with the government shutdown in terms of client conversations and client demand with the shutdown? Thank you.

Mike Thompson | CEO and President:

Yeah, great question. Thanks, Brennan. So Yeah, we did talk about that last quarter. In fact, last quarter, we mentioned that we started to see a little bit of green shoots in public sector and, you know, thought that sector was coming around a bit from a project orientation. That has reverted, right? That I'll say influx of project work is basically really quiet. Now, Deb mentioned in her remarks, and I think it's important, You know, we've got a lot of renewals and have had a lot of renewals this year in public sector and are doing well to renew, you know, those particular accounts. But we're not seeing the uptick in the project work that we had started to see. So, you know, there are a couple areas where we're leaning in. You know, we talked about that a little bit on the call, but You know, we talk about the justice system. You know, we talk about access management and things like that. There are what I would consider nondiscretionary areas in public sector where the demand is fairly constant, and there's some project work in that space. But clearly, there is, continues to be a pause in project work in public sector, specifically related to U.S. public sector. I wouldn't say that holds true across the board. You know, we mentioned on the call about an Australian client that we had some good success with and expansion in other regions. But U.S. public sector is also where a good chunk of our CA&I business is allocated. So there's definitely been kind of a pause in project work there. And so the green shoots that we started to see in Q2 have really subsided and You know, I think there's a little bit of a wait-and-see approach here, and we expect that that's going to continue for a couple quarters. So, you know, we're kind of sitting tight. We're having good conversations with folks, but there's a lot of uncertainty there.

Brandon | Analyst, Needham & Company (on behalf of Mayank Tandon):

Thanks. That's super helpful. Thanks, guys.

Mike Thompson | CEO and President:

Thank you.

Operator | Conference Operator:

The next question comes from Anya Sorenstrom of Sedoti. Please go ahead.

Anya Sorenstrom | Analyst, Sedoti & Company:

And thank you for taking my questions. A lot of them have been covered already. But can you just, I think you mentioned you're starting to see pricing pressure. Is that something you only started to see now in the third quarter? Or can you talk a little bit more about that?

Mike Thompson | CEO and President:

Hey, Anya. Good to talk to you again. Yeah, no, we did mention that. I wouldn't say it's something we're just seeing in the third quarter. As you know, this is a highly competitive space that we're in. I would say in the third quarter and especially as we go through renewal cycles with clients, there's more and more players in that renewal cycle. And, you know, frankly, in a couple instances, we've seen competitors really just undercut pricing to, in my mind, levels that we're just not willing to go to, right? You know, we've made a commitment as a management team that we're going to stay disciplined and the contracts that we're signing. We know we've got value. We know that we can bring that value to our clients. But, you know, we're not just going to sign contracts to maintain a top line if it's not helping our bottom line. You know, our objectives were very clear, and we continue to follow them. We're trying to grow profit dollars. We want that margin percentage to increase. We're increasing cash flow or, you know, obviously, moving positively in the cash flow arena. And we think that's the better way to drive shareholder value. And so, you know, that pricing pressure I think is, you know, certainly relevant and continues to be relevant in our discussions. But, you know, please don't take that comment to think that we're not competitive in pricing. We are. You know, we're right there in every deal that we're talking about. But there's a limit to how far we're willing to go. And from our perspective, if the client doesn't have the capability for us to grow or the capability or want to move to our next-gen solutions, we're really not interested in just re-signing a contract at lower values for the old delivery model.

Anya Sorenstrom | Analyst, Sedoti & Company:

Okay, thank you. And then I'll take you and just maybe go over some puts and takes for the free cash flow for 2026.

Mike Thompson | CEO and President:

Sure, Deb, we don't take that?

Deb McCann | Chief Financial Officer:

Yeah, so as far as, you know, for 2026, we're not, you know, giving guidance at this point for 2026, and we'll discuss that when we report fourth quarter. But there are, to your point, you know, a lot of moving pieces. So obviously, you know, with the capital market transformation we did, right, we lowered our pension contributions, but the interest expense will move higher. And, you know, so there are moving parts that as we're formulating our plan for 2026, you know, we'll lay out to you when we report that next quarter. But I think a key thing is, you know, the biggest driver, you know, L&S is clearly a big driver at 70% margin. So, you know, as we finalize what that number we've set on average, 400 million, and those are 70% margins. So those, you know, are a big impact. But I think what's most important is we feel we have a really strong liquidity position. So as we go into 2026, you know, right now our cash balance is 320 million. And if you look at the cash color we've given, you know, to hit about 110 million, pre-pension, that puts us about \$390 million of cash by the end of the year. So we feel like, you know, we'll be entering 2026 in a good place from a liquidity perspective. And we also have that \$125 million ABL we just renewed that's also undrawn. So we feel good from a liquidity position. And, you know, as we shape the algorithm, what that's going to look like in 2026, you know, we feel confident in that.

Anya Sorenstrom | Analyst, Sedoti & Company:

Okay, thank you. And then also, if I understand right, the lower LNS this quarter was due to some being pushed into the fourth quarter and into 2026. Can you just elaborate on that a little bit and what you're seeing there?

Mike Thompson | CEO and President:

Yeah, so just to be clear, the push in the quarter got signed in the early days of Q4 for LNS. So that's not anything into 26. That is really just a shift of something we thought was going to sign by September 30th, signed in October. All of it was signed. All of it is in-house. So no real issue from an L&S cash perspective, just a quarterly timing. Deb, anything?

Deb McCann | Chief Financial Officer:

Yep. Nope. No, that's just all within this year. Okay. Great. Thank you. That was all for me.

Mike Thompson | CEO and President:

Great. Thanks, Anya.

Operator | Conference Operator:

Once again, if you would like to ask a question, please press star, then 1. And our next question will come from Arun Sisadri of Forza. Please go ahead.

Arun Sisadri | Analyst, Forza:

Everyone, thanks for taking my questions. Just a couple from me. It sounds like the book to bill is still pretty strong. So does that reflect confidence in the, you know, I guess, you know, what the timing impacts in LNS as well? And sort of what are you seeing in terms of that renewal activity and You talked a little bit about renewal activity being, you know, enhanced this year. Is that, I guess, those two are potentially related. But any color there. And then secondly, if you could, is there any way you could size that renewal in LNS that moved over to Q4 that would be helpful? Thanks.

Mike Thompson | CEO and President:

Yeah, so I'll start that. And, Deb, I'll ask you to kind of chime in here with some color as well. So you're right, the book-to-bill, I think we are at 1.1 is what we're talking about on book-to-bill. And, you know, clearly that's a solid book-to-bill and happy with that and aligned to kind of our, you know, contracting models and our normal modeling for our forecasting. So, you know, the renewal cycle that I talked about, I mean, and I was actually talking more about XLNS, L&S, we've talked about the renewal cycle quite a bit, and, you know, as we've indicated, that renewal cycle is actually increasing our L&S expectations over the next three years. So I'm going to discount that for a second, Arun, and based on your question, and really speak about XL&S. So for this year, just to give you a sample, the XL&S renewal cycle for this year is about three times what it will be for next year, right? So it gives you a sense of the baseline that we're actually renewing this year. And if you think about that, the resources it takes to go after all of that renewals is also, you know, obviously puts some pressure on the work that we're able to do in new logo acquisitions. So there's a pretty high renewal cycle this year. We've been very successful in that renewal cycle. Now, I'm not saying we've renewed every single contract that was out there, and a couple of them, as I've mentioned, you know, we didn't because the, you know, the investment that the client was looking for us to make was not conducive to the pricing that we expected to get. So a couple of those contracts we did not renew, but the lion's share we did, and for many of those we've actually renewed them at better margin profiles and have increased some scope and or expansion in those accounts. So we've been pleased so far with the the ability to renew those and to renew that work under our new delivery model, right? That's really key, that we're converting these clients upon

renewal to the delivery model that's technology-based, and that's an important element of that cycle because that brings in the enhanced margin profile. So, you know, get happy with, you know, the current book-to-bill, happy with the progress we're making on renewals, We have quite a bit of renewals coming up in Q4. Progress on those have been very good. So, again, kind of pleased with where we're at there. Would I like to win every single one and get them at higher margins? Sure. Is that a realistic assumption? Probably not. Deb, anything you want to add to this?

Deb McCann | Chief Financial Officer:

Yeah, just that, as you can see, I mean, the TCV year to date, right, XLNS renewals is 572 million versus last year, 321. So it's 78%. increase over last year, just to demonstrate kind of how big our, you know, the renewal cycle's been this year. And then related to your one on the L&S renewal that shifted out, that was just a few days after the quarter. That was about \$12 million we had mentioned of revenue that shifted out one quarter. But it won't impact, it will not impact the full year.

Arun Sisadri | Analyst, Forza:

Got it. And then, but also, you also have a fairly significant expectation, I think, for the for Q4 that's factored into the numbers? And it sounds like your confidence is pretty high in terms of that XLNS renewals in Q4.

Mike Thompson | CEO and President:

Yeah, I think as common on the renewals was the LNS component. And of course, we're super confident in the LNS component. And we're also confident in the XLNS component of renewals. You know, so look, everything that we're not confident about has been baked into kind of our you know, updated guidance. So we feel pretty good about what's out there to close. And, you know, obviously at this point in the year have pretty good insight to, you know, how the next couple months are going to close out.

Deb McCann | Chief Financial Officer:

But to your point around the LNS renewals, right, one, a few day slip, right, can shift. And so we mentioned that throughout the script, right, that we do have high expectation for for Q4, which we feel confident in, but, you know, there is always that slip of an element.

Mike Thompson | CEO and President:

Yeah, wonderful point, Deb, and really, if you think about it, Arun, you know, our talk on that has always been around not if, but when, right? So we're really confident that it's going to renew, and, you know, and we're very confident that it's going to renew in the timing that we expect it to, but, you know, as we've just seen in this quarter, a shift of a couple days makes a difference. Thanks, Arun.

Operator | Conference Operator:

The next question comes from Matthew Galenko of Maxim Group. Please go ahead.

Matthew Galenko | Analyst, Maxim Group:

Hey, thanks for taking my quick question. If we see the other side of the government shut down in the relatively near future, do you expect like a quick return on forward momentum on project work that's been gummed up? Or, you know, how quickly do you see the market responding to things opening up?

Mike Thompson | CEO and President:

Hey, Matt, thanks for the question. Good talk to you again. Look, I don't think our expectations are that it's going to be a light switch effect where the government opens back up and all of a sudden all this project work starts to open up immediately. As we indicated last quarter, we just started seeing some green shoots on that work and then it shut back down. So we think that's going to linger, frankly, for, you know, a couple quarters. So do I think it's going to be like a Q1 recovery if the government opens up before then? No, I do not, right? We've got to kind of reengage. They've got to reassess what the outputs of that government work is. The focus is going to be on non-discretionary work first and then project work second. So, you know, we're kind of baking into our expectation that that's going to be several quarters prolonged.

Matthew Galenko | Analyst, Maxim Group:

Great. Thank you. Thanks, Matt.

Operator | Conference Operator:

This concludes our question and answer session. I would like to turn the conference back over to Mike Thompson for any closing remarks.

Mike Thompson | CEO and President:

Thank you, operator. Before we wrap up, I just want to reiterate a few key points we hope you take away from today's call. First, the trends remain strong in our most powerful profit and cash driver, which is L&S Support Solutions. We plan to meet our increased expectation of \$430 million for this year, and have increased our expectations for the average annual LNS revenue in out years from 26 through 28 to \$400 million per year. Second, while the market dynamics posted headwinds in our ex-LNS business that we don't expect to dissipate overnight, we're adjusting our approach to mitigate those impacts, and importantly, we're continuing to deliver on our profit and cash flow objectives, And then lastly, you know, we're building momentum in our AI-led solutions with technology-first delivery models. This is making us more competitive, supporting our margins, enabling us to scale our most differentiated innovation more quickly, and we're seeing more and more clients and industry analysts support the belief in that momentum. So, you know, I'd like to just make sure we take away those three points from today's call. And, Operator, thank you for your time, and you can close the call.

Operator | Conference Operator:

The conference has now concluded. Thank you for attending today's presentation and you may now disconnect.