NYSE:UIS Q4 2025 Earnings Call Transcript

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Operator:

Good morning and welcome to the Unisys Corporation fourth quarter and full year 2025 financial results conference call. All participants will be in a 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 a touch-tone phone. 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 fourth quarter and full year 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 these statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed on this call. 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 Form 10-K and 10-Q 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, that exclude certain unusual or non-recurring items, such as post-retirement expense, cost reduction activities, and other expenses that the company believes are not indicative of its ongoing operations. While we believe these measures provide a more complete understanding of our financial performance, they are not intended to be a substitute for GAAP. Reconciliation for non-GAAP measures are provided in the slides for today's call, which are available on our investor website. With that, I'd like to turn the call over to Mike.

Mike Thompson | CEO and President:

Thank you, Michaela. Good morning, and thank you for joining us to discuss the company's fourth quarter and full year 2025 financial results. I want to start off with three clear messages that we hope you take away today. First, we continue to execute against a consistent operating strategy, which is yielding improved profitability and free cash flow as we continue to advance our pension removal strategy. Second, the market perception of Unisys and our solution continues to advance among our clients, prospects, partners, and industry analysts. And third, which relates to a subject I know that's top of mind for everyone, we believe artificial intelligence is poised to become a powerful driver of long-term demand in the solutions that are core to Unisys as a designer, orchestrator, and enabler of modern IT ecosystems. Before discussing AI, I want to discuss my first message of how consistent execution of our strategy is translating into financial results. Fourth quarter revenue grew 5% year over year, resulting in a slight improvement in our full year revenue projections coming in above our revised midpoint. Our non-GAAP operating margin was 18% in the quarter and 9.1% for the year, exceeding the top end of our upwardly revised projections and representing 30 basis points of annual improvement. We had a high degree of confidence in achieving the fourth quarter weighting of our license and support revenue, and we met those expectations. Full-year L&S revenue exceeded our original expectations by nearly $40 million, making this the third consecutive year of substantial upside in our highest margin profit center. Our actions to streamline corporate cost reduced SG&A as a percent of revenue

by nearly 300 basis points over the past three years. We generated $128 million of full-year pre-pension free cash flow in 2025, up 55% from the prior year and above the $110 million we expected. We have strong liquidity with over $400 million of cash on the balance sheet at year-end, up almost $40 million year-over-year. We increased our year-end cash balance while net leverage, including pension, has improved to 2.8 times compared to 3.0 times at the end of 2024. Our liquidity also improved despite using $50 million of cash as part of a discretionary contribution to our U.S. pensions. Our total contributions have reduced our global pension deficit by $300 million to $450 million at year-end, and lowered future expected contributions by more than the interest on the incremental debt we raised, improving near-term cash flows. We also executed another annuity purchase, which removed approximately $320 million of gross U.S.-defined benefit pension liabilities in 2025. This, coupled with our liability duration matching strategy, which has successfully removed substantially all market volatility from the total future contributions keeps us on a fixed path for full removal of the U.S. defined benefit pension plan. I want to shift to my second message, which is that awareness and perception of Unisys and our solutions continues to advance. We're seeing this evidence by our wins and our pipeline. 2025 was an especially large renewal year, and our team successfully signed $1.7 billion of renewal TCB, securing a large portion of our recurring revenue base. Over a billion dollars of renewal TCB was signed in the fourth quarter alone, which included closing a three-year extension and improved economics with our largest DWS client, who has been with us for nearly three decades. This field services renewal spans US, Canada, and Latin America, and secures the necessary scale for us to provide affordable field services across our client base. Multi-year renewals can be a catalyst for expansion within client account by integrating new solutions that support enhanced client centricity and improved overall margin profile. We capitalized on these opportunities in the fourth quarter, which was our largest quarter of new scope signings in recent years. Almost all of our largest renewals during the quarter included new scope, evidencing improved perception within our existing client base. For example, during the quarter, we signed a five-year renewal with one of the largest public university systems in the United States for cloud transformation, migration, and modernization services and expanded scope to include centralized application management across campuses, and a center of excellence that will leverage AI agents to standardize and modernize application management, streamlining processes for both students and staff. As we discussed last quarter, we've seen some competitors price aggressively to prioritize revenue over profitability and delivery quality. While that contributed to a few significant renewal losses and presents several hundred basis points of growth headwinds for 2026, We're confident our investments in our core areas of our portfolio will continue to drive market and wallet share gains and will both reduce client costs and extend the scope of our delivery for our clients. In our wins and pipeline, we're seeing more instances of clients placing increased value on delivery quality and viewing it as a real differentiator. For example, in the fourth quarter, we won back a public sector client in Australia with a large scope for DWS solutions after they experienced a decline in delivery quality with one of our competitors. This win sets a powerful new foundation for our business in the region and provides a global playbook for showcasing delivery differentiation. We also added several new logo opportunities to our DWS and CA&I pipeline from chief information officers who moved to new organization and engaged us immediately to participate in their transformations because they know we're a true partner with all the necessary skills to modernize and reliably manage complex IT ecosystems post-transformation. We're also achieving new heights in recognition and awareness among industry analysts that influence client decisions when selecting IT solution providers. During 2025, we build upon several years of advancing awareness and recognition within the analyst community, Again, increasing our total report placements by over 20%, including two new leader recognitions. In the fourth quarter, we received a very significant recognition from Gartner, which elevates Unisys to a global leader position in their outsourced digital workplace services Magic Quadrant for the first time. Magic Quadrant reports are the culmination of rigorous fact-based research evaluating completeness of vision, an ability to execute and provide a wide-range view of the relative position of providers. In addition, in its companion critical capabilities for outsourced digital workplace services report, Gartner ranked Unisys as the number one overall provider for the North American market and the number one global provider for both service desk and device management capabilities. This acknowledgement is already helping us access more opportunities, giving us an edge, especially relative to the three of our largest competitors that fell out of the leader quadrant. Unisys was also named the Forbes list of America's best midsize employers in 2026, which comes on the heels of being named Time Magazine's

world's best companies in 2025. Our culture is reflected in our below-average voluntary attrition, which was 11.4% for the year. As we look to the future, I want to discuss why we view AI as a powerful long-term driver of demand for our solutions and how we've invested in solution development and delivery skills to capitalize on it. As I said earlier, Unisys ultimately develops, enables, and orchestrates the IT ecosystem. In all three of our segments, we provide solutions that enable emerging technology throughout the enterprise and are agnostic to the placement of AI, software, or hardware that make up our clients' environment. As the industry heads into a major multi-year AI infrastructure build-out to supply the technology needed for broad AI adoption, there's a growing shortage of skilled technicians and that will provide the design and service layer for modernization and postmodernization support. Importantly, demand for services will grow regardless of whether clients develop custom AI agents on private infrastructure, leverage standard capabilities from software providers and hyperscalers within private or public clouds, or a combination of both within hybrid environments. For us, the scale and reach of AI goes beyond the software and extends to physical AI, The scale and skills of our field service organizations present a unique market opportunity for us. We're already beginning to support private AI builds for OEM partners, requiring liquid cooling skills, complementing the work we already do in maintaining critical hybrid infrastructure, such as servers and storage and data centers, or IoT devices in everything from conference rooms to restaurants. We will also continue expanding services our existing use of agentic AI and expect AI agents to continue to be layered throughout our managed service offerings, orchestrating increasingly complex and automated workflows. Clearly, AI is adding complexity to managing the IT estate. Tokenization costs are high, business cases are challenging, and measuring returns on investments is difficult. We expect all these factors to increase client reliance on external providers. Unisys can reduce the cost of AI adoption for clients by developing solutions that can be leveraged across a large base of clients with standardized architectures for faster deployment. In 2025, we launched Service Experience Accelerator, an agentic AI framework for delivering next-generation service desk. SEA is now in production with some of our largest clients, and we are enhancing our solution to improve its ability to handle input ambiguity. We plan to roll this out to about a third of our existing client base during 2026, which establishes a growing base of leverageable technology to support long-term expansion, continued delivery optimization, and enhanced quality. In CA&I, we're advancing our intelligent operations architecture, with an integrated framework for rapidly developing, deploying, and orchestrating AI agents to streamline IT operations and aid in financial operation decision-making, especially as it pertains to design and compute. Our alliance partners offer a significant and relatively untapped opportunity to scale distribution and continue raising awareness in the market. Hyper scalers are eager to promote solutions that use their cloud platforms, tools, and models to drive AI adoption and development of their AI-enabled cloud ecosystem. For example, in CA&I, we're standardizing our SOC managed service delivery with Microsoft's Sentinel and Defender threat detection as its main components. We are powering the service layer with AI agents, which helped us engage with Microsoft on development and discussions about joint promotions. Many of our key enterprise software partners are also seeking to accelerate uptake of their AI capabilities. As another example, we are a high volume user of AgentForce internally, which we adopted to optimize our field service dispatch, and we're engaging with Salesforce to explore how we can jointly offer our internal framework as a service to some of their other clients and prospects. These examples illustrate the repeatable playbooks we developed across our portfolio that we think will help us capitalize on AI-related demand, strengthen our partnerships, and ultimately accelerate our growth in XLNS solutions. In the ECS segment, we continue to be highly confident in the enduring value of our ClearPass Forward ecosystem, despite hypothetical threats posted by AI development. AI coding capabilities do not replicate decades of development required to integrate processes code, equipment, and environments with unmatched latency, availability, redundancy, and security. Our core platform offer an unmatched combination of speed, resilience, and most importantly, security, which is of critical importance to the financial services, government agencies, healthcare, and travel transportation companies we serve. Replicating these benefits would require parsing our unified platform into numerous functions and a wholesale reorganization of business processes for minimal benefit, bringing with it significant business risk. At the same time, we continue investing in our core platforms, which are already cloud compatible, enhancing our value-added products, such as data exchange and ePortal, which unlock valuable data and allow it to move across environments and applications powering AI and analytics. These solutions represent increased extensibility and ecosystem expansion that establish ClearPath Forward as a pillar of a

modern AI-enabled enterprise solution advancing digital transformation. At the same time, we are leveraging AI to help us quickly assess workforce skills, identify gaps and vulnerabilities, as well as assist in cross-training and upskilling talent for the future. We are beginning to leverage our internal engineering expertise into advisory engagements with ECS clients. And while quantum computing may not be imminent in the short term, we are beginning to see tangible client engagement for quantum advisory services we introduced early in 2025. With that, now I'll turn the call over to Deb to go through our financial results in more detail.

Deb McCann | CFO:

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 for 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, our results reflect consistent execution of our business strategy and effective de-risking of our future pension contributions, making our financial performance and liquidity stronger and more predictable for investors. We have seen an ongoing positive shift in how we engage with partners, clients, and industry experts, and we think much of that is related to our agility in adopting artificial intelligence within delivery and solution frameworks. And we expect AI to be a strong, long-term driver of demand for our largest solutions. Looking at our results in more detail, you can see on slide six, fourth quarter revenue was $575 million, up 5.3% year-over-year, as reported, and 2.7% in constant currency, driven by the timing of L&S renewal. For the full year, revenue was $1.95 billion, down 2.9% as reported and 3.3% in constant currency, slightly above the midpoint of our revised guidance range. Excluding license and support solutions, revenue was $388 million in the fourth quarter and $1.52 billion for the full year, both of which were down 3.9% in constant currency. I will now discuss segment revenue performance in constant currency terms shown on slide 8. Fourth quarter digital workplace solutions revenue of $126 million was flat sequentially to third quarter and down 3.7% year over year. For the full year, DWS revenue was $508 million down 3.1%. Both fourth quarter and full year segment revenue were impacted by PC related revenue declines, including lower third party hardware and PC field services volumes. As we mentioned last quarter, Microsoft's extension of Windows 10 support has led to some clients delaying upgrade projects or pushing out purchases of new PCs required for compatibility with Windows 11, and recently, higher PC prices due to memory chip shortages have compounded delays. However, we expect PC price increases to benefit us over time as they increase the significance of device costs within client budgets, potentially leading to incremental interest in our device subscription service. which provides intelligent forecasting and planning and a more flexible and predictable cost model. PC-related declines were partially offset by growth in higher-value infrastructure field services in areas such as enterprise storage and network infrastructure, which typically have lower volumes but higher margin and profit associated with them. And as we mentioned before, we believe the PC volume declines have stabilized. Fourth quarter cloud applications and infrastructure solutions revenue was $191 million, a decline of 4.1% year over year. For the full year, CA&I revenue was down 4.8% to $733 million. Similar to what we saw in earlier quarters of 2025, the fourth quarter was impacted by a lower volume of short-term project work at U.S. public sector clients due to federal funding disruptions that have created budget uncertainty in the public sector. This remained a prominent factor in the fourth quarter, the first half of which experienced a federal government shutdown. We were pleased to still be able to secure multi-year renewals in both CA&I and DWS Solutions with several of our largest U.S. public sector clients, some including New Scope. Enterprise computing solutions revenue was $237 million in fourth quarter, up 14% year-over-year. Full-year segment revenue was $629 million, relatively flat to 2024. Within the segment, L&S solutions revenue was $186 million in the fourth quarter, up 19.8%, bringing full-year L&S revenue to $428 million in line with our increased expectations. Fourth quarter revenue for specialized services and next-generation compute solutions, the ex-L&S solutions within ECS, was flat sequentially and down 3.7% year-over-year against a stronger prior-year comparison. Full-year S&C revenue grew 4.9% year-over-year

due to increased project work and business process solutions volumes at financial services clients in Europe, Latin America, and Asia Pacific. Total company TCV was $2.2 billion for the full year, driven by strong growth in XLNS renewal signings and new scope bookings with existing clients. Full year new business TCV totaled $491 million, down 38% year over year, primarily driven by elongated sales cycles with prospective clients and hesitancy in the public sector. Full-year new business TCV includes an approximate $200 million adjustment to reflect a mutually agreed termination of a first quarter 2025 new logo signing in DWS where contractual terms were not aligned. We were pleased with this outcome as it averts risk of future profit dilution while preserving a positive relationship with a large prospective client that we anticipate will invite Unisys to bid should they seek new proposals for any portion of this work or for other Unisys solutions. Trailing 12-month book-to-bill was 1.1 times for the total company and 1.2 times for our XLNS solutions. We ended the year with a backlog of $3.2 billion, up 12% sequentially and 11% from prior year. Moving to slide 9, fourth quarter gross profit was $195 million and gross margin was 33.9%. up 180 basis points from the prior year due to L&S revenue growth over a relatively stable cost base. XL&S gross profit was $51 million in the fourth quarter, a 13.2% margin. While this was 540 basis points lower than 18.6% in the third quarter, the majority of the margin compression was due to the aggregate impact of incremental cost reduction charges and timing of variable compensation. Full year gross profit was $549 million, a 28.2% gross margin compared to 29.2% in the prior year period, driven by an increased proportion of lower margin L&S hardware relative to the prior year, which we expect to be more normalized in 2026. Full year SL&S gross profit was $255 million, a 16.8% gross margin compared to 17.6% in the prior year period, which includes approximately 40 basis points of incremental cost reduction expenses. Overall, we were pleased with XLNS profitability considering some of the revenue headwinds we faced this year, and we expect lower cost reduction charges and greater efficiency gains in 2026, supported by workforce and technology investments made in 2025. I will now discuss segment growth profit as shown on slide 10. EWS segment growth margin was 10.5% in the fourth quarter compared to 15.9% in the prior year period. Nearly 400 basis points of the year-over-year margin decline was driven by one-time items, including transition costs. Full-year DWS gross margin was 14.5% compared to 15.7% in the prior year. Over time, we expect a continued long-term shift towards these higher value infrastructure field services, which typically are at a higher margin. CA&I segment growth margin was 20.7% in the fourth quarter, up 210 basis points year over year due to workforce and labor market optimization and increased automation and AI use in solution development and delivery, as well as an 80 basis point one-time benefit. Full year CA&I growth margin was 20.2%, relatively flat to the prior year. At a high level, strong delivery gains have been able to offset the slower pace of investment and project work at U.S. public sector clients. Looking ahead, we are pushing the pace of solution development and standardization in the CA&I segment and sustaining a focus on workforce optimization and rapid adoption of the latest AI models and tools to support additional efficiency gains. ECS segment gross margin was 65.9% in the fourth quarter, up 270 basis points year over year, and full year gross margin was 55.5%. a 250 basis point decline related to increased hardware revenue mix, which should normalize in 2026. Moving to slide 11, fourth quarter non-GAAP operating profit margin was 18%, driven by the higher concentration of L&S revenue in the fourth quarter. For the full year, non-GAAP operating profit margin was 9.1%, above the top end of our upwardly revised guidance range. The sustained strength of the trends in our L&S solutions again contributed more profit than we anticipated. Over the past two years, we have also diligently executed on a detailed plan to streamline our corporate, real estate, and central IT costs. We've been able to reduce SG&A by 13% for nearly $60 million. We expect to again lower SG&A in 2026 in absolute dollar terms by at least $10 to $20 million as we receive a full-year benefit from savings while most of the costs to achieve them are behind us. Fourth quarter net income was $19 million and $63 million on a non-GAAP basis, translating to diluted earnings per share of 25 cents and non-GAAP earnings per share of 86 cents. For the full year, GAAP net loss was $340 million or a diluted loss of $4.79 per share. This included an approximate $228 million one-time non-cash expense related to a pension annuity purchase occurring in the third quarter. Full year non-GAAP net income was $68 million and non-GAAP earnings per share was 93 cents. Turning to slide 13, capital expenditures totaled approximately $20 million in the fourth quarter and $78 million for the full year, relatively flat to 2024. As a reminder, a significant portion of capital expenditure relates to our L&S software and there is no change to our overall capital light strategy. Pre-pension free cash flow, which is free cash flow prior to pension and post-retirement contributions, was $113 million in the fourth quarter and $128 million for

the full year, which exceeded our expectation for $110 million. This is the result of a stronger profit performance and more favorable working capital relative to our assumptions. Full year free cash flow was negative $218 million, which includes a $250 million discretionary pension contribution. and $95 million of required U.S. and non-U.S. post-retirement contributions. Moving to slide 14, our cash balance was $414 million at year end, compared to $377 million at the end of 2024. Our cash balance increased by $37 million year over year, which is primarily due to our strong pre-pension free cash flow, as well as some positive impacts from foreign exchange and cash balances and hedge settlements. As a reminder, our changing cash balance includes a $250 million discretionary pension contribution, which was funded by approximately $200 million of incremental borrowing, as well as $50 million of cash from the balance sheet. 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 2.8 times inclusive of global pension deficit down from three times a year ago. I will now provide an update on our global pension plans beginning with slide 15. As of December 31st, 2025, the gap deficit in our U.S. qualified defined benefit plans was $239 million and our global gap pension deficit inclusive of all U.S. and international plans was approximately $450 million. This compared to approximately $750 million at the end of 2024, or a $300 million improvement. $250 million in improvement in our global pension deficit was driven by our discretionary contribution with the remaining approximately $50 million resulting from $95 million of planned contributions to our global plans. On slide 16, you can see a detailed projection of our expected cash contributions. We are forecasting approximately $350 million of remaining cash contributions to our global pension plans in aggregate through 2029, reflecting stability from the actions we took to remove volatility in our U.S. qualified defined benefit plans. Moving to slide 17, we have provided an updated projection of how expected future contributions and the benefits we disbursed to pensioners are expected to impact our U.S. qualified defined benefit plans deficit both with and without annuity purchase assumptions, and the implied cost of full removal at the end of 2029. At the bottom, we've also included our expected deficit reduction in all other plans. However, it is important to remember that while international contributions are negotiated every few years and very stable, the international deficit is impacted by asset returns and has more volatility. These projections are meant to provide a directional indication only of the relative conversion of contributions to leverage reduction in a given year, which will also change if contributions shift between years. Turning to slide 18, I'll now discuss our financial guidance for the full year and the additional assumptions we provide. We expect total company revenue to decline between 6.5% and 4.5% in constant currency, which based on February 1st foreign exchange rates equates to a reported revenue decline of negative 3.8% to negative 1.8%. Guidance assumes XLNS revenue decline of 7% to 4.5% in constant currency. We also expect full year LNS revenue of $415 million at a gross margin of approximately 70%. We also continue to expect 2027 and 2028 LNS revenue to average $400 million per year and continue to see artificial intelligence as a driver of consumption and adoption of value-added products within the ecosystem. and have detected no change in client commitment to our platform. As a reminder, the timing and exact amount of L&S revenue can be difficult to forecast with precision, and it depends on the renewal timing, term, and client consumption levels, among other factors. We expect non-GAAP operating profit margin to be between 9% and 11% for the full year, which reflects a higher margin percentage in L&S, 100 to 200 basis points of improvement in ex-L&S growth margin, and another modest reduction in operating expense in absolute dollar terms. Looking specifically at the first quarter, we expect approximately $415 million of total company revenue on a reported basis, which assumes approximately $60 million of license and support revenue. Based on renewal timing during the year, the first quarter is expected to be the lowest L&S revenue quarter, and we expect an approximate weighting of 30% of L&S revenue in the first half of the year and 70% in the second half. with the third quarter likely the largest quarter of LNS revenue. Based on these assumptions, we expect first quarter non-GAAP operating margin to be slightly positive. We expect a number of non-cash expenses impacting GAAP net income and earnings per share in 2026, including pension annuity purchases and streamlining certain legal entities expected in the second half, which we will guide on a quarterly basis. Also, as a reminder, In 2025, we've removed hedges on our intercompany balances, which could create non-cash FX gains as the U.S. dollar strengthens or losses if the U.S. dollar weakens. These are difficult to guide due to constantly changing rates, but will impact quarterly gap net income. Full-year free cash flow is expected to be approximately negative $25 million, which translates to positive $67 million of pre-pension free cash flow. This assumes approximate payments of $85

million in capital expenditures $70 million of cash taxes, $70 million of net interest payments, $30 million in other payments, primarily restructuring, and $92 million of post-retirement contributions, consisting of $87 million of pension contributions and $5 million of other post-retirement contributions. Approximately $17 million of the pension and post-retirement contributions is expected in the first quarter. We are confident that we have the liquidity we need to comfortably support our pension contributions. We are focused on continuing to increase our efficiency and profitability during this period and maximize our underlying cash generation levels for investment and capital return. Before we open the line for questions, Mike has a few additional remarks.

Mike Thompson | CEO and President:

Thank you, Deb. I wanted to take a moment to address our 2026 guidance. We're proud of what we've achieved in 2025, but disappointed that we didn't overcome all of the industry headwinds impacting our XLNS revenue. For 2026, our expectations for mid-single-digit decline in XLNS solutions reflects an intentional deeper push into the adoption of emerging technology within our existing base of clients, and the macro headwinds impacting discretionary spend in 2025 that we expect to linger through the first half of 2026, as we mentioned last quarter. Relative to 2024 year-end, we have more expansive book-to-bill ratio, more expected full-year revenue already contracted and in backlog, and there is less embedded risk from assumptions for timing of revenue ramp on contracted new business. Similarly, for profitability, the majority of the required Efficiency gains have already been actioned or identified. Achieving our 2026 guidance ranges keeps us on a path to potential full removal of the U.S. defined benefit pension obligations by 2029, after which U.S. pension contributions would cease, and we expect a host of new possibilities for investments in capital return. Based on our interactions with existing and prospective clients, and the sequential growth in pipeline activity so far this year, we believe we'll achieve positive XLNS revenue growth in 2027. With that, operator, you can open up the line for questions.

Operator:

We will now begin the question and answer session. To ask a question, you may press star then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster. The first question today comes from Rod Bourgeois with Deep Dive Equity Research. Please go ahead.

Rod Bourgeois | Analyst, Deep Dive Equity Research:

Okay, thank you. I'll start with an AI question. So I want to ask, how are AI and automated code modernization tools influencing the roadmap that you have and the demand for ClearPass Forward? We've clearly seen some recent concerns that COBOL refactoring may affect IBM's mainframe business. So I want to ask how you're assessing the implications of that trend for the ClearPass Forward platform. Thanks.

Mike Thompson | CEO and President:

Great. Hey, Rod, thanks for the question. Certainly very timely with the communications that we've all seen. Look, the code factoring component of the dialogue that's, I guess, the issue du jour is not really new. Maybe the tools that we're using are new, but we've been talking about code factoring for a long, long time. years, in fact, and, you know, you referenced IBM here, and I think they have a piece out as well, kind of reacting to that. It's really only a part of the story, and it really is talking about, in my opinion, the enhancement of the platform. I mean, the code modernization is kind of the easy part. That doesn't change the engineering challenge of running the mission-critical workloads at scale and doing it securely. I mean, really, it's about

Kind of the architecture redesign, the runtime replacement, you know, transaction processing integrity, the hardware tuning and years of performance tuning that's embedded in the platform. Code factoring does none of that, right? It really is just about the kind of modernization of what I would consider to be above the enterprise level of the corp. So from a strategic perspective, you know, internally we talk about clear path forward 2050. I mean, that's kind of the timeframe that we're looking out for that ecosystem. And we think net-net is going to be a positive to kind of drive more demand to the platform. And think of it as kind of the automation above the enterprise level and giving our clients more and more flexibility to that. And I guess secondarily, I would say that, you know, the other area that it's really important for is the continual kind of documentation of the code base, et cetera, testing, and really reverse testing, right, kind of doing scripts in in current languages and maybe refactoring them back to COBOL into kind of a legacy mindset. So the reality is we don't view that as any change from the strategy that we're currently on. And I think if you look at what we've encountered, I mentioned in my prepared remarks, three straight years of roughly $40 million of improvement against our expectations in that business. That's a byproduct of longer contracts being signed, additional consumption being signed, and the tooling that we've done over the course of the last, say, five years in that ecosystem has really positioned it to be AI-enabled. So I don't think it's really changed our strategy at all, and we see it as a continuation of the ability to kind of automate around the enterprise platform layer.

Rod Bourgeois | Analyst, Deep Dive Equity Research:

So, Mike, I just want to take an extra second on that. I mean, what you're saying is that the co-factoring threat, I think what you said was automation above the enterprise level actually adds to the usage of your platform. Can you just add more color on that point?

Mike Thompson | CEO and President:

Yeah, look, I think in general what we've been targeting and what we've been seeing is to put tools above the enterprise platform that allows for analysis and data extract, data movement across platforms, et cetera. And so using kind of AI agents and I'll say refactoring of code above that enterprise level really just continues to enable the use of the data. And remember the data set that we're talking about are standardized data sets and decades worth of data embedded in there, right? So if you're really trying to enhance a large language model, the key is really access of that data, not necessarily what code it's written in to get there. So the easier we can make that, the more customized or localized we can make that interface through the use of these particular agents, I think will be beneficial and cause more use of data, not less.

Rod Bourgeois | Analyst, Deep Dive Equity Research:

Got it. Okay. Thank you. And then just a question about the outlook for bookings in 2026. Last year had a big load of renewal activity, but at the same time, over the last couple of years, you've invested to win new logos. So I want to get a perspective on your latest pipeline and sales efforts and what the outlook is for your bookings activity and your bookings mix. I mean, will the mix shift towards existing client scope expansion, where I think you had some positive commentary. What's the outlook for the bookings next for 2026? Thanks.

Mike Thompson | CEO and President:

Yeah, thank you, Rod. Great question, and I appreciate the opportunity to expand on that a little bit. So you're right. I mean, we signed $1.7 billion of renewals in 2025. That clearly took a lot of the team and the client's focus away to kind of get that behind us, which was great. We've got a really strong backlog and, frankly, a higher backlog position going into 26 than we had going into 25 in relation to that. But the corollary or knock-on to that is when you're doing that renegotiation on renewals, typically clients are not talking about

new scope opportunities, right, because you're really focused on what that renewal looks like. So on the heels of that, and we mentioned in our prepared remarks that when we've done those renewals, we've actually embedded into that some new scope opportunities. So as you know, we think of new business as new scope and new logo. So I would say two things. One, our focus on new logo expansion in 26 is enhanced. because we've got a lot more, I'll say, bandwidth to really get after that because the renewal cycle is a little smaller this year, probably about a third of what it was last year. So we'll have some more focus there. And then secondarily, and more importantly, I think, is the new scope expansion opportunities in the existing base will allow us to grow that new business as well. So I think you're right in looking at kind of that new business, and I bucket it that way intentionally because it's not just about new logo. It's really about the proliferation of new scope opportunities, whether that's in our existing base or whether that's with new logo clients. We talk about having roughly a $31 billion TAM in our existing base for new scope opportunities, so that's a really important element to our growth trajectory of the future.

Rod Bourgeois | Analyst, Deep Dive Equity Research:

All right, thank you.

Mike Thompson | CEO and President:

Thank you.

Operator:

The next question comes from Mayang Tandon with Needham. Please go ahead.

Mayang Tandon | Analyst, Needham & Company:

Thank you. Good morning. Mike, you mentioned the longer sales cycles and some of the competitive pricing dynamics. So maybe if you could just provide a little bit more details around how you counter some of that competitive pricing. And of course, you can't control the overall market. Discussionary spending slowdown. But how do you maybe counter that with your go-to-market strategy, some of your sales investments to maybe help, maybe offset some of that pressure points in the market?

Mike Thompson | CEO and President:

Yeah, thank you, Amin, for the question. Super important, right? Look, when we think about the sales cycles in general, I would say 25 was a really tough year just because of all of the macros and kind of the adoption of new technology, people a little uncertain around how much to adopt, where to adopt it, uncertainties around, you know, whether it was tariff-related or, again, other macro-related issues, geopolitical, et cetera. I think that weighed on the longevity of the contracting cycle a little bit more than the mechanics of, you know, what we typically see. And I would say some of that is already starting to ease. We've got a pretty good jump-off point for Q1 as far as our pipeline is concerned, our discussions with clients in regards to that. In fact, just anecdotally, I had some correspondence with hopefully a future client that's talking about setting kind of record pace in their contract renewal cycle, really trying to expedite the use of that. So I think those were a little bit more macro-oriented than they are, you know, process-oriented from our perspective. But clearly we've done a lot from the embedding of tools and technologies and process changes, qualifications of the pipeline, and also, you know, kind of how we're approaching opportunities. to enhance and streamline the first touch point to contract closure. So, you know, very focused on trying to do everything we can to shorten that cycle and be very prescriptive about how we approach clients and who we approach for what. So

definitely are some elements embedded in that. As far as pricing is concerned, look, it's always been very competitive pricing environment. I think what has made it a little bit more competitive is you've got this pause, I guess, or the hesitancy to grow some of the industry, right? We've seen our traditional industry CAGRs from say four and a half or some percent CAGR growth down to flat, which means you've got a lot of folks chasing a smaller pie, right? And so from our perspective, We rarely want to have a discussion or even start a discussion that talks about commodity pricing and base to the bottom, right? All of our go-to-market approach is around enhanced experience and value and quality, right? And so, and we mentioned a couple of the renewals that we didn't win, and I mentioned those in Q2 and in Q3. that we need to maintain pricing discipline. We know what the value and the market-based pricing is for what we deliver. And we think we're delivering value in advance of that market pricing. So we should be able to get at least market-based pricing. And so not trying to, you know, just compete on price. If the client doesn't see the value we offer, obviously that's going to be a longer term problem anyway, right? So our point is really to get in front of that early, make sure we can illustrate the value that we bring to our clients, and we have plenty of quals to support that. So that's kind of how we're addressing the market on both of those fronts.

Mayang Tandon | Analyst, Needham & Company:

That's very helpful. And just a very quick follow-up for Deb, maybe. Deb, given the guidance range, I'm just curious, as you entered this year, have you built in a little bit more buffer in your expectations given some of the uncertainty and macro headwinds, or would you say you've basically aligned your guidance with your historical strategy? And in that context, you know, what dictates whether you come in at the low end of the range or the high end? Like, what are some of the factors we should be considering?

Deb McCann | CFO:

Right. Yes, I think, you know, we definitely, as Mike talked about, some of the revenue, you know, pressure, some of the industry headwinds is what we considered, you know, as we did the guidance. So I think You know, the things to look for are, you know, as some of those macro factors, you know, alleviate is what we assumed that later in the year some of those factors alleviate. You know, we had some, you know, as Mike talked about, the mix of new logo is planned for, you know, to have a lot more new logo this year as far as renewals. So as we're doing that, we think the Gartner logo Magic Quadrant will help, and so if we sell new logo kind of faster, that'll be another, an element to look for that would increase, you know, what we put out there as our guidance. But we've kind of built in all these headwinds, you know, through MOSA 26.

Mike Thompson | CEO and President:

Yeah, look, I would say too, like, we absolutely took a different approach to our guidance this year. It's not last year's same exact strategy. You know, we saw, you know, obviously the PC refresh cycle. We were expecting that, you know, never came to fruition. And so we've kind of backed that off and looked at the trajectory a little bit when we talk about that cycle. You know, clearly we've got the hardware cost components, and we think that that's going to have some opportunities for DSS. But I would say, in general, there was a little bit more of a conservative approach to the way we set guidance. But I want to just be really clear. related to top line. I think from a bottom line perspective, we have been very consistent in our ability to execute bottom line improvement. We're also calling for another, say, 150-ish basis points of bottom line improvement. Good line of sight to that. But we definitely took into consideration the kind of market hesitancy that we have seen. We've kind of carried that through the first half of the guidance And, and I think, you know, we want it, as you know, we're, we're, we kind of pride ourselves on the level of transparency, uh, that, that we, that we put out on a regular basis as it pertains specifically, uh, to our guidance. And, and we really kind of went through element by element to say, Hey, is this an area, what we feel really good about it and, and, and kind of how to get there. So a little bit of a different approach on top line, I would say in general, you know, just taking out

some of the things that we thought were going to happen that didn't happen in 25 and expect it as they pick up throughout the year, kind of a mid-year convention on that.

Mayang Tandon | Analyst, Needham & Company:

Great. Thank you so much, Mike and Deb. Sure. Thank you.

Operator:

Appreciate it. You're welcome. Thanks. The next question comes from Maggie Nolan with William Blair. Please go ahead. Hi. Thank you.

Maggie Nolan | Analyst, William Blair:

I wanted to look ahead a little bit. You talked about several things that you're working on in the script that would help accelerate XLNS revenue growth. And I'm just wondering what leading indicators we can watch to assess this progress. And then what is kind of a realistic timeline, especially given, you know, some of the first half pressures you just outlined? What is the realistic timeline for, you know, seeing some level of growth accelerations?

Mike Thompson | CEO and President:

Great. Thanks, Maggie, for the question, and really good one and intuitive here, too. I would say to you, you know, clearly our new business kind of conversion rate is the, I'll say, earliest indicator on top line. So I look at that question in two ways. One is really about the top line expansion and the growth. And the other is about the deployment of our embedded technology, right, when we talk about enhancing the capabilities of our bottom line, right? So pushing that technology out to our existing client base we think will add some ability for us to grow top line through the use of, you know, as I mentioned earlier, new scope opportunities within those accounts. Just know that that also comes with a little bit of a headwind, right? So leaning into the adoption, and one of the examples I gave was the service experience accelerator adoption that we're looking to push out to a third of our existing install base. Well, when we push that out, there's going to be some pricing pressure on that top line because clearly it is – The agentic service desk that we're using is a lower cost of delivery, and some of that we have to share with our client base. So you're pushing out this technology, which is going to put a little bit of a headwind pressure on, but we think we're going to overcome that headwind with the expansion of the opportunity embedded in that client and the addition of new logos to that base as well. So those are the things that we think are really going to support that XLNS growth rate. That's a DWS example. On the flip side, when I think about CA&I and the example there, we talked about the intelligent operations platform and really adding those agentic agents to expand our scope within the construct of the hybrid infrastructures that we support and manage. Frankly, when we think about the current drivers I'll probably misquote this, so we may need to change it, but I think there was a recent McKinsey report out where we talked about a $300 billion to $400 billion TAM in what I would consider to be the above enterprise layer automation of AI agents, right? And we saw a lot of noise in the market around software and service implementers for software. That's not what we do, right? Like, we're more in orchestration. on that, but when we think about the application of AI agents above the SAS level enterprise software, that is what we do. That automation component, both to help with transition and to actually orchestrate and manage post-orchestration of the IT ecosystem, that actually allows us to participate a little more fully in what used to be just solution implementers of ERPs or CRMs or HCMs, where they're taking that customization layer or that integration layer and moving it above the enterprise stack, that's an area we do play in that we historically haven't, right? So I think it gives us a lot more opportunity to participate in that legacy TAM and in this future TAM on both CA&I and DWS.

Maggie Nolan | Analyst, William Blair:

That's very helpful. Thank you. For my second question, just on margins, could you maybe distill for us the main puts and takes on margins in the next year, just kind of excluding the SG&A efficiencies you've gained, assuming that there's not incremental efficiency to drive there in the near term beyond what you've already outlined, the efficiencies that we'll be annualizing?

Mike Thompson | CEO and President:

Yeah, look, I mean, I think it's been fairly consistent from our perspective where we think those are coming from. Primarily, it is the application of emerging technology, right? The embedding of AI into our delivery platform allows us to deliver in a much more efficient manner. So clearly, there's going to be margin benefit from doing that. And, you know, as I mentioned, some of that margin benefit comes in the form of a revenue share, if you will, right, giving some of that back to the clients. But, you know, clearly a portion of that stays embedded in our delivery platforms. And as we then add to that platform through the use of top line growth, there's going to be obviously additional margin pull through from that point of view. So I would say it's primarily in the application of emerging technology. There are still opportunities for us to be more efficient. There are still opportunities for us to continue to look at, I'll say, upskilling or rightskilling or rightshoring components of what we do, and we continue to look at those opportunities as far as the delivery workforce is concerned. But again, the adoption of a digital workforce, working alongside our human workforce, we're kind of working both sides of that equation. And then I would say lastly, when you think about the mix shift, as we continue to push more and more into some of these newer elements of our solution, and I'll just pick on field services as a very practical example. as we continue to shift the mix of what we're actually supporting with those field service technicians, whether that's liquid cooling, whether that's hybrid infrastructure, whether that's high-end storage, those are just higher margin elements of work for, you know, the same technician moving away from some of the more traditional PC break fix. So I think those three elements would be what I would point to as the real drivers of where we should expect to see margin improvements. which is, again, why I think we're really confident in the ability to execute it because a lot of the technology is obviously already embedded and we're already moving it into production. And, again, I think we've put a track record out there, you know, almost 600 basis points improvement, you know, over the last three years in XLNS gross margin, right? So we're looking for another, you know, 150 basis points there in 26th.

Maggie Nolan | Analyst, William Blair:

Thank you.

Mike Thompson | CEO and President:

Thank you.

Operator:

The next question comes from Anna Goschko with Bank of America. Please go ahead.

Anna Goschko | Analyst, Bank of America:

Hi. Thanks very much. So first question is on the L&S revenue outlook, I do sense your kind of historical pattern of being conservative and then you know, beating and raising. So, you know, back in October when, I think it was October when you had the Clear Paths kind of webinar for us, you had talked about a $400

million CAGR for the next three years, and it looks like you're already kind of beating that with the $415 expected for this year. But then I think you did comment that you still expect about $427.28. So just wanted to understand, I understand there's license renewals in there, but it seems that the driver is AI in terms of consumption. So wanted to understand what you're thinking or expecting with regard to the impact of AI being a continued driver of consumption.

Mike Thompson | CEO and President:

Great. Thank you, Anna, for that call and that call out. I'm going to reiterate a comment I made in an earlier point. We did revisit kind of the way we were putting our guidance together, and this is another good example of that. And so you saw that we actually put out here $415 million of L&S revenue, even though a little while ago we were talking about an average of $400 over that three-year period, and we carried that average I think we started that maybe in the 360 to 370 range, moved it to 390, moved it to 400, and are still saying 400 in those out years. And you're exactly right also that the driver of that has been consumption and use. much more so than just the license renewal schedule. And we do think that that's the AI comment that I made earlier in regards to Rod's question, right? The more tools and techniques and processes that we can build and put on the front end of that ecosystem or that platform, the more consumption of that data and obviously the more value that orients to the platform and, frankly, to our clients and to us. So we do expect that trend to continue, which is why we increased that CAGR average for those out years. And I would just note too that, you know, the 40 million beat over the last three years, which you kindly pointed out as well, you see the 415 kind of take some of that now into our guidance to go okay, you know, this has been a pattern here of continued consumption, so we wanted to bake some of that in so that we're not, you know, sometimes it's just bad to continually overperform than it would be to underperform. So we're trying to do a better job at making sure that some of that overperformance that we've seen and expect to continue to see is baked into the numbers.

Anna Goschko | Analyst, Bank of America:

Okay. But for 27, 28, you just haven't really adjusted that yet for any of us that are following the AI space or the AI impacts. I mean, consumption levels should continue to increase. Is that fair?

Mike Thompson | CEO and President:

Yeah, look, I would say it's too far out for us to adjust. you know, multiple year out consumption estimates. But I would say if history is indicative of the future, then yes, we would expect as we go further down the road that we'll revisit that estimate. But for now, we felt pretty comfortable with it's already a $10 to $15 million step up from what we were chatting about before. So you can assume there is some consumption baked in there.

Anna Goschko | Analyst, Bank of America:

Okay, great. And then, Deb, so just on some of the kind of balance sheet stuff, so I just want to make sure I'm understanding on the free cash flow guide, which is a use of 25, so that is largely your expected all-in use of cash, right? So if I just do this simple arithmetic on your current cash balance, you're going to be approximately $25 million lower at the end of 26.

Deb McCann | CFO:

That's correct. And that translates to pre-pension of $67 million, you know, compared to the $128 million this year. Right.

Anna Goschko | Analyst, Bank of America:

And then the slides on the pension outlook are great. Thank you very much. It's really clarifying. So then if I look at the slide on the potential annuity purchases, you've really, you know, give us the estimates of what the deficit's going to be. So at the end of the day, you know, whether you purchase an annuity or not, like your pension deficit's going to be down roughly in the $50 million range, right? So net, net, like your net debt is going to be lower at the end of the year because your cash is only going down by like 25, but your pension deficit's going down by, at least 50. Is that the right way to put it?

Deb McCann | CFO:

It's down by that, yes. So it's down by about that much, but in the next few years, 229, 180, 137, it's all on that chart 17.

Mike Thompson | CEO and President:

Yeah, I mean, every contribution is going to drive down that deficit value. It's not dollar for dollar, but you will see you know, continual improvement in the deficit and in net leverage.

Anna Goschko | Analyst, Bank of America:

Okay. And then the annuity purchases are non-cash.

Deb McCann | CFO:

Right. We use the plan assets to reduce the plan liabilities. Correct. Okay.

Anna Goschko | Analyst, Bank of America:

Okay. And then, so, you know, I know you worked really hard last year to do the bond issuance and, you know, it came at a rate that was, a little higher than you probably preferred, and your plan at some point is to refinance those lower. Obviously, like the market overall is pretty messy right now. So those bonds are trading below par. Have you thought about using some of your cash to buy back some of that debt at this point? Because it's a pretty attractive rate.

Deb McCann | CFO:

Yeah, I mean, we always look at everything. But, I mean, at this point, You know, we're always looking to conserve cash, right, given the pension obligations, given everything. But we're always looking at everything. But it's not, you know, something at this exact moment we're planning to do. But we're always looking at it.

Anna Goschko | Analyst, Bank of America:

Okay, so the preference is just to keep, like, a solid cash balance, it sounds like. Yes. Okay, great. Okay, well, thank you very much.

Operator:

You're welcome. The next question comes from Anya Soderstrom with Sidoti. Please go ahead.

Anya Soderstrom | Analyst, Sidoti:

Thank you for taking my question. Most of them have been addressed already, but I'm just curious. You mentioned that the public sector has been a headwind in 2025. What are you seeing there as we have entered 2026?

Mike Thompson | CEO and President:

Hey, Anya, it's Mike. Thank you for the question. Look, I think I would say that we've seen an improvement in public sector in general across the board. So we're optimistic that we'll get back to some level of normalcy. I mean, you can only kick the can so far down the road. These things, and you know the work that we do is not discretionary work, right? So at some point we have to get on with business. And so I think in general, so far, the tail end of 25, we've started to see a little bit of easing of that pressure. I think that has continued into 26. And we're hopeful by kind of mid-year that we'll get back to kind of our normalcy as it pertains to kind of public sector work that we're doing. In fact, we signed a big deal Recently in Australia public sector that was in one case we had a win back from a competitor and another we expanded a relationship there that was pretty significant in the region. So we're optimistic.

Anya Soderstrom | Analyst, Sidoti:

Okay, thank you. That was all for me.

Mike Thompson | CEO and President:

Thank you, Anya.

Operator:

This concludes our question and answer session and concludes our conference call today. Thank you for attending today's presentation. You may now disconnect.