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NCR - Q4 2015 NCR Corp Earnings Call

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OVERVIEW:

Co. reported 4Q15 results. Expects 2016 revenue to be \$6.1-6.2b and non-GAAP EPS to be \$2.72-2.82. Expects 1Q16 YoverY reported revenue to decline 2% and non-GAAP EPS to be \$0.30-0.35.



CORPORATE PARTICIPANTS

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Bill Nuti *NCR Corporation - President, CEO, and Chairman*

Bob Fishman *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

Andy Heyman *NCR Corporation - SVP and President, NCR Financial Services*

CONFERENCE CALL PARTICIPANTS

Katy Huberty *Morgan Stanley - Analyst*

Dan Perlin *RBC Capital Markets - Analyst*

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Rick Faulkner *Oppenheimer & Co. - Analyst*

PRESENTATION

Operator

Good day and welcome to the NCR Corporation fourth-quarter fiscal-year 2015 earnings conference call. Today's conference is being recorded. At this time I'd like to turn the conference over to Mr. Gavin Bell, Vice President of Investor Relations. Please go ahead, sir.

Gavin Bell - NCR Corporation - VP, IR

Good afternoon, and thank you for joining our fourth-quarter 2015 earnings call. Joining me on the call today and offering opening remarks are Bill Nuti, Chairman and Chief Executive Officer; and Bob Fishman, Chief Financial Officer. Additionally, available on the call today for Q&A are Andy Heyman, Senior Vice President and President, Financial Services; Michael Bayer, Senior Vice President and President, Retail Solutions; and Paul Langenbahn, Senior Vice President and President of Hospitality.

Our presentations and discussions today include forecasts and statements that are considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. While these statements reflect our current outlook, expectations, and beliefs, they are subject to a number of risks and uncertainties that could cause actual results to vary materially. These risks and uncertainties are described in our earnings release and our periodic filings with the SEC, including our annual report to stockholders.

On today's call we will be referring to presentation materials posted on our website. We will also be discussing certain non-GAAP financial information, such as free cash flow and results excluding the impact of pension and other items. Reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures and other information concerning such measures are included in the presentation materials and in our earnings release.

These are also available on the investor relations section of NCR's website. A replay of the call will be available later today on our website, ncr.com.

With that, I'd like to turn the call over to Bill Nuti.



Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Thanks, Gavin. Good afternoon, everyone, and thank you for joining us today. Before we get into Q4 and full-year results, I wanted to provide a brief retrospective on 2015. First, let me say that 2015 turned out to be far more challenging than we initially expected as a result of slower-growing China and Russia markets; significantly increased foreign exchange headwinds, which negatively impacted 2015 revenue by \$415 million, profit by \$72 million, and EPS by \$0.27 -- a third of which was not included in our initial full-year guidance, not to mention the impact significantly weaker local currencies have on the cost of our products in several strong NCR markets around the world.

Just to put that in perspective, in 2015 the Canadian dollar dropped by 16%, Australian dollar by 10%, Brazilian real by 30%, and the euro by 10%. Additionally, as the year wore on, we faced the unexpected macro challenge of lower oil prices and destabilization in many of our stronger oil-sensitive countries, geopolitical [attacks], lower global GDP growth than expected, and volatile capital markets in the back half of the year.

On top of all that, we were immersed in an all-encompassing strategic review process that took the better part of a year to complete and successfully culminated with an \$820 million investment in NCR by Blackstone, coupled with a \$1 billion share buyback.

With that as a backdrop, I was particularly impressed with NCR's 2015 results and want to thank my team for their hard work throughout the year. The NCR team did what they said they were going to do with regard to our key metrics of revenue growth, operating income, EPS, and free cash flow -- the latter of which, as you know, is an investor area of focus and significantly exceeded our initial guidance.

While I'm proud of the NCR team, I'm also confident that the diversity of our business and strategic focus on omnichannel solutions were two key reasons for our success. Through organic and inorganic investment, we have positioned NCR as a clear market and thought leader in the rapidly-growing omnichannel market, and we experienced solid software growth as a result. Our omnichannel leadership, coupled with the diversity of our markets, geographies, and revenue streams have become important strengths and provide NCR with an ability to produce solid results in the face of unusual headwinds.

Now I'll turn the call over to Bob to provide perspective on Q4 and full-year results. Bob?

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

Thank you, Bill. Slide number 4 shows our financial highlights for Q4. Revenue was down 5% on an as-reported basis due to continued negative currency headwind. On a constant currency basis, Q4 revenues were flat. Revenue came in line with our guidance that we provided back in October after adjusting for additional unfavorable FX in the quarter. Recurring revenue increased 6% constant currency and was 41% of total revenue.

Looking at margins, we were pleased with our operational gross margin being up 70 basis points constant currency in the quarter, due to a higher mix of software-related revenue. In the bottom left box, Q4 NPOI was up 14% constant currency, and non-GAAP EPS was up 13% constant currency, both strong numbers. Free cash flow was very solid in the quarter and reflected our improved linearity throughout 2015.

Moving to the next slide, which shows our financial highlights for the full year, revenue was down 3% on a reported basis in 2015 but up 3% constant currency. Constant currency revenue growth was driven mostly by our retail solutions and hospitality segments through further expansion of our software and cloud revenue. Recurring revenue reached 43% of total revenue compared to 41% at the end of 2014. Increasing our recurring revenue is a key area of focus at NCR, and the team did a solid job against that goal this year.

Operational gross margin was 29.3% in 2015, down 20 basis points for the year. Although the mix of software-related revenue improved in the year, it did not offset lower hardware margin rate. NPOI was up 10% constant currency, and non-GAAP EPS was up 11% constant currency for the year -- both very good numbers.

And lastly, free cash flow was \$409 million in 2015, up \$96 million from the prior year. We made great progress executing against our free cash flow goal and exceeded our initial full-year free cash flow guidance of \$325 million to \$375 million. This has been an ongoing priority for NCR, and I'm pleased with what we've accomplished in 2015.

Turning now to slide number 6, you will see our Q4 and full-year 2015 software-related revenue. In Q4 on a constant currency basis, software-related revenue was down 1%, and cloud revenue increased 5%. For the full year on a constant currency basis, software-related revenue increased 4%, and cloud revenue increased 10%, including strong growth in our hospitality business.

I'm on slide 7 now, which covers our Q4 and full-year operational results in a little more detail. We experienced unfavorable foreign currency fluctuations during the fourth quarter, with impacts of approximately \$90 million in revenue, \$21 million in NPOI, and \$0.07 in non-GAAP EPS. On a constant currency basis, fourth-quarter revenue was flat, NPOI was higher by 14%, and non-GAAP EPS was higher by 13%.

For the full year, foreign currency headwinds were \$415 million in revenue, \$72 million in NPOI, and \$0.27 in non-GAAP EPS. On a constant currency basis, revenue grew 3%, NPOI was up 10%, and non-GAAP EPS grew 11% for the year -- all very good numbers while we continued with our transformation.

The next slide shows our fourth-quarter and full-year GAAP result. The reconciling items between these GAAP results and our operational results are included in the supplementary non-GAAP information slide. As noted on the supplementary slide, reconciling items include amortization of acquired intangibles, acquisition-related costs, restructuring-related charges, and pension expense.

In Q4 2015, pension expense included a \$29 million mark-to-market charge compared to \$150 million in Q4 2014. Additional reconciling items in the fourth quarter of 2015 are a \$20 million reserve related to a subcontracting arrangement in Middle East/Africa in the emerging industries and a \$34 million non-cash charge relating to the pending divestiture of the IPS business. We made the decision in Q4 to sell the IPS business and focus our efforts on NPR's core. The Q4 charge reflects IPS being classified as held-for-sale on our balance sheet and valuing it at fair value. The decrease in full-year GAAP EPS is primarily due to a \$427 million non-cash settlement of a pension plan in the UK in the second quarter of 2015.

Slide 9 shows the revenue by segment. As you can see, FX had a significant impact in the quarter and the year. On a constant currency basis, financial services was down 5% for the quarter and up 1% for the year. Retail solutions was up 4% for the quarter and up 5% for the year. And hospitality was up 12% for the quarter and up 7% for the year.

Slide 10 is a very important page. It shows that we delivered operating margin expansion in all of our businesses in 2015. In financial, we grew full-year operating margins by 40 basis points, primarily as a result of growing software-related revenue by 5% constant currency and significantly increasing our high-value solution.

Retail solutions grew operating income by 10% constant currency after a challenging year in 2014. Higher cloud revenue and good expense management helped the retail business.

Hospitality had a terrific year. Operating margins were up 300 basis points, and operating income grew by 26%. The significant improvement was driven by software-related revenues growing by 17% constant currency.

So, again, tremendous balance across our businesses in 2015. Improving the mix to higher software-related revenues and strong cost management is a key to driving operating margin dollar growth. I'll cover Q4 segment results in more detail on the next few slides.

On slide 11 you will see our financial services update. On a constant currency basis, revenues were down 5%. Excluding Brazil, Russia, India and China, revenue was up 1% on a constant currency basis. Operating margin was up 160 basis points at 18%. This improvement was due to a favorable mix of revenue and expense management.

We remain focused on driving operating margin expansion through our transformation initiatives, improved mix, and software growth, despite revenue headwind. Current economic conditions are putting pressure on ATM sales, including the attached software, which is impacting near-term profitability. Our high-value solutions, including branch transformation, cloud, and enterprise software improved in the year, driving full-year software-related revenue up 5% on a constant currency basis. In addition, we are encouraged by the positive trends in a number of key businesses, including community banks and cloud-delivered digital banking applications.



The next slide shows our retail solutions Q4 results. Revenue was up 4% on a constant currency basis due to improvements in the Americas and Europe. Operating margin was 10.4%, an increase of 150 basis points. Retail operating income increased from the prior year due to higher revenue and expense management.

Q4 software-related revenue was down 10% on a constant currency basis due to some larger customer rollouts in the prior year. The retail market continues to show improved fundamentals, and our Retail ONE omnicommerce platform is gaining traction the market after a successful NRF tradeshow. Additionally, we were recognized for our global leadership position in point-of-service and were named number one in global self-service check-out for the 14th consecutive year according to RBR.

Turning to the next slide, hospitality revenues were up 12% on a constant currency basis, driven by improvements in the higher-margin revenue streams, including cloud and professional services. Operating margin performance was 21.2%, up 430 basis points due to this higher software-related revenue, including cloud and professional services revenue.

We are driving improved results through sales transformation and increased software revenue. Our strong cloud revenue growth is driven by omnichannel applications, with cloud application sites up 17%. We are making traction in international markets, and our SMB market strategy is generating strong results. The full-year constant currency software-related revenue was up 17%, and cloud revenue was up 24%.

Next, looking at our emerging industries business on slide number 14, revenues were up 6% on a constant currency basis, driven by our telecom and technology business. Operating income was roughly flat in dollar terms while we continued to invest in NCR Silver, our cloud-delivered mobile point-of-sale solution for small business.

On slide 15, on a constant currency basis, software-related revenue was down 1% for the quarter but up 4% for the full year. Hardware revenue was down 6% for the quarter, up 2% for the full year. And other services were up 8% for the quarter and 5% for the full year. Cloud revenue growth was significant, up 10% for the full year on a constant currency basis.

On slide 16, you can see free cash flow for the quarter and full year. Full-year free cash flow of \$409 million exceeded our expectations and represented 85% of non-GAAP net income, a significant improvement conversion rate versus prior years. Slide number 17 shows our net debt to EBITDA metric, where we closed the year a little better than expected, with a net debt leverage ratio of 2.8 times.

Slide 18 includes our full-year 2016 guidance. In 2016 we are providing guidance for revenue, earnings per share, and free cash flow. We are now including ongoing pension-related expense in our non-GAAP EPS guidance. Through the actions we have taken related to our pension plans over the last couple of years, we have reduced the volatility of ongoing pension expense, and we'll now include it on a go-forward basis. Ongoing pension expense includes service costs, interest costs, and the expected return on plan assets, but excludes the Q4 mark-to-market adjustment.

The top section of the chart shows our revenue, EPS, and free cash flow guidance for 2016. Our revenue guidance is \$6.1 billion to \$6.2 billion. Our non-GAAP EPS guidance is \$2.72 to \$2.82, and our free cash flow guidance is \$425 million to \$475 million.

In 2016 we will be divesting our IPS business and including ongoing pension-related expense. For the IPS divestiture we have assumed the closing at the end of the first quarter. In addition, we are expecting incremental foreign currency headwinds of \$135 million versus 2015, with an EPS impact of \$0.10.

These three items create an apples-to-oranges comparison to our 2015 reported results. In order to show the operational growth year on year, we have included the reconciliation at the bottom of the chart. As you can see, the constant currency revenue growth on the same basis as 2015 was 3% to 4%; and the non-GAAP EPS growth was a solid 4% to 8% percent. Despite challenging economic conditions, we continue to take advantage of the omnichannel market opportunity, which is allowing us to drive higher software-related revenues. The free cash flow guidance of \$425 million to \$475 million is a very good result for us and reflects a non-GAAP net income conversion rate of approximately 95%.

On slide 19 you will find Q1 2016 guidance. I expect revenue will be down 2%, as reported, but up 1% constant currency. This includes a negative FX impact of approximately 3 points or \$45 million. Our non-GAAP EPS is expected to be \$0.30 to \$0.35 for the quarter, down for the first quarter

versus prior year for a number of reasons. Our pension change, higher tax rate, and unfavorable foreign currency -- offset by the lower share count -- is driving roughly \$0.06 of headwind, as you can see noted in the chart.

The balance of the change is due to market condition and major financial customer rollouts ramping later in the year. Encouraging news is that we have seen positive signs in the fourth quarter in all of our businesses.

Financial services had significant backlog coming into 2016, and our higher-value offerings are doing very well. The market is moving in our favor within retail, and hospitality has been on a very strong trajectory. We look forward to a very successful 2016.

Now I'll turn the call back to Bill for some closing comments.

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Thank you, Bob, and terrific job on free cash flow. In summary, despite the factors that went against us in 2015, NCR achieved success in most of our key metrics and, importantly, drove higher than expected free cash flow. It's clear that omnichannel is maturing, and the market opportunities for NCR are very exciting.

We are also fully aware of the competitive lead we've established, but remain healthfully paranoid about competition in the years to come. This healthy paranoia drives us harder every day to fuel innovations that will further expand our competitive advantage. We hope that it is evident to our investors by the leadership position we are taking in introducing new omnichannel products and solutions. And 2016 will be one of NCR's biggest years ever for new product introductions.

It's important to us, because every customer call I attend -- regardless of market or geography -- CxOs are focused on omnichannel enablement over the next several years. In addition, the solutions to enable omnichannel are now becoming mainstream, with market leaders making long-term buying decisions in the next 12 to 24 months.

We talk a lot about branch transformation as one solution subset of omnichannel, but solutions with even higher potential are rapidly maturing. Unified commerce software and store transformation and retail are both examples of large, growing markets and future growth drivers in the years ahead. These same solutions helped NCR retail achieve solid results in Q4 and 2015. Similarly in hospitality, omnichannel software, guest experience applications, and mobile points-of-sale were drivers of success this past year and will be more so in the years to come.

As mentioned, branch transformation continues to be an exciting growth market in financial services. But like other industries, we are seeing [antebuzz] omnichannel software growth becoming an important solution for the future of this market. And while we are facing stronger macro headwinds in the financial services space, we remain very confident in the growth potential of this segment.

Finally, I want to comment on our progress in services and sales transformation as well as be ongoing market consolidation in our industry. First, I wanted to update you that NCR is making good progress vis-a-vis services and sales transformation. We are seeing better results across the board in terms of improved customer satisfaction and our ability to successfully transition to a more consultative solutions-selling capability -- both areas of focus on multiyear efforts and remain critical to our future success.

As for our industry, there is finally recognition that the future is about omnichannel enablement and end-to-end solutions, not selling boxes a couple of effective services. While we continue to maintain our position as the number-one provider of point-of-sale, self-checkout, and ATMs, we are also transforming our Company into the leading omnichannel solution provider globally; and legacy consolidation continues to occur -- first with Oracle and Micros, and then with Toshiba Tec and IBM, and now with Diebold and Wincor.

And we strongly believe that market consolidation will only increase the opportunities for NCR. This consolidation and future strategic moves by industry participants are a clear response to the needs of our customers and their inherent focus on omnichannel enablement. As I said earlier, we feel like we have established a healthy competitive advantage that we intend to build on by ramping up our innovation efforts, new product introduction, and further cloud as well as mobile growth.



Now I'll open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Katy Huberty, Morgan Stanley.

Katy Huberty - Morgan Stanley - Analyst

Typically, over the past three or four years the first quarter EPS has made up about 15% to 19% of the full-year earnings. And guidance implies a much lower mix, around 12% of EPS coming in the first quarter. Can you just walk through what some of the headwinds are in first quarter that then alleviate as you move through the year? And then I have a follow-up.

Bob Fishman - NCR Corporation - SVP, CFO, and Chief Accounting Officer

Katy, this is Bob; and then others can chime in. But when I look at the operating income as a percentage of the full-year guidance, it's around 15%. The nine-year average has been 15.5%. The last couple of years have been a little bit higher than that, you're right -- 16%, 17%.

So it is little bit slower than what we saw the last couple of years. But overall, I would say the backlog is good coming into the year. I mentioned a couple of times that we are seeing slower backlog rollout, primarily in the financial industry. So while the first quarter is a little bit less, it's not a lot. And it's really reflective of that rollout.

Bill Nuti - NCR Corporation - President, CEO, and Chairman

Katy, this is Bill. I would add that the primary reason really is some slower rollout of large branch projects that are coming mainly in Q2 and Q3. So it's a little bit slower, but I'm quite pleased with the ramp in the first half of the year and Q2, and then in the back half.

Katy Huberty - Morgan Stanley - Analyst

And last quarter you talked about the delayed conversion of backlog relating to a higher mix of innovative products and higher mix of software. Do you think that that still explains the delay? Or is some of the weakness we've seen in the stock market and the bank stocks in particular telling us that there's maybe some constraints around budgets?

Bill Nuti - NCR Corporation - President, CEO, and Chairman

I'll kick the call off with an answer, and then Andy will give you his point of view as well on budgets. But we are not seeing right now any budgetary constraints. And in fact, I would say for branch in particular and new product rollouts, some of this is NCR-induced in that we are working hard on finalizing some of our new solutions in the market, and that is also taking some time.

So we are partly to blame on new product rollout, but generally speaking, the ramp of the backlog is really Q2 and beyond. Andy?



Andy Heyman - *NCR Corporation - SVP and President, NCR Financial Services*

Yes, Katy -- I mean, you're looking at a situation -- it's a really good story medium- to long-term. Quarter to quarter it's got the challenges that you're mentioning.

And, you know, you got a backlog position in financial services that ends 2015, up 14% constant currency. You have got a brand-new product launch that is both in the ATM and branch space that starts to come live in a big way in the second quarter. And then we ramp from there. So like Bill said, not budgetary constraints at all; we just need to drive the launches of these solutions, and then we start releasing significant backlog conversion different than we were able to in 2015.

Katy Huberty - *Morgan Stanley - Analyst*

Okay, thank you. That's helpful color.

Operator

Dan Perlin, RBC Capital Markets.

Dan Perlin - *RBC Capital Markets - Analyst*

Thanks. My question is: can you just give us an update on -- you know, now the Blackstone transaction is behind you guys, I'm just wondering how those conversations are going in terms of what they are helping you with, bringing to the table -- you know, incremental cost synergies that they envision, maybe, that's not fully vetted yet. It might be conservative guidance. I don't know. I'm just wondering if you could bring us forward a little bit on those discussions? Thanks.

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Yes, Dan, we're off to a good start with Blackstone. We are working with their internal operations team on a number of initiatives, mainly around improving our cost structure. And Bob will give you some examples in a moment of some short-term wins. But we are working with them very tightly, taking advantage of their \$100 billion in procurement spend to reduce our overall direct costs.

We are working with their teams on looking at areas like BPI for business process improvement and also enterprise quality. But I'd say that, generally speaking, we are looking to recoup the annual cost of that relationship through the efforts that we're now underway with them. Bob, any other --?

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

Yes, I'd agree. I'd say it's widespread across the Company. Their portfolio of businesses have the \$100 billion of purchasing power. So it's everything from lower prices at Hilton to taking advantage of some of their sourcing processes, their purchasing tools, as an example. And so, really, every function at NCR is getting with a Blackstone counterpart and looking at ways that they can optimize their spend.

I'd also add that what we're seeing is the access to the talent pool that exists within Blackstone. So if we are looking for a business process improvement person, or some other skill around any of our transformation areas -- whether it be software services or sales transformation -- there does seem to be team there that can help us with those initiatives. So I've been pleased around the purchasing and costs, but also the talent management.



Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Yes, a final comment, Dan: Having Chinh Chu and Greg Blank on our Board has also been a real value added for us. You mentioned guidance, and my only other comment there would be that I think our guidance is appropriately conservative and prudent in light of the world around us today. But we feel very confident in the achievement of our current guidance.

Dan Perlin - *RBC Capital Markets - Analyst*

In that same vein, are some of these cost initiatives, and access to talent pools, and procurement -- are those all contemplated in these estimated numbers? Or is that something that's going to play out over the course of 2016, and then we might see incremental benefits, actually, in the latter years?

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

I think that that will play out, Dan, over the course of 2016. There could be benefits in 2016. Bob and I will cover more of that at the upcoming analyst day in March. But no doubt that we do not have contemplated in the current guidance any significant improvement that would come about as a result of our Blackstone initiatives.

Dan Perlin - *RBC Capital Markets - Analyst*

Okay. And then one last one, if I could ask Andy: in the financial services segment, I kind of want to follow up a little bit on the original questions. There is this question about demand out there, and we've heard a lot of it.

I wonder, if you look at the size of financial institutions -- larger versus small and mid-tier -- can you just parse, maybe, the demand environment and the conversations you're having with those different sized financial institutions? Because they don't sound like their budgeting process or their demands are at all created equal at this point. Thanks.

Andy Heyman - *NCR Corporation - SVP and President, NCR Financial Services*

Yes, it's a fair question when you look at the top-level growth rates for 2015. It is a tale of two stories, Dan. I would not break it down by segment of customer; I would break it down more from a BRIC versus rest-of-world perspective. And when you look at an overall -- what was a fairly level business in 2015 versus 2014, really it was BRIC shrink caused us 500 to 600 basis points of growth.

So the rest-of-world grew 5%-plus, but the BRIC shrink dragged down the growth rates in a fairly significant way, to where it looks like a pretty level business in 2015. So it's really a BRIC story.

And when we look at 2016, we have really de-risked the BRIC business in terms of our outlook here. Last year was a tough year in the BRICs. NCR is not the only company that had that issue. And we are confident in our BRIC outlook in 2016.

Dan Perlin - *RBC Capital Markets - Analyst*

Okay. Thank you, guys.

Operator

Kartik Mehta, Northcoast Research.



Kartik Mehta - Northcoast Research - Analyst

Bill maybe you could -- or, Andy, you could just expand on the comments you just made a little while ago. I'm wondering, as you look at 2016, at least for the financial self-service business by geography, what kind of growth you're expecting? It sounds like, Andy, your expectations for 2016 growth in the BRIC countries is pretty low. But I wanted to get your perspective on just growth by geography in that business.

Bill Nuti - NCR Corporation - President, CEO, and Chairman

Hi, Kartik; it's Bill. I think we'll give you little bit of color in terms of growth in the sense of how markets might move in the year. But Andy, could you give him a little more color than that on geographic growth?

Andy Heyman - NCR Corporation - SVP and President, NCR Financial Services

Sure. Just in terms of the way that we're looking at 2016 from a financial services perspective, what we're really looking at right now is a business that -- you know, you look at low single digits on a global basis for financial services in terms of growth. And that's with about a 300 basis point headwind from the BRICs. So we expect the BRICs will shrink again low double digits, offset by about 5% to 6% growth in the rest of the world. That really covers the financial services business.

Kartik Mehta - Northcoast Research - Analyst

And then, Bill, I think you mentioned that you're seeing some good growth -- or growth, at least, in the community of five. And I'm assuming you meant the US. I'm wondering what's driving: is it hardware or software?

Andy Heyman - NCR Corporation - SVP and President, NCR Financial Services

Bill, do you want me to take that?

Bill Nuti - NCR Corporation - President, CEO, and Chairman

Go ahead, Andy, take it.

Andy Heyman - NCR Corporation - SVP and President, NCR Financial Services

Yes, so it's actually a great story. Let me start with how we closed Q4, which was order growth in the community financial institution segment of high 20%, almost 30% on order growth. So the key to the success is really not any one of the point solutions. It's really the omnichannel story taking off.

So if you look at a customer that's looking for a stable partner who can seamlessly integrate physical and digital channels and then take out costs in terms of leveraging their legacy systems, there's really only one choice for customers. So it's the omnichannel story that -- we are the only game in town for them. And then comes with that it's a hardware/software cloud bundle that is the name of the game for the community financial institutions segment.

Kartik Mehta - Northcoast Research - Analyst

So, Andy, is it -- are you saying it's both hardware and software, or is -- because of the omnichannel, it's a greater amount of software?

Andy Heyman - NCR Corporation - SVP and President, NCR Financial Services

Well, I wouldn't say greater one way or the other. What I would say is it's a software-driven sale that then we attach hardware onto. You know, the old NCR was certainly a hardware-driven sale. And today, and really for all of our industry teams today, it's a software-driven sale -- and especially true in the community financial institution segment, where they don't have the time to best-of-breed the decision process. They are looking for a fully integrated solution, including cloud and digital banking, tied in with the integration to self-service and branch transformation channel that, oh, by the way, has hardware that attaches with that to bring it to life.

Kartik Mehta - Northcoast Research - Analyst

And I guess just one last question: I wanted to understand free cash flow, Bob. Your 2016 guidance -- is there a difference between the guidance you gave from a GAAP standpoint versus non-GAAP in terms of the free cash flow you'll generate?

Bob Fishman - NCR Corporation - SVP, CFO, and Chief Accounting Officer

You mean from the free cash flow guidance of \$425 million to \$475 million, Kartik, was your specific question?

Kartik Mehta - Northcoast Research - Analyst

Yes, the \$425 million to \$475 million -- you know, if I compared that to GAAP in 2016, will it be the same? Or if there is a difference, what are the differences?

Bob Fishman - NCR Corporation - SVP, CFO, and Chief Accounting Officer

Yes, I mean, again, the free cash flow number starts with a GAAP number of operating cash flow; and then you back out CapEx and discontinued ops. So no change from 2015. And it's certainly -- I think people view it as a non-GAAP term, free cash flow, but it's very GAAP in terms of starting with operating cash flow and just backing out CapEx and disc ops.

Kartik Mehta - Northcoast Research - Analyst

Oh, perfect, Bob. So it sounds like a real solid number for 2016, then?

Bob Fishman - NCR Corporation - SVP, CFO, and Chief Accounting Officer

Yes, I think from my perspective, if you look at kind of the history of free cash flow, we were in the 20% to 30% about five years ago. We had a lot of legacy issues, pension contributions, environmental; and as we have worked our way through that and driven the software business, we hit 85% conversion in 2015 -- 95% forecast in 2016. And we've made our numbers three years in a row.

Last year, I gave guidance of \$325 million to \$375 million, and we landed at \$409 million. So that was a good answer. The whole Company is energized around free cash flow. This year I've given guidance of \$425 million to \$475 million.

Kartik Mehta - Northcoast Research - Analyst

Perfect, thank you.



Operator

Matt Summerville, Alembic Global Advisors.

Matt Summerville - *Alembic Global Advisors - Analyst*

Just a couple questions. First, Bob, can you talk about what your goal would be in terms of the a net debt to EBITDA ratio heading out of 2016? I know you exited 2015 at 2.8. And then I have a follow-up, please.

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

Yes, I'll share a lot more of that as part of analyst day and capital allocation strategy. I will say this, though: our goal remains to be solid DD. So that has not changed.

Matt Summerville - *Alembic Global Advisors - Analyst*

And then just as a follow-up: Bill, you mentioned some things you guys are trying to do on the sales and service side of the Company. Can you sort of talk about metrics that you're looking at that we can focus on? How much have your close rates improved across your sales organization? How much have your capture rates improved across your service organization? And, I guess, how much more room to go is there before you would feel that you've hit your target?

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Many of the metrics we use to track sales effectiveness and transformation you would not see, Matt. But the best proxy for that in my view is software growth.

Ultimately, our sales organization today is transitioning from, I would say, a point-product hardware orientation to a software solutions orientation. And we are in the fifth inning of that game. And while we made good progress last year, we still have one to two years left to complete that journey.

And I would tell you today that if you track our software growth, it's a really good proxy for sales force effectiveness. And ultimately the transition really is around solution selling and leading with software.

Matt Summerville - *Alembic Global Advisors - Analyst*

Thank you.

Operator

Meghna Ladha, Susquehanna.

Meghna Ladha - *Susquehanna Financial Group - Analyst*

In the financial services segment you indicated that you are seeing positive trends in key businesses, with orders up 30% in community banks, overall backlog up. I guess the question really is: is this related to just market share gains or market growth in general?



Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Andy, why don't you take that?

Andy Heyman - *NCR Corporation - SVP and President, NCR Financial Services*

Sure, yes. You know, when we look at the markets out there right now -- and, obviously, the competitive landscapes are changing quite a bit -- in the markets that we call addressable markets, in other words, where we've got sales coverage and we've got product fit, we are gaining share. No question.

And then in terms of the overall market, there are certainly some areas that are growing faster than others. But generally speaking, where we have addressable market, meaning we are focused on from a sales perspective and we have product fit, we are growing share.

Meghna Ladha - *Susquehanna Financial Group - Analyst*

Got it. And then, Bob, in the past you've provided outlook for each segment. Can you give us some color for 2016?

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

We will provide a lot more color on the business as part of analyst day. But right now it was important for us to establish guidance around total revenue, around EPS earnings, and free cash flow. We'll provide more detail as part of analyst day.

Meghna Ladha - *Susquehanna Financial Group - Analyst*

Okay. So then -- so would you be providing more details around the margins, as well? Because I'm trying to figure out as well, you know, how should we think about margins in each of the segments? In which segment should we see the most margin expansion in 2016?

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

I think as we put together -- start putting together the analyst day deck, I think you will find it quite insightful in terms of the analysis that we provide. So as we move into more of the omnichannel space, we'll be talking about the business consistent with that.

Meghna Ladha - *Susquehanna Financial Group - Analyst*

Got it. Thank you.

Operator

Gil Luria, Wedbush Securities.

Gil Luria - *Wedbush Securities - Analyst*

I had a couple of just financial clarifications. First of all, what's your underfunded status for the pension and obligations as of the end of the year?

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

Let me get that answer to you as part of this call. But maybe go to your next question, Gil, and then I'll give you an update on that.

Gil Luria - *Wedbush Securities - Analyst*

Sure. The \$20 million reserve reversal -- could you give us little bit more detail into what that entailed? What was the situation there?

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

Yes, I can. So this was in our emerging industries. It relates to a airport construction project in the Middle East. In this situation, the prime contractor got dismissed, and we were a subcontractor. We've been a very valued partner of the government and continue to be. This has been a long-term project for us. It was revenue that was booked years ago at relatively low margins in terms of being an airport rollout. And this change of the prime contractor has caused a challenge in terms of ultimate payment.

So we took a reserve. We continue to work that. It was necessary to book a reserve at the end of Q4, but we continue to work through payment options, even though they might take some time.

Gil Luria - *Wedbush Securities - Analyst*

Got it. So then the only other one I have is branch transformation -- the growth rate decelerated in the fourth quarter. How much total dollars did you do branch transformation last year? And what's your expectation for this year?

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Yes, I think total year, Gil, FX-neutral, was somewhere in the \$205 million range against our target of \$230 million. We probably caused about \$15 million to \$20 million of the gross challenge, in that product readiness was an issue for us in the back half of the year that will solve here the first half of 2016. So demand was certainly there for our solution, but we missed the mark.

Andy, why don't you give additional color on that and some color on 2016?

Andy Heyman - *NCR Corporation - SVP and President, NCR Financial Services*

Yes, you know, it's a business that we are looking at. And you're talking about a 50% type of growth business. We think that will continue into 2016. The real drivers for us in 2016 continue to be the same things, but in broader geographies.

So you've got customers out there trying to change the game in terms of expanded store hours, expanded distribution points, less labor to handle, the service models that they're putting in place. The community financial institution market in the United States has been a main driver for us. The majors are a big driver for us in 2016.

Expanding more broadly in Middle East/Africa in 2016, as they need to change their economic models, and how they run branches, and their retail network. And then, finally, Western Europe -- we see steam picking up greatly there as well. That's what the funnel tells us.

Gil Luria - *Wedbush Securities - Analyst*

Got it, thank you.

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

Hey, Gil, on your pension question.

Gil Luria - *Wedbush Securities - Analyst*

Yes.

Bob Fishman - *NCR Corporation - SVP, CFO, and Chief Accounting Officer*

So it's very consistent with what we had signaled back in Q2. You'll remember, we transferred the overfunded London plan. So what that left was around \$580 million of underfunded. Think of that primarily as US and Germany, Germany as a pay-as-you-go plan. So that's very close to what you'll see in the 10-K.

Gil Luria - *Wedbush Securities - Analyst*

Got it. Thank you very much.

Operator

(Operator Instructions) Ian Zaffino, Oppenheimer.

Rick Faulkner - *Oppenheimer & Co. - Analyst*

This is actually Rick Faulkner for Ian. Just wondering if you have seen any change in the pricing environment in financial, given the consolidation between Wincor and Diebold?

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Yes, we have seen for the latter part of 2015 and into early 2016 consistent pressure on pricing, I think, as both of those companies are coming together and wanting to perform well prior to integration. But we do expect post-integration for that hopefully to improve going forward. But, Andy, you may have some additional color?

Andy Heyman - *NCR Corporation - SVP and President, NCR Financial Services*

Yes, Rick, it's a marriage that's not yet happened. And we are in an engagement period now. And like any marriage that's pending, lots of things get said now; and what ends up happening, we don't know.

What typically happens is you'll see stabilization occur in terms of two companies that become one have to drive a tremendous amount of rationalization when it comes to product lines and costs. And so we're looking forward to that occurring. And we think once that happens, that -- what our customers are telling us is they're really looking for stable partners. They're really looking for clarity and roadmaps. How that may -- when we're coming out with products in that same period of time, our hope is that can be favorable to margins.

In between now and then, it's certainly highly competitive, as it always is these markets, in the ATM space. Less competitive in the branch transformation and software space, where we have a competitive edge and clear differentiation.



Rick Faulkner - *Oppenheimer & Co. - Analyst*

Okay, yes. I guess I was expecting that maybe the pricing environment could become more favorable. But it sounds like you're saying it's a little too early to tell.

Andy Heyman - *NCR Corporation - SVP and President, NCR Financial Services*

I would say if things do become more favorable, typically in situations like this what you'll see is that that would happen after the marriage was consummated -- which, of course, it is not the case just yet.

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

Rick, through all of that, as you can see, we did improve operating margins both in Q4 and on the full year in financials, through all of the challenges we faced, plus a pricing environment that was a bit more aggressive than usual.

Rick Faulkner - *Oppenheimer & Co. - Analyst*

Okay, great. Thanks.

Operator

Matt Summerville, Alembic Global Advisors.

Matt Summerville - *Alembic Global Advisors - Analyst*

I just had a quick follow-up. First, on China, your two largest competitors have announced some sort of pursuing of a joint venture type strategy in order to be able to better participate in that market. We all know about the buy-local-requirement theme that's going on there. So if you could talk about how you're thinking about China, how you're positioning around that?

And then secondarily, with Brazil, I believe towards the second half of this year, your contract expires with Bradesco -- sort of what the thought is there. What kind of happens going forward in your view? Thank you.

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

On China, Matt, we are looking at multiple options of how to successfully participate in that market. Having lived and worked there myself, I have a unique insight in how to do that. And I won't comment on our competition and what they've done, but we will address that this year. And the way we'll address it, I think, will be most beneficial to our shareholders and our long-term aspirations in China.

On Brazil, Andy, why don't you take that one?

Andy Heyman - *NCR Corporation - SVP and President, NCR Financial Services*

Yes, I think the partnership we have in Brazil -- as we look long-term, we've now built a nine-figure business in Brazil from a much smaller base five years ago. So as we look at the next five years, we are continuing to expand in Brazil with a more software-driven approach.

How we do that will depend on a few different variables. Going about it now alone, after the scaffolding can be removed from the current joint venture that we have, we are very confident in an independent, thriving Brazil business -- notwithstanding the market challenges there, given the economy. So that right now would be, I'd say, our most likely scenario as we think medium- to long-term in Brazil. But we've got a lot of options, and we'll explore all of them.

Rick Faulkner - *Oppenheimer & Co. - Analyst*

Thanks, guys.

Operator

And that does conclude -- oh, I'm sorry, go ahead.

Bill Nuti - *NCR Corporation - President, CEO, and Chairman*

No, no, that's it. Thank you all for joining, and we'll see you on March 7. And I look forward to seeing you there. Good night.

Operator

Thank you. And that does conclude today's conference call. We do thank you for your participation today.

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