

XEROX CORP  
Form 10-Q  
October 27, 2006

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: September 30, 2006

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from

to

Commission File Number 1-4471

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**XEROX CORPORATION**

(Exact Name of Registrant as specified in its charter)

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New York  
(State or other jurisdiction of  
incorporation or organization)

P.O. Box 1600

16-0468020  
(IRS Employer

Identification No.)

06904-1600

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**Stamford, Connecticut**  
(Address of principal executive offices)

(Zip Code)

**(203) 968-3000**

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act Rule

Large accelerated filer:  Accelerated filer:  Non-accelerated filer:

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at September 30, 2006
Common Stock, \$1 par value	965,277,511 shares

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### Forward-Looking Statements

From time to time, we and our representatives may provide information, whether orally or in writing, including certain statements in this Quarterly Report on Form 10-Q, and any exhibits to this Form 10-Q, that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995 (the Litigation Reform Act ). These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information currently available.

The words anticipate, believe, estimate, expect, intend, will, should and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected, intended or using other similar expressions. We do not intend to update these forward-looking statements, except as required by law.

In accordance with the provisions of the Litigation Reform Act, we are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated by the forward-looking statements contained in this Quarterly Report on Form 10-Q, any exhibits to this Form 10-Q and other public statements we make. Such factors include, but are not limited to the outcome of litigation and regulatory proceedings to which we may be a party; actions of competitors; changes and developments affecting our industry; quarterly or cyclical variations in financial results; development of new products and services; interest rates and cost of borrowing; our ability to maintain and improve cost efficiency of operations; changes in foreign currency exchange rates; changes in economic conditions, political conditions, trade protection measures, licensing requirements and tax matters in the foreign countries in which we do business; reliance on third parties for manufacturing of products and provision of services; and other risks that are set forth in the Risk Factors section, the Legal Proceedings section, the Management's Discussion and Analysis of Results of Operations and Financial Condition section and other sections of this Quarterly Report on Form 10-Q, as well as in our Quarterly Report on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006 and our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission ( SEC ).

**XEROX CORPORATION**

**Form 10-Q**

**September 30, 2006**

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Restated Certificate of Incorporation of Registrant filed with the Department of State of the State of New York on November 7, 2003 as amended by Certificate of Amendment to Certificate of Incorporation filed with the Department of State of New York on August 19, 2004.	
By-Laws of Registrant, as amended through December 10, 2003.	
Amendment No. 1 to Registrant's 1991 Long-Term Incentive Plan.	
Registrant's 2004 Equity Compensation Plan for Non-Employee Directors, as amended through October 12, 2006.	
Amendment No. 1 to the Restatement of Registrant's 2004 Performance Incentive Plan.	
Amendment No. 4 to the 2004 Restatement of the Registrant's Unfunded Supplemental Executive Retirement Plan.	
Amendment No. 3 to Registrant's Universal Life Plan.	
Computation of Ratio of Earnings to Fixed Charges and Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends.	
Certification of CEO pursuant to Rule 13a-14(a) or Rule 15d-14(a).	
Certification of CFO pursuant to Rule 13a-14(a) or Rule 15d-14(a).	
Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	
For additional information about Xerox Corporation and access to our Annual Reports to Shareholders and SEC filings, free of charge, please visit our World-Wide Web site at <a href="http://www.xerox.com/investor">www.xerox.com/investor</a> . Any information on or linked from the Web site is not incorporated by reference into this Form 10-Q.	

## Item 1

## PART I FINANCIAL INFORMATION

## XEROX CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in millions, except per-share data)	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
<b>Revenues</b>				
Sales	\$ 1,736	\$ 1,721	\$ 5,284	\$ 5,242
Service, outsourcing and rentals	1,900	1,822	5,600	5,545
Finance income	208	216	632	664
<b>Total Revenues</b>	<b>3,844</b>	<b>3,759</b>	<b>11,516</b>	<b>11,451</b>
<b>Costs and Expenses</b>				
Cost of sales	1,142	1,108	3,417	3,325
Cost of service, outsourcing and rentals	1,083	1,017	3,211	3,162
Equipment financing interest	75	81	227	250
Research, development and engineering expenses	230	242	685	709
Selling, administrative and general expenses	985	1,011	2,988	3,066
Restructuring and asset impairment charges	110	17	146	296
Other expenses, net	128	206	278	160
<b>Total Cost and Expenses</b>	<b>3,753</b>	<b>3,682</b>	<b>10,952</b>	<b>10,968</b>
<b>Income from Continuing Operations before Income Taxes, Equity Income, Discontinued Operations and Cumulative Effect of Change in Accounting Principle</b>				
	<b>91</b>	<b>77</b>	<b>564</b>	<b>483</b>
Income tax (benefits) expenses	(416)	29	(347)	(88)
Equity in net income of unconsolidated affiliates	29	23	85	80
<b>Income from Continuing Operations before Discontinued Operations and Cumulative Effect of Change in Accounting Principle</b>	<b>536</b>	<b>71</b>	<b>996</b>	<b>651</b>
Income from Discontinued Operations, net of tax				53
Cumulative Effect of Change in Accounting Principle, net of tax		(8)		(8)
<b>Net Income</b>	<b>\$ 536</b>	<b>\$ 63</b>	<b>\$ 996</b>	<b>\$ 696</b>
Less: Preferred stock dividends, net		(14)	(29)	(43)
<b>Income Available to Common Shareholders</b>	<b>\$ 536</b>	<b>\$ 49</b>	<b>\$ 967</b>	<b>\$ 653</b>
<b>Basic Earnings per Share</b>				
Earnings from Continuing Operations	\$ 0.55	\$ 0.06	\$ 1.03	\$ 0.63
Earnings from Discontinued Operations				0.06
Loss from Cumulative Effect of Change in Accounting Principle		(0.01)		(0.01)
<b>Basic Earnings per Share</b>	<b>\$ 0.55</b>	<b>\$ 0.05</b>	<b>\$ 1.03</b>	<b>\$ 0.68</b>
<b>Diluted Earnings per Share</b>				
Earnings from Continuing Operations	\$ 0.54	\$ 0.06	\$ 0.99	\$ 0.62
Earnings from Discontinued Operations				0.05

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Loss from Cumulative Effect of Change in Accounting Principle (0.01) (0.01)

**Diluted Earnings per Share** \$ 0.54 \$ 0.05 \$ 0.99 \$ 0.66

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

## XEROX CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30,	December 31,
(in millions, except share data in thousands)	2006	2005
<b>Assets</b>		
Cash and cash equivalents	\$ 1,336	\$ 1,322
Short-term investments	120	244
Total cash, cash equivalents and short-term investments	1,456	1,566
Accounts receivable, net	2,233	2,037
Billed portion of finance receivables, net	277	296
Finance receivables, net	2,578	2,604
Inventories	1,397	1,201
Other current assets	1,094	1,032
Total current assets	9,035	8,736
Finance receivables due after one year, net	4,802	4,949
Equipment on operating leases, net	455	431
Land, buildings and equipment, net	1,582	1,627
Investments in affiliates, at equity	862	782
Intangible assets, net	288	289
Goodwill	1,917	1,671
Deferred tax assets, long-term	1,529	1,547
Other long-term assets	1,890	1,921
<b>Total Assets</b>	<b>\$ 22,360</b>	<b>\$ 21,953</b>
<b>Liabilities and Equity</b>		
Short-term debt and current portion of long-term debt	\$ 1,499	\$ 1,139
Accounts payable	1,126	1,043
Accrued compensation and benefits costs	570	621
Unearned income	195	191
Other current liabilities	1,216	1,352
Total current liabilities	4,606	4,346
Long-term debt	5,904	6,139
Liabilities to subsidiary trusts issuing preferred securities	620	626
Pension and other benefit liabilities	1,104	1,151
Post-retirement medical benefits	1,207	1,188
Other long-term liabilities	958	1,295
Total liabilities	14,399	14,745
Series C mandatory convertible preferred stock	889	889
Common stock, including additional paid-in-capital	5,069	4,741
Treasury stock, at cost	(225)	(203)
Retained earnings	3,988	3,021
Accumulated other comprehensive loss	(871)	(1,240)
<b>Total Liabilities and Equity</b>	<b>\$ 22,360</b>	<b>\$ 21,953</b>
Shares of common stock issued	980,626	945,106
Treasury stock	(15,348)	(13,917)

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Shares of common stock outstanding	965,278	931,189
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The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.



**XEROX CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(in millions)	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
<b>Cash Flows from Operating Activities:</b>				
Net income	\$ 536	\$ 63	\$ 996	\$ 696
Adjustments required to reconcile net income to cash flows from operating activities:				
Depreciation and amortization	163	157	481	483
Provisions for receivables and inventory	38	30	104	75