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NCR - Q1 2015 NCR Corp Earnings Call

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OVERVIEW:

Co. reported 1Q15 non-GAAP EPS of $0.43. Expects 2Q15 reported revenue will be down roughly 3-4% vs. prior year.

CORPORATE PARTICIPANTS

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Dan Perlin *RBC Capital Markets - Analyst*

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Paul Chung *JPMorgan - Analyst*

PRESENTATION

Operator

Good day and welcome to the NCR Corporation first-quarter fiscal year 2015 earnings conference call. Today's conference is being recorded. At this time I would 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 first-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 of 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 in 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 their 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 would like to turn the call over to Bill Nuti.

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

Thanks. Good afternoon, everyone, and thank you for joining us today.

NCR got off to a good start in 2015. Our total Company Q1 financial results were in line with our expectations. We faced increasing foreign currency headwinds as the quarter progressed, which negatively impacted revenue by an additional 1% and NPOI by an additional $8 million versus the guidance we provided on our Q4 call.

I'm on slide number 3, which shows our financial results for the quarter. Revenues were down 3% year over year due to the impact of FX and were up 3% on a constant currency basis. Recurring revenues were 45% of our total revenues in Q1, which were down 2% from last year and up 4% on a constant currency basis. Operational gross margin was 27.6% in Q1, which was 100 basis point decrease or 75 basis points decrease on a constant currency basis.

Although product gross margin was negatively impacted by mix and FX headwinds, our services gross margin improved significantly in the quarter. We generated NPOI of $146 million, which is down 6% as reported and up 6% on a constant currency basis.

Non-GAAP EPS came in at $0.43 in Q1, which was down 14% as reported and up 2% on a constant currency basis. And lastly, free cash flow improved by $75 million in Q1 to a positive $24 million, which represented an encouraging start to the year. The increase was due to improvements in cash flows from operations, as well as lower capital expenditures and discontinued operations.

I'm now on slide number 4, which gives some details on software. We grew software-related revenues 5% in Q1 as reported, which were up 9% on a constant currency basis. This includes the strong expansion of our cloud revenues, which were up 19% year on year.

So overall, we made further progress expanding software in Q1, and this remains an area of long-term focus in each of our businesses.

Moving on to slide number 5. I wanted to take a few minutes to talk about an exciting recent development at NCR, the launch of Kalpana, our cloud-based ATM software platform.

Kalpana is a game-changing innovation for financial institutions. Businesses and consumers are increasingly turning to enterprise or cloud-based solutions that reshape security and enable fast, nimble and dynamic customer experiences.

NCR Kalpana is consistent with this shift and delivers compelling benefits to ATM outfitters across key functional areas.

First, Kalpana delivers channel integration by giving financial institutions the ability to provide a seamless omni-channel experience to consumers. Its flexibility also means banks can run a combination of Kalpana-powered ATMs, along with existing traditional ATMs, as our cloud-based software blends into existing banking and IT infrastructure.

Second, Kalpana delivers improved security. All of our software updates are housed and controlled at the server level. This will reshape the ATM security landscape and help drive the elimination of malware.

Third, Kalpana delivers improved speed. Today, ATMs operate on an outdated legacy PC architecture that is both inefficient and complex. By transitioning ATM software and operations from the cloud, new devices and services can be brought to the market up to twice as fast as before.

And fourth, Kalpana delivers sizable cost reductions as we enable banks to move away from the existing technology. In fact, we believe we can reduce the total cost of ownership of a 100 ATM network by as much as 40% or over $0.5 million.

Overall, Kalpana is consistent with our commitment to deliver disruptive innovation and omni-channel software capabilities that transform how financial institutions operate. We are excited about the offering and how it will empower customers to deliver improved customer experiences, as well as simplify their businesses.

Slide number 6 shows the key highlights for Q1. First, improving execution across NCR will strengthen opposition across our end markets. As I mentioned earlier, FX headwinds increased throughout Q1, and we do not expect a material improvement throughout the year.

In financial services, our omni-channel solution portfolio continues to generate higher and differentiated demand versus traditional ATM hardware suppliers. Financial institutions are increasingly looking to transform their retail distribution network using NCR technology to improve revenue, increase fixed costs productivity and improve the customer experience.

In addition, we continue to see strong growth in our digital banking offers, as well as improving average revenue per user, driven primarily by increases in mobile users.

Lastly, we are beginning to see a meaningful shift in customer decision processes and buying criteria more towards financial technology companies who can deliver omni-channel solutions versus point products.

While we're not pleased with the results in retail solutions, they are consistent with our forecast. However, we are pleased with the signs of momentum building, including higher than expected year-over-year solution order growth, customer spending priorities looking back to omni-channel software and the signing of a major services contract that we will begin to deploy in earnest during Q3.

Although revenue was lower than the prior year in Q1, as we mentioned on the Q4 call, we continue to expect improvement in retail solutions in the second half of 2015. And in hospitality, higher software and cloud drove strong operating margin expansion in that business. And we are pleased with our year-over-year improvement in this vertical segment.

Another highlight in Q1 was the growth in software and cloud that I mentioned, including the solid year-over-year expansion in cloud revenues. We also made progress strengthening NCR as an organization, particularly through our ongoing sales and services transformation initiatives.

One of our major goals this year is to optimize our go-to-market strategy to better align our people with our highest growth opportunities. This includes empowering our sales and services organizations to be more productive and efficient and get closer to our customers.

During Q1, we continue to build our more software-driven, hardware-enabled-oriented sales organization while improving productivity and efficiency in our services delivered.

Also, I want to note that the restructuring plan that we introduced last year remains on track.

Lastly, free cash flow was the highlight for the quarter, and we generated solid year-over-year improvement in Q1, driving increased free cash flow generation with improved linearity remains a primary focus of ours, and we are off to a solid start this year.

In summary, Q1 was a good start to our year as our financial, hospitality and emerging businesses are also forming well with the retail business demonstrating key metrics around improved momentum. We remain excited about the year and the opportunities that lie ahead.

Now I'd like to turn the call over to Bob to review our performance by segment and our financials. Bob?

Bob Fishman - *NCR Corporation - SVP, CFO and CAO*

Thank you, Bill. I'll start on slide 7, which shows our Q1 operational results on an as reported and constant currency basis, which Bill previously discussed.

We experienced unfavorable foreign currency fluctuations during Q1 with impacts of approximately $95 million in revenue, $18 million in NPOI and $0.08 in EPS, all higher than previously expected. Revenue was higher by 3%, NPOI was higher by 6% and non-GAAP EPS was higher by 2%, all on a constant currency basis.

The next slide shows our Q1 GAAP results. The decrease in GAAP results is primarily related to the restructuring plans and FX. The restructuring plan charge included in income from operations was $16 million in Q1 2015 as expected.

On slide 9, you'll see our financial services' Q1 results. On a constant currency basis, revenues from 9% to do improvements in the Americas, Europe and Middle East Africa. Operating margin was up 20 basis points at 13.2% and up by 70 basis points on a constant currency basis. The improvement was due to an improved mix of higher-margin omni-channel solutions.

Key market developments in financial services include solid performance across our major global markets. This includes wins in North America and Asia-Pacific, as well as outperforming the overall market in Europe. This was offset in part by continued challenging conditions in China and Russia.

Bill highlighted for you the recent launch of Kalpana, our cloud-based ATM software platform. We are excited about the potential for Kalpana and are pleased at the market reaction thus far.

The next slide shows our retail solutions' Q1 results. Revenue was down 9% and down 4% on a constant currency basis due to reduced spending by retailers. Operating margin was 3.6%, which decreased 300 basis points on a constant currency basis. Retail operating income was lower than the prior year in Q1 due to a less favorable mix of software-related revenue.

However, as Bill mentioned, we are expecting improvement in retail in the second half of 2015. We had positive order momentum in Q1 as evidenced by a number of key customer wins. We continued to see improving demand for our omni-channel and self checkout solutions. We had a significant service win in Q1 resulting from our strong customer services execution.

Turning to the next slide, hospitality revenues were up 1% on a constant currency basis, driven by improvements in the higher margin revenue streams offset by lower hardware revenue. Software-related revenues were up 14%, which includes cloud revenues up 24%.

Additionally, cloud applications sites increased 21%. Operating margin performance was 12.2%, up 410 basis points due to this favorable mix of revenue. We saw growth in international software-related revenue, which is up 33% year on year and continued to see progress in the North America SMB market with 11% revenue growth and 21% software-related revenue growth.

Next, looking at our emerging industries business on slide number 12, revenues were flat year over year and up 8% on a constant currency basis, driven by a 6% increase in telecom and technology revenues. Operating margin was 8.2%, up 350 basis points driven by higher services margins.

On slide 13, you can see the solid growth in cloud, software license and software maintenance, and total software related revenue on an as reported basis. On a constant currency basis, cloud was up 20%, and software-related revenues grew 9%. Hardware revenue was down 5% as reported, up 2% on a constant currency basis, and other services, which includes our traditional break fix business, was down by 5% as reported, up 2% on a constant currency basis.

On slide 14, you can see free cash flow for the quarter. Free cash flow for Q1 2015 was $24 million compared to free cash outflow of $51 million in the prior year. The $75 million increase in free cash flow was mainly due to improvements in cash from operations, capital expenditures and discontinued operations. We are reaffirming our full-year free cash flow guidance range of $325 million to $375 million in 2015.

Slide 15 is an update on the restructuring plan. We incurred a pretax charge of $16 million in the first quarter of 2015 and expect to incur an additional $21 million to $46 million in 2015. The cash impact was $16 million in the first quarter of 2015, and we expect to pay an additional $55 million to $70 million in 2015.

As far as savings generated, we had $18 million of savings in 2014 and estimate approximately $70 million in 2015 and $105 million in 2016. As previously communicated, we expect approximately 50% of the savings to benefit NPOI with the remainder reinvested in the business.

Slide 16 shows our net debt to EBITDA metric where we closed Q1 with a leverage ratio of 3.2 times, significantly better than Q1 2014.

On slide 17, we show our full-year 2015 guidance. We previously expected unfavorable foreign currency impacts of 5% in revenue, $50 million in NPOI and $0.20 per share in non-GAAP diluted EPS. We now expect unfavorable foreign currency impacts of 6% in revenue, $75 million in NPOI and $0.30 per share in non-GAAP diluted EPS. Even with the additional unfavorable impact of FX, we are reaffirming our full-year guidance.

Slide 18 shows our 2015 full-year revenue guidance by segment. We are reaffirming our as reported revenue growth by segment. We have updated our constant currency revenue by segment to reflect the additional 1% of FX headwinds.

On slide 19, you will find our Q2 2015 guidance. I expect revenue will be down roughly 3% to 4% compared to the prior year on an as reported basis, which includes a negative FX impact of roughly 6%. On a constant currency basis, I expect revenue to be up 2% to 3%.

And finally, I expect NPOI to be approximately $190 million to $200 million in Q2 2015, which includes a negative FX impact of roughly $20 million compared to the prior year.

Operator, I'll now open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Katy Huberty, Morgan Stanley.

Katy Huberty - *Morgan Stanley - Analyst*

Thank you, what are the operational offsets to the one point of additional revenue headwind and $0.10 of additional EPS headwind from currency this year? What's allowing you to offset that additional headwind and keep guidance as you reported three months ago? And then I have a follow-up.

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

Katy, what we did this year is we gave a wider range of guidance on the top line and NPOI to allow for some additional volatility in FX. So if you look to prior year's guidance, the range is a bit more tight. So that would be the point one. We have a wider range, and we still feel comfortable we are within the range.

Point number two would be that we did have a good Q1 in order volume, solution order volume across all of NCR, financial and retail in particular, and that gave us some confidence you're going into the back half.

Katy Huberty - *Morgan Stanley - Analyst*

Okay. And does your comment about the wider range, does that imply you're more likely to be in the lower half given the currency headwind, or is that not the case?

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

No, that's not the case right now. I think that where the consensus is right now, we're quite comfortable with that, and it's very balanced.

Katy Huberty - *Morgan Stanley - Analyst*

Okay. And then just as a follow-up, operational gross margin down 75 basis points ex currency, why is that not moving in the other direction given makeshift to higher value solutions and software investments?

Bob Fishman - *NCR Corporation - SVP, CFO and CAO*

What we saw in Q1 with the 75 basis points down on constant currency was services margins were strong. They were up significantly in the quarter. Product margins were down and offset that increase. Product margins were really based on hardware margin rates and that business can be lumpy. It can be based on country mix, influenced by country mix. It can be influenced by large customers versus smaller customers. So that's what we saw in Q1 from a product and hardware perspective.

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

The only other point that I'd make would be that we did see in Q1 an unusually higher percentage of software sales in both retail and financial being more third-party software. It's more one time in nature and not expected to repeat itself.

Katy Huberty - *Morgan Stanley - Analyst*

Okay. Thank you very much.

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

You're welcome.

Operator

Dan Perlin, RBC Capital Markets.

Dan Perlin - *RBC Capital Markets - Analyst*

Thanks. I had a question on retail for a moment. That business continues to be pretty challenged, and I know you mentioned the dynamics that you think are at work in the second half for improvement. But I'm wondering if you could talk maybe more directly about how those order growth opportunities, you talk about priorities shifting back, and the service contract.

How does that break down when you think about self-checkout versus legacy register, which I suspect is declining? And then Retalix, which sounds like software that's driving business there is third-party and not actually what we want it to be. If you could highlight that some, I'd appreciate it.

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

Michael Bayer, you may just want to jump in here and give your perspective?

Michael Bayer - *NCR Corporation - SVP and President, Retail Solutions*

Yes, Michael Bayer speaking. Coming back to your first point, I really looked at the order performance as an indication for further shift back to the core platform with respect to strong omni-channel demand.

We also have seen now that all of the major waves and investments for PCI and for the readiness of EMV are done, and we are seeing the discussions really going back to omni-channel and how omni-channel can drive commerce. That was one of the major activities around the order performance, and the order performance has also fell to a very highly appreciated backlog.

We talk about Retalix and we talk about third-party software, the comment Bill made. That has nothing to do with our Retalix business. We had closed two very, very strong deals, which implemented third-party software through us on a broader solutions scale. It is not in our traditional Retalix area.

For Retalix, we see strong commitments of their existing customers to the platform, and we are onboarding new customers onto those platform elements as we speak.

That's it from my side. Any further clarification?

Dan Perlin - *RBC Capital Markets - Analyst*

Well, the other question I had is in the services contract that it sounds like it's going to be a big part of the recovery in the back half, what is an example of that? Is this the multi-year service contracts, is it tied to software or is this (multiple speakers)?

Michael Bayer - *NCR Corporation - SVP and President, Retail Solutions*

It's a full-year services contract touching all of the different businesses we provide to this particular customer, and it's rolling out as we speak. And so as you onboard those customers, you see the full benefit after you have onboarded all of their estates, and we will be done with the onboarding throughout Q3, and we'll see the benefit then of the full contract impacting our second half.

I have to say that due to the strong performance we deliver with our services organization, especially during the peak performance (technical difficulty) Q4 last year, we have seen revitalization of our services business.

Dan Perlin - *RBC Capital Markets - Analyst*

And can I just ask one other quick question? One of your competitors in the (inaudible) business in Europe clearly had some problems in the quarter. You guys outperformed their numbers for sure. I'm just wondering what is it that you think was the differentiation between yourself and them? Thanks.

Michael Bayer - *NCR Corporation - SVP and President, Retail Solutions*

I think one of our differentiations and especially when it comes to Eastern Europe, you're asking for, right, and central Europe?

Dan Perlin - *RBC Capital Markets - Analyst*

Yes and this was more on the ATM side.

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

Yes, so I think what I'll do is I'll give some perspective and ask Andy to jump in. But for a long time, we have been working hard to help the investors in our Company, as well as the sell-side understand the fundamental differences in our strategic plans for the financial services business. And I think for the first time, we are beginning to see how different our Company strategically and tactically we have set up versus that of what I would consider to be more of the older world point product providers.

Andy, you may want to give some more color on that.

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

Yes, I mean, I think when you go back to 2013, which was only two years ago but in many ways it seems like more than a decade ago, the needs of financial institutions were -- there were two ways to address it. One was just keep doing what you're doing around physical channels, i.e. ATMs and self-service, and the other one was to have a much more software-driven transformative approach in terms of how to impact our customers' P&Ls. And we very publicly made big investments towards revamping our solution portfolio to help them, our customers, be more successful.

I think if you fast-forward to the first quarter and really we started to show up in the fourth quarter, and there was some demonstrable significant differences between our competitors and us whether that be in the developing markets or even the mature markets like Western Europe. And so the results speak for themselves in terms of we are well into double-digit growth Western Europe, while in an industry that's growing at small single-digit. So the result of that, of course, is competitors are flat to declining in those markets, while we are increasing significantly both on the top line and the margin dollars. So we are pleased and most importantly our customers are pleased with that as well.

Dan Perlin - *RBC Capital Markets - Analyst*

Okay. And I'll just ask one more, and then I'll jump off. Bob, could you just clarify for purposes of everyone on the call, the AR facility that you entered into in 2014, how are you flowing that through your cash flow statement? Thanks.

Bob Fishman - *NCR Corporation - SVP, CFO and CAO*

The AR facility, that was really a better way to finance than our revolver. So we are using our AR base to effectively borrow, and that's treated similar to the revolver as part of the financing cash flows. So that's part of financing.

Dan Perlin - *RBC Capital Markets - Analyst*

Thank you.

Operator

Gil Luria, Wedbush Securities.

Gil Luria - *Wedbush Securities - Analyst*

Thanks for taking my question. First of all, would you mind, I'm sorry if I missed this, would you mind quantifying how much of the revenue in the quarter was attributed to third-party software, in which part of the business was that, and how much do you think you are going to get for the rest of the year?

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

Yes, I think, Gil, again I'm going to be very clear here that we had one significant transaction in retail with the US government that contains a high proportion of low margin software, and that will not repeat itself in Q2 or beyond. It was a good win where we are happy to have the footprint in that space as well, but we don't expect that.

And we have an unusual couple of deals in financial, again, not significant but enough to retard the margin a bit. Again, we don't expect those to repeat in Q2 and beyond. So again, I don't have exact numbers, but they were enough to impact margin rates, along with what Bob mentioned in Q1, which was unfavorable mix on the hardware side.

Gil Luria - *Wedbush Securities - Analyst*

Got it. And then on the drop-down of the impact of foreign exchange, the previous guidance was 5% topline, $0.20 bottom line. That's a little less than 2 to 1 drop-down to the bottom line. You are adding 1 point to the top line and $0.10 to the bottom line. That's more like a 5 to 1 drop-down to the bottom line, at least 3 to 4 times. Why is currency flowing down more to the bottom line? Should we expect that going forward if we see the US dollar strengthening more?

Bob Fishman - *NCR Corporation - SVP, CFO and CAO*

I would say what we are seeing, Gil, the way I think about it is on the revenue we are seeing an impact of around 20% of NPOI impact on FX. But before, we had it at closer to 16% to 17%. In the kind of latest view, we looked at the mix of the countries whether it's Brazil or Europe, and the flow-through was around 20% of the revenue impact from an NPOI perspective.

So I think that would be a good proxy to use going forward, Gil, now that we have a better sense of what the country mix is going to be.

Gil Luria - *Wedbush Securities - Analyst*

Got it. Thank you very much.

Operator

Ian Zaffino, Oppenheimer.

Ian Zaffino - *Oppenheimer - Analyst*

Hi. Great. Thank you very much. You know, as far as your guidance for the retail business, I guess you're expecting like you said a big, big ramp, and you have the contracts in place or at least the orders in place. Can you just help us understand what the nature of the orders are?

Is it basically to use slang, is it money in the bank, or is it something that we might see like last year where you saw some delays in the orders. Just help us understand how confident you are in those numbers.

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

Yes, I think unlike last year, Ian, we are not really betting the farm on the current quarter of orders. As much. And by the way, three weeks in, we are still feeling good about that.

So for me, I feel really good about the over performance in orders in Q1. It was quite significant. It was a big order for retail peak order quarter for retail. And beyond that, we had the large surfaces win that we will begin rolling out in Q3/Q4.

I would also say, to be very candid with you, Ian, we are lapping some easy comps in the back half, particularly Q3. So the ramp for retail really isn't a -- it's a back-half ramp, but it's really a Q3 story. Because when you look at their Q4 forecast right now, it looks kind of more normal run rate growth. But Q3 looks outside as a result of that lapping that easy count.

Ian Zaffino - *Oppenheimer - Analyst*

Okay. Thanks. I just wanted to step back and maybe ask more of a philosophical question here, but if you look at the business, three different businesses, explain to us or where is sort of your head and the way you're looking at the businesses right now? Do they need to be together? Does it make sense maybe to not be together? Are there large dis-synergies if you think take them apart? Is it more value creating if you take them apart? Just what are you thinking here and just give us little insight into the value of being together versus the value of not being together?

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

Sure. I'll give you the short answer, but I could spend four hours on the topic on this one with some bad jokes mixed in.

First, I'd say that every industry we're in is moving towards omni-channel software platforms, and what we provide, whether you are a bank or a retailer or a restaurant, is a common platform to deliver on the promise of omni-channel. And so there's a lot of synergy from a technology point of view.

There would be, if you pulled the business apart, significant dis-synergies. For example, all of my divisions here are common services delivery infrastructure around the world. I don't have a separate services business for retail and financial and hospitality. All of them share a common supply chain infrastructure: plants, distribution centers. Of course, we get lots of value from that scale, and they all share a common G&A infrastructure as well. So it would be very difficult if not value destructive to sort of pull that apart.

Ian Zaffino - *Oppenheimer - Analyst*

Okay. Thank you very much.

Operator

SK Prasad Borra, Goldman Sachs.

SK Prasad Borra - *Goldman Sachs - Analyst*

Thanks for taking my questions. A couple if I may. Probably, starting off with the service margins, they are definitely much better than expected. What major changes have been made in the services segment to achieve those margins?

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

You know, we've been working hard the last two years. If you go back two years ago, you remember me talking about services investments that did impact negatively on profit in late 2012 and Q4 2012 and all of 2013 and to a lesser extent what began to improve in 2014 and the late part of 2014. Those investments were meant to drive higher productivity and more efficiency of delivery, and all of those programs are now beginning to kick in.

And beyond that, the real positive impact of those investments is not just we can expect higher margins and services but also better customer loyalty. Our customer SAT has improved significantly in the last few years, and I'm really proud of the team overall because that's driving across more orders and more revenue as a result.

SK Prasad Borra - *Goldman Sachs - Analyst*

When you compare, say, Q3 of 2014 to now, is it just a case of timing of a lot of these investments actually seeing some tangible increment or delivering some value, or you would say it's largely execution on a lot of the projects that are undertaken then?

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

Almost exclusively execution on the projects we began to undertake in 2012, and the tangential good news is that I also expect our services revenue to begin growing at a faster rate in the back half of the year and into 2016.

SK Prasad Borra - *Goldman Sachs - Analyst*

Okay. Now it's clear. Just on the retail segment, can you probably describe what the company landscape is in the retail segment across various segments, whether it sales checkout or Retalix? And with regards to your own investments, you have talked about a lot more focus on software.

Can you talk about the 1900 persons which you are recruiting, how much of that -- how many of those persons would go into retail and specifically focused on software?

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

Yes, I think that the transformation of retail has been probably for us the most choppy in the last few years but, of course, made more challenging by a very challenging end market and set of conditions there, particularly last year going into Q3.

I'm feeling a lot better about the current state of the retail business internally. And I'd say that one of the major external factors that impacted us negatively was our customers parsing off more of their capital for data privacy, for PCI compliance which has to be done by October, and all of the terminals they needed to buy at the front end, which we don't sell to accomplish both PCI compliance, as well as EMV upgrades.

In Q1, and I kind of pointed to this in Q4 as well, we began to see a shift of time and attention and now business coming to us in a focus on omni-channel, and software, and services. That's a good sign. My client meetings have all been far better than they were in July and August and mainly September of last year. They've become more positive, and certainly there's a lot more focus on what we do at NCR.

Retalix is actually doing quite well internally. We have -- there will be more to talk about there on the July call relative to some announcements coming out about new solutions. But Retalix has not been a significant challenge for us in the market or on the top line or profitability wise.

Hardware slowed down significantly for us as a result of the data privacy focus and move towards PCI. That really impacted us quite negatively. And so that's beginning to come back as did self-checkout, which also is looking quite promising on the year right now.

Michael, any other comments from you?

Michael Bayer - *NCR Corporation - SVP and President, Retail Solutions*

Bill, I'd like to add to your comments on self-checkout. What we are seeing now is that we are not only defending our leadership position, we are also at the forefront of opening new markets. There are a couple of announcements set to come where we still need to wait for the final customer approvals. But you are going to see us with significant rollouts in markets where self-checkout has not been introduced so far, which gives me a high confidence that we will be able to establish our market leadership there.

And in the whole European market where we see a trend now back into convenience, our new product, which we launched at the end of last year, a small version, that card-only self checkout, which you put into a normal checkout lane, is picking up nicely and gets real interest from a lot of the customers we have and also prospects who have not been our customers so far in continental Europe as there is almost no restructuring in the exit area of the store needed, and the smaller form can create new fast lane checkout activities.

So overall, the UK remains a bit challenging. Those of you follow the market have seen the recent announcements of the quarter results of the big retailers in the UK. You can draw your own conclusions, but overall the market is going into the right direction for us.

SK Prasad Borra - *Goldman Sachs - Analyst*

So on that, do you guys feel confident about achieving a high single-digit growth rate in retail in the second half based on your order book?

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

Yes, I do. Michael, you may want to comment on your end.

Michael Bayer - *NCR Corporation - SVP and President, Retail Solutions*

Yes, as I said before, I think we touched those points, but let me reconfirm them. Q3 is quote-unquote easy comparison as it was a bad quarter for us last year. The order book looks good. The order velocity looks good. The backlog has dedicated rollout teams associated to it. We are talking about rolloff teams which have been signed off to deliver revenue this year. So overall we keep the guidance.

SK Prasad Borra - *Goldman Sachs - Analyst*

That's all from my end. Thank you.

Operator

Meghna Ladha, Susquehanna.

Meghna Ladha - *Susquehanna - Analyst*

Hi. Thanks for taking my questions. Despite the weakness that one of your competitors is seeing in Europe, I see that you are raising your constant currency guidance of financial services today. What changed since your prior guidance. Are you picking up market share?

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

Yes, Meghna, there's no question. We did pick up share in the last quarter as well. But by the way, just to put some numbers to this. For all of NCR, EMEA -- Europe, Middle East and Africa -- for us grew constant currency 6% in Q1. It was a really good quarter despite the FX headwinds.

And when I take Russia out of the equation, we grew 9% as a corporation in all of EMEA in Q1. Western Europe, as Andy said, is doing really well. Andy, you may want to give more color on NCR versus the competition and why we're gaining share?

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

Yes, we talked about it a little bit earlier. But just to expand on it, in Western Europe the market conditions have been tough for our customers in terms of them really trying to eke out profit growth through pretty flat or declining revenues given their situation.

And so they need technology, increasingly software-driven technology that helps them with things like lowering cost per transaction. And a lot of our investments that we've made in the last couple of years from a software perspective both organically with some acquisitions have played very well into them now having tools to take out costs through moving transactions from higher cost channels to lower cost channels while at the same time having a seamless consumer experience. That message, along with our track record for delivering results to those customers, has led to fairly material double-digit growth for us in Western Europe, offset, of course, by the geopolitical situation with Russia, which gets you to Bill's comments on 9% constant currency growth.

Meghna Ladha - *Susquehanna - Analyst*

Thank you, Andy. And then also moving on to branch transformation, do you still expect to generate an incremental $100 million in revenue this year, or could we see an upside to this number?

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

I think, Meghna -- go ahead, Andy.

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

Yes, sorry, Bill. So for branch transformation for us, first of all, this year is going to be a great year. The question is how good, and frankly, it comes down to customer adoption speed. There's not a customer we talked to that is not convicted around their desire to move as fast as they possibly can within their environments to transform their branches.

It is helpful as they build out new branches where they can lower their square footprint and reduce operating costs that way, as well as take out operating costs from a labor perspective and keep their branches open longer. Those are the drivers for our customers.

And then when it comes to our solutions, we are considered by our customers globally to be the leader to help them to do that. So the nine-figure kind of growth we are expecting that you mentioned, we feel very solidly on track for.

Could there be upside? I would say where I sit right now, this is a long-term play from a serious sustainable growth perspective. I wouldn't see a tremendous amount of revenue upside this year. There could be significant order impact backlog upside this year where it would give us even more confidence in exceeding our models in 2016 and beyond.

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

And Meghna, on that point in Q1, order growth for branch transformation and financial was up 58% year on year.

Meghna Ladha - *Susquehanna - Analyst*

Thank you. That's very helpful. And just last question on my side, the number one priority for the Company to enhance shareholder value, and could we see a potential announcement of a share buyback or dividend once you reach your target leverage ratio?

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

The number one priority for us is to continue to execute and do what we said we are going to do. We are coming off of Q3 last year, we were not happy about that miss to be very candid with you, and our goal right now is to continue to execute and not surprise our investors negatively at all. We feel really good about Q1. I'm feeling confident in Q2 and the full year, and we'll continue on that track.

Now, of course, there's a number of priorities vis-a-vis strategic execution and tactical execution beyond that, but I think that's point one.

Could you see something from us vis-a-vis share buyback or dividends? We are currently undergoing, as I've said on previous calls, an entire review of all of our strategic alternatives, and right now, we are deep into that process. And the answer would be, of course, you could, but until we are ready to report something, we'll hold off on giving any particular guidance on that.

Meghna Ladha - *Susquehanna - Analyst*

Thank you very much.

Operator

Kartik Mehta, Northcoast Research.

Kartik Mehta - *Northcoast Research - Analyst*

Bill, I wanted to ask you about ATM pricing and what kind of pressure you're seeing and if this year is any different than years past?

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

You know, this is my 10th year here, and it's a great question, especially in light of some of the challenges of our traditional hardware competition.

The answer to your question would be not really. The environment still is quite competitive in the emerging markets. It always has been. So we tend to see lower margins in the emerging and developing countries. That's not changed.

And by the way, when you have a higher mix of those countries in our revenue, you see it in our gross margins. Not unlike what you saw in Q1.

In the developed markets because we're so differentiated today and our hardware is attached to an end-to-end software solution, we are somewhat more protected a bit from the hardware to hardware degradation you might see in an RFP.

We're not completely insulated, by the way. But we are able to protect our hardware margins now as a result of packaging hardware in a larger end-to-end solution play, including software, digital banking and services.

So in the developed markets, it's less of an impact. I think we need to give this issue of quarter or two more and see how the competition reacts before I can give you more feedback on that.

Kartik Mehta - *Northcoast Research - Analyst*

So Bill, when you model when you're giving out guidance, what type of degradation do you assume on an annual basis for the ATM hardware and then service business?

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

We tend to look at price erosion of 5% to 7% in that range, and our job is to out run that and to reduce our costs on a BOM basis, bill of materials, by more than that to maintain margin. But we see typically 5% to 7%, Kartik.

Kartik Mehta - *Northcoast Research - Analyst*

And then just one last question, Bill. You talked about the common service platform, which you are able to leverage across all of your platforms. When you mentioned that, is it just that the person servicing either the ATM business or retail business is the same, or is there more to it than just that infrastructure, and does it get more complex and deeper when you look at the service business and your ability to leverage it across your platforms?

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

It's a lot deeper than that, Kartik. For example, all of our customer engineers we have about 11,500 people who are badged NCR employees who repair our equipment. All of them use common systems for dispatch, common logistical infrastructure for delivery of parts. A common system like the tools that are provided to do their jobs and they do share on calls.

So a CE who fixes an ATM can also fix a self-checkout device. And by the way, they are not that different from each other. They both have similar cash dispensers and so on. They're not quite that different.

Kartik Mehta - *Northcoast Research - Analyst*

Well, thank you very much, I appreciate it.

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

Yes, thank you.

Operator

Paul Coster, JPMorgan.

Paul Chung - *JPMorgan - Analyst*

This is Paul Chung on for Coster. Thanks for taking my questions. A question on Kalpana. Does the introduction of Kalpana disrupt sales of prior generation ATMs, and does it reduce visibility into second half as customers evaluate the software?

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

Andy, why don't you take that one?

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

Hey, Paul. Kalpana -- we burst Kalpana two years ago or conceived Kalpana two years ago and just came to market with it this month. And the design of it was because there's many markets around the world, despite our leadership position globally, where we wanted to be even more competitive to grow our available market, many places in India and China even in core Western markets where we were not cost competitive from a TCO perspective.

So we launched Kalpana with a focus on significantly reduced total cost of ownership for our customers with significantly improved security with the goal being to expand our available market.

So fast forward to now, when we signed our first contract and we are in the midst of many more right now and there with companies that traditionally the only way we could do business with them was for, call it, a negative 20% to 50% margin kind of business, which, of course, meant that we walked away from that business.

So fast forward to right now and we've got a fast growing fund around Kalpana that in most places is net new for us. So that's kind of where we look at things.

To the extent that there are situations where it would be a replacement cycle for current customers, we would look at that as additive from a margin dollar perspective. So we feel quite good about our position right now with Kalpana.

Paul Chung - *JPMorgan - Analyst*

Got you. Thank you very much. And then on Digital Insight, can you guys confirm revenue operating income, monthly average users, and where do you see growth trending there? Thanks.

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

We're not giving specific guidance any longer on DI. However, I can tell you that DI is performing above our internal plans and expectations and really has been a really important add-on and inorganic investment in the omni-channel space for us and really is making a difference for NCR.

I can tell you also that I think it's in the prepared presentation we had a great year in terms of growth of digital banking users, so it was a really superb year in terms of growth there.

Paul Chung - *JPMorgan - Analyst*

Thanks, guys.

Operator

This concludes today's question-and-answer session. At this time, I'd like to turn the conference back to management for any additional or closing remarks.

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

Well, we're looking to schedule an Analyst Day. You should all be aware of that sometime in Q3. Gavin will be talking to all of you about that. Looking forward to that and I also wanted to thank you for attending today's call. Have a great night.

Operator

This concludes today's conference. Thank you for your participation.