UNISYS CORP
Form 10-Q
October 27, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

[ ] 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 1-8729

UNISYS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	38-0387840
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Unisys Way Blue Bell, Pennsylvania	19424
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (215) 986-4011

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 [X] NO [ ]

Indicate by 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. (Check one):

Large Accelerated Filer [X] 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 [X]

Number of shares of Common Stock outstanding as of September 30, 2006: 344,577,714.

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Part I - FINANCIAL INFORMATION

Item 1. Financial Statements.

UNISYS CORPORATION
CONSOLIDATED BALANCE SHEETS
(Millions)

	September 30, 2006 (Unaudited)	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 612.0	$ 642.5
Accounts and notes receivable, net	1,139.9	1,111.5
Inventories:		
Parts and finished equipment	100.3	103.4
Work in process and materials	88.4	90.7
Deferred income taxes	112.2	68.2
Prepaid expenses and other current assets	157.0	137.0
Total	2,209.8	2,153.3
Properties	1,346.3	1,320.8
Less-Accumulated depreciation and amortization	998.8	934.4
Properties, net	347.5	386.4
Outsourcing assets, net	410.6	416.0
Marketable software, net	307.7	327.6
Investments at equity	1.1	207.8
Prepaid pension cost	1,298.0	66.1
Deferred income taxes	138.4	138.4
Goodwill	191.3	192.0
Other long-term assets	137.8	141.3
Total	$5,042.2	$4,028.9
Liabilities and stockholders' equity		
Current liabilities		
Notes payable	$ .8	$ 18.1
Current maturities of long-term debt	.6	58.8
Accounts payable	377.7	444.6
Other accrued liabilities	1,469.2	1,293.3
Total	1,848.3	1,814.8
Long-term debt	1,049.2	1,049.0
Accrued pension liabilities	353.8	506.9
Other long-term liabilities	662.7	690.8
Stockholders' equity (deficit)		
Common stock, shares issued: 2006, 346.6; 2005, 344.2	3.5	3.4
Accumulated deficit	(2,408.1)	(2,108.1)
Other capital	3,937.7	3,917.0
Accumulated other comprehensive loss	(404.9)	(1,844.9)

Stockholders' equity (deficit)	1,128.2	(32.6)
Total	$5,042.2	$4,028.9

See notes to consolidated financial statements.

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UNISYS CORPORATION
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(Millions, except per share data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Revenue				
Services	$1,217.6	$1,174.0	$3,618.5	$3,517.7
Technology	192.5	213.1	586.7	671.5
	1,410.1	1,387.1	4,205.2	4,189.2
Costs and expenses				
Cost of revenue:				
Services	1,058.9	1,036.0	3,271.7	3,080.8
Technology	92.5	105.1	310.0	324.7
	1,151.4	1,141.1	3,581.7	3,405.5
Selling, general and administrative	256.1	261.0	834.2	790.0
Research and development	45.5	61.2	184.7	192.7
	1,453.0	1,463.3	4,600.6	4,388.2
Operating loss	(42.9)	(76.2)	(395.4)	(199.0)
Interest expense	19.0	17.1	57.9	44.9
Other income (expense), net	.4	13.3	153.1	45.8
Loss before income taxes	(61.5)	(80.0)	(300.2)	(198.1)
Provision (benefit) for income taxes	16.0	1,548.2	(.2)	1,502.7
Net loss	$ (77.5)	$(1,628.2)	$ (300.0)	$(1,700.8)
Loss per share				
Basic	$ (.23)	$ (4.78)	$ (.87)	$ (5.01)
Diluted	$ (.23)	$ (4.78)	$ (.87)	$ (5.01)

See notes to consolidated financial statements.

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UNISYS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Millions)

	Nine Months Ended September 30	
	2006	2005
Cash flows from operating activities		
Net loss	$ (300.0)	$(1,700.8)
Add (deduct) items to reconcile net loss to net cash (used for) provided by operating activities:		
Equity loss (income)	4.3	(3.8)
Employee stock compensation	4.8	.2
Depreciation and amortization of properties	88.1	89.7
Depreciation and amortization of outsourcing assets	100.5	96.0
Amortization of marketable software	98.7	91.6
Gain on sale of NUL shares and other assets	(153.2)	(15.8)
Loss on the tender of debt	-	10.7
(Increase) decrease in deferred income taxes, net	(44.0)	1,474.5
Decrease in receivables, net	8.0	20.7
Decrease in inventories	5.2	19.6
Increase (decrease) in accounts payable and other accrued liabilities	69.8	(245.9)
(Decrease) increase in other liabilities	(64.8)	199.4
Decrease (increase) in other assets	21.2	(48.8)
Other	22.7	35.2
Net cash (used for) provided by operating activities	(138.7)	22.5
Cash flows from investing activities		
Proceeds from investments	5,617.8	5,758.9
Purchases of investments	(5,620.7)	(5,746.2)
Investment in marketable software	(81.2)	(93.7)
Capital additions of properties	(48.2)	(84.9)
Capital additions of outsourcing assets	(68.9)	(115.7)
Proceeds from sale of NUL shares and other assets	380.6	23.4
Purchases of businesses	-	(.5)
Net cash provided by (used for) investing activities	179.4	(258.7)
Cash flows from financing activities		
Net (reduction in) proceeds from short-term borrowings	(17.3)	3.8
Proceeds from employee stock plans	.9	12.8
Payments of long-term debt	(57.9)	(500.2)
Financing fees	(4.6)	-
Proceeds from issuance of long-term debt	-	541.5
Net cash (used for) provided by financing activities	(78.9)	57.9
Effect of exchange rate changes on cash and cash equivalents	7.7	(16.1)
Decrease in cash and cash equivalents	(30.5)	(194.4)

Cash and cash equivalents, beginning of period	642.5	660.5
Cash and cash equivalents, end of period	$ 612.0	$ 466.1

See notes to consolidated financial statements.

Unisys Corporation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

In the opinion of management, the financial information furnished herein reflects all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods specified. These adjustments consist only of normal recurring accruals except as disclosed herein. Because of seasonal and other factors, results for interim periods are not necessarily indicative of the results to be expected for the full year.

a. The following table shows how earnings (loss) per share were computed for the three and nine months ended September 30, 2006 and 2005 (dollars in millions, shares in thousands):

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Basic Loss Per Share				
Net loss	$ (77.5)	$ (1,628.2)	$ (300.0)	$(1,700.8)
Weighted average shares	344,182	340,914	343,351	339,736
Basic loss per share	$ (.23)	$ (4.78)	$ (.87)	$ (5.01)
Diluted Loss Per Share				
Net loss	$ (77.5)	$(1,628.2)	$ (300.0)	$(1,700.8)
Weighted average shares	344,182	340,914	343,351	339,736
Plus incremental shares from assumed conversions of employee stock plans	-	-	-	-
Adjusted weighted average shares	344,182	340,914	343,351	339,736
Diluted loss per share	$ (.23)	$ (4.78)	$ (.87)	$ (5.01)

At September 30, 2006, no shares related to employee stock plans were included in the computation of diluted earnings per share since inclusion of these shares would be antidilutive because of the net loss incurred in the three and nine months ended September 30, 2006.

b. As part of the company's repositioning plan to right size its cost structure, on March 31, 2006, the company committed to a reduction of approximately 3,600 employees. This resulted in a pretax charge in the

first quarter of 2006 of $145.9 million, principally related to severance costs. The charge is broken down as follows: (a) approximately 1,600 employees in the U.S. for a charge of $50.3 million and (b) approximately 2,000 employees outside the U.S. for a charge of $95.6 million. The pretax charge was recorded in the following statement of income classifications: cost of revenue-services, $83.4 million; cost of revenue-technology, $2.0 million; selling, general and administrative expenses, $45.4 million; research and development expenses, $17.6 million; and other income (expense), net, $2.5 million. The income recorded in other income (expense), net relates to minority shareholders' portion of the charge related to majority owned subsidiaries which are fully consolidated by the company.

As part of the company's continuing repositioning plan to right size its cost structure, during the three months ended June 30, 2006, the company committed to an additional reduction of approximately 1,900 employees. This resulted in a pretax charge in the second quarter of 2006 of $141.2 million, principally related to severance costs. The charge is broken down as follows: (a) approximately 650 employees in the U.S. for a charge of $22.1 million and (b) approximately 1,250 employees outside the U.S. for a charge of $119.1 million. The pretax charge was recorded in the following statement of income classifications: cost of revenue-services, $101.4 million; selling, general and administrative expenses, $28.3 million; research and development expenses, $11.8 million; and other income (expense), net, $.3 million. The income recorded in other income (expense), net relates to minority shareholders' portion of the charge related to majority owned subsidiaries which are fully consolidated by the company.

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During the three months ended September 30, 2006, the company committed to an additional reduction of approximately 100 employees outside the U.S that resulted in a pretax charge of $36.4 million, principally related to severance costs. The pretax charge was recorded in the following statement of income classifications: cost of revenue-services, $28.1 million and selling, general and administrative expenses, $8.3 million.

For the nine months ended September 30, 2006, the pretax charge of $323.5 million was recorded in the following statement of income classifications: cost of revenue-services, $212.9 million; cost of revenue-technology, $2.0 million; selling, general and administrative expenses, $82.0 million; research and development expenses, $29.4 million; and other income (expense), net, $2.8 million. The income recorded in other income (expense), net relates to minority shareholders' portion of the charge related to majority owned subsidiaries which are fully consolidated by the company.

Of the total of approximately 5,600 employee reductions announced through September 30, 2006, approximately 90% are expected to be completed by the end of 2006 with the remaining reductions targeted for the first half of 2007. Net of increases in offshore resources and outsourcing of certain internal, non-client facing functions, the company anticipates that these combined actions will yield annualized cost savings in excess of $340 million by the second half of 2007. The company continues to explore other approaches to reducing its cost structure, including additional work force reductions and potential idle facility charges which could result in additional cost reduction charges in the fourth quarter of 2006.

A further breakdown of the individual components of these costs follows (in millions of dollars):

	Headcount	Total	U.S.	Int'l.

Charge for work force reductions	5,631	$323.5	$72.5	$251.0
Minority interest		2.8		2.8
	5,631	326.3	72.5	253.8
Utilized	(3,237)	(98.0)	(27.8)	(70.2)
Changes in estimates and revisions	(411)	(2.4)	(1.9)	(.5)
Translation adjustments		5.2		5.2
Balance at September 30, 2006	1,983	$231.1	$42.8	$188.3
Expected future utilization:				
2006 remaining three months	1,400	$84.1	$23.2	$ 60.9
2007 and thereafter	583	147.0	19.6	127.4

c. On March 17, 2006, the company adopted changes to its U.S. defined benefit pension plans effective December 31, 2006, and will increase matching contributions to its defined contribution savings plan beginning January 1, 2007.

The changes to the U.S. plans are part of a global effort by the company to provide a competitive retirement program while controlling the level and volatility of retirement costs.

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The changes to the U.S. pension plans affect most U.S. employees and senior management. They include:

* Ending the accrual of future benefits in the company's defined benefit pension plans for employees effective December 31, 2006. There will be no new entrants to the plans after that date.

* Increasing the company's matching contribution under the company savings plan to 100 percent of the first 6 percent of eligible pay contributed by participants, up from the current 50 percent of the first 4 percent of eligible pay contributed by participants. The company match is made in company common stock.

The changes do not affect the vested accrued pension benefits of current and former employees, including Unisys retirees, as of December 31, 2006.

As a result of the amendment to stop accruals for future benefits in its U.S. defined benefit pension plans, the company recorded a pretax curtailment gain of $45.0 million in the first quarter of 2006. U.S. GAAP pension accounting rules require companies to re-measure both plan assets and obligations whenever a significant event occurs, such as a plan amendment. The company has performed such re-measurement as of March 31, 2006. As a result of the re-measurement, the company's U.S. qualified defined benefit pension plan is no longer in a minimum liability position and, accordingly, the company has reclassified its prepaid pension asset from other comprehensive income to a prepaid pension asset on its balance sheet. Based on the changes to the U.S. plans, the March 31, 2006 re-measurement and including the $45.0 million curtailment gain, the company currently expects its 2006 worldwide pension expense to be approximately $135 million, down from $181 million in 2005. The expected pension expense

in 2006 is based on actuarial assumptions and on assumptions regarding interest rates and currency exchange rates, all of which are subject to change. Accordingly the expected expense amount could change.

Net periodic pension expense for the three and nine months ended September 30, 2006 and 2005 is presented below (in millions of dollars):

	Three Months Ended September 30, 2006			Three Months Ended September 30, 2005		
	Total	U.S. Plans	Int'l. Plans	Total	U.S. Plans	Int'l. Plans
Service cost	$ 26.0	$ 13.9	$ 12.1	$ 28.4	$ 17.3	$ 11.1
Interest cost	91.7	63.0	28.7	91.9	65.8	26.1
Expected return on plan assets	(114.2)	(83.1)	(31.1)	(119.1)	(90.3)	(28.8)
Amortization of prior service (benefit) cost	(.4)	(.5)	.1	(1.7)	(1.9)	.2
Recognized net actuarial loss	40.3	27.5	12.8	44.7	35.1	9.6
Net periodic pension expense	$ 43.4	$ 20.8	$22.6	$ 44.2	$ 26.0	$18.2

	Nine Months Ended September 30, 2006			Nine Months Ended September 30, 2005		
	Total	U.S. Plans	Int'l. Plans	Total	U.S. Plans	Int'l. Plans
Service cost	$ 83.2	$ 47.5	$35.7	$ 88.2	$ 52.0	$ 36.2
Interest cost	298.5	215.3	83.2	278.0	197.3	80.7
Expected return on plan assets	(374.8)	(284.1)	(90.7)	(359.9)	(270.8)	(89.1)
Amortization of prior service (benefit) cost	(.9)	(1.5)	.6	(4.7)	(5.7)	1.0
Recognized net actuarial loss	130.8	93.9	36.9	135.2	105.2	30.0
Curtailment gain	(45.0)	(45.0)				
Net periodic pension expense	$ 91.8	$ 26.1	$65.7	$136.8	$78.0	$ 58.8

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The company currently expects to make cash contributions of approximately $80 million to its worldwide defined benefit pension plans in 2006 compared with $71.6 million in 2005. For the nine months ended September 30, 2006 and 2005, $53.3 million and $49.3 million, respectively, of cash contributions have been made. In accordance with regulations governing contributions to U.S. defined benefit pension plans, the company is not required to fund its U.S. qualified defined benefit pension plan in 2006.

Net periodic postretirement benefit expense for the three and nine months ended September 30, 2006 and 2005 is presented below (in millions of

dollars):

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Interest cost	$3.2	$3.5	$ 9.6	$10.4
Expected return on assets	(.2)	(.1)	(.3)	(.3)
Amortization of prior service benefit	(.5)	(.5)	(1.5)	(1.5)
Recognized net actuarial loss	1.4	1.6	4.0	4.8
Net periodic postretirement benefit expense	$3.9	$4.5	$11.8	$13.4

The company expects to make cash contributions of approximately $28 million to its postretirement benefit plan in 2006 compared with $26.4 million in 2005. For the nine months ended September 30, 2006 and 2005, $19.1 million and $18.8 million, respectively, of cash contributions have been made.

d. In March 2006, the company sold all of the shares it owned in Nihon Unisys, Ltd. (NUL), a publicly traded Japanese company. The company received gross proceeds of $378.1 million and recognized a pretax gain of $149.9 million in the first quarter of 2006. NUL will remain the exclusive distributor of the company's hardware and software in Japan.

At December 31, 2005, the company owned approximately 29% of the voting common stock of NUL. The company accounted for this investment by the equity method, and, at December 31, 2005, the amount recorded in the company's books for the investment, after the reversal of a minimum pension liability adjustment, was $243 million. During the years ended December 31, 2005, 2004 and 2003, and for the nine months ended September 30, 2006 and 2005, the company recorded equity income (loss) related to NUL of $9.1 million, $16.2 million, $18.2 million, $(4.2) million and $3.7 million, respectively. These amounts were recorded in "Other income (expense), net" in the company's consolidated statements of income.

e. Under the company's stockholder approved stock-based plans, stock options, stock appreciation rights, restricted stock and restricted stock units may be granted to officers, directors and other key employees. At September 30, 2006, 5.5 million shares of unissued common stock of the company were available for granting under these plans.

As of September 30, 2006, the company has granted non-qualified stock options and restricted stock units under these plans. Prior to January 1, 2006, the company applied the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for those plans, whereby for stock options, at the date of grant, no compensation expense was reflected in income, as all stock options granted had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. Pro forma information regarding net income and earnings per share was provided in accordance with Statement of Financial Accounting Standards (SFAS) No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" (SFAS No. 148), as if the fair value method defined by SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123) had been applied to stock-based compensation. For purposes of the pro forma disclosures, the

estimated fair value of stock options was amortized to expense over the options' vesting periods.

Effective January 1, 2006, the company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), which replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The company adopted SFAS No. 123R using the modified-prospective transition method, which requires the company, beginning January 1, 2006 and thereafter, to expense the grant date fair value of all share-based awards over their remaining vesting periods to the extent the awards were not fully vested as of the date of adoption and to expense the fair value of all share-based awards granted subsequent to December 31, 2005 over their requisite service periods. Stock-based compensation expense for all share-based payment awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. The company recognizes compensation cost net of a forfeiture rate and recognizes the compensation cost for only those awards expected to vest on a straight-line basis over the requisite service period of the award, which is generally the vesting term. The company estimated the forfeiture rate based on its historical experience and its expectations about future forfeitures. As required under the modified-prospective transition method, prior periods have not been restated. In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC's interpretation of SFAS No. 123R and the valuation of share-based payments for public companies. The company has applied the provisions of SAB 107 in its adoption of SFAS No. 123R. The company records share-based payment expense in selling, general and administrative expenses.

The company's stock option and time-based restricted stock unit grants include a provision that if termination of employment occurs after the participant has attained age 55 and completed 5 years of service with the company, or for directors, the completion of 5 years of service as a director, the participant shall continue to vest in each of his or her awards in accordance with the vesting schedule set forth in the applicable award agreement. For purposes of the pro forma information required to be disclosed by SFAS No. 123, the company recognized compensation expense over the vesting period. Under SFAS No. 123R, compensation expense is recognized over the period through the date that the employee first becomes eligible to retire and is no longer required to provide service to earn the award. For grants prior to January 1, 2006, compensation expense continues to be recognized under the prior method; compensation expense for awards granted after December 31, 2005 is recognized over the period to the date the employee first becomes eligible for retirement.

Options have been granted to purchase the company's common stock at an exercise price equal to or greater than the fair market value at the date of grant. Options granted before January 1, 2005 generally have a maximum duration of ten years and were exercisable in annual installments over a four-year period following date of grant. Stock options granted after January 1, 2005 generally have a maximum duration of five years and become exercisable in annual installments over a three-year period following date of grant. On September 23, 2005, the company accelerated the vesting of all of its then-issued unvested stock options. On December 19, 2005, the company granted fully vested stock options to purchase a total of 3.4 million shares of the company's common stock at an exercise price of $6.05, the fair market value of the company's common stock on December 19, 2005.

Prior to January 1, 2006, restricted stock units had been granted and were subject to forfeiture upon employment termination prior to the release of the restrictions. Compensation expense resulting from these awards is recognized as expense ratably from the date of grant until the date the restrictions lapse and is based on the fair market value of the shares at the date of grant.

For stock options issued both before and after adoption of SFAS No. 123R, the fair value is estimated at the date of grant using a Black-Scholes option pricing model. As part of its adoption of SFAS No. 123R, for stock options issued after December 31, 2005, the company reevaluated its assumptions in estimating the fair value of stock options granted. Principal assumptions used are as follows: (a) expected volatility for the company's stock price is based on historical volatility and implied market volatility, (b) historical exercise data is used to estimate the options' expected term, which represents the period of time that the options granted are expected to be outstanding, and (c) the risk-free interest rate is the rate on zero-coupon U.S. government issues with a remaining term equal to the expected life of the options. The company recognizes compensation expense for the fair value of stock options, which have graded vesting, on the straight-line basis over the requisite service period of the awards.

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The fair value of stock option awards was estimated using the Black-Scholes option pricing model with the following assumptions and expected weighted-average fair values as follows:

	Nine Months Ended September 30	
	2006	2005
Weighted-average fair value of grant	$2.46	$3.27
Risk-free interest rate	4.35%	3.43%
Expected volatility	45.88%	55.00%
Expected life of options in years	3.67	3.50
Expected dividend yield	-	-

Prior to January 1, 2006, the company would grant an annual stock option award to officers, directors and other key employees generally in the first quarter of a year. For 2006, this annual stock option award has been replaced with restricted stock unit awards. The company currently expects to continue to grant stock option awards, principally to newly hired individuals. The restricted stock unit awards granted in March of 2006 contain both time-based units (25% of the grant) and performance-based units (75% of the grant). The time-based units vest in three equal annual installments beginning with the first anniversary of the grant, and the performance-based units vest in three equal annual installments, beginning with the first anniversary of the grant, based upon the achievement of pretax profit and revenue growth rate goals in 2006, 2006-2007, and 2006-2008, for each installment, respectively. Each performance-based unit will vest into zero to 1.5 shares depending on the extent to which the performance goals are met. Compensation expense resulting from these awards is recognized as expense ratably for each installment from the date of grant until the date the restrictions lapse and is based on the fair market value at the date of grant and the probability of achievement of the specific performance-related goals.

During the nine months ended September 30, 2006, the company recorded $4.8 million of share-based compensation expense, which is comprised of $4.4

million of restricted stock unit expense and $.4 million of stock option expense.

The adoption of SFAS No. 123R had an immaterial impact to income before income taxes and net income for the nine months ended September 30, 2006.

A summary of stock option activity for the nine months ended September 30, 2006 follows (shares in thousands):

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value ($ in millions)
Outstanding at December 31, 2005	47,536	$16.54		
Granted	570	6.29		
Exercised	(150)	6.25		
Forfeited and expired	(3,559)	16.47		
Outstanding at Sept. 30, 2006	44,397	16.45	4.4	$ -
Vested and expected to vest at Sept. 30, 2006	44,397	16.45	4.4	-
Exercisable at Sept. 30, 2006	43,576	16.65	4.4	-

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The aggregate intrinsic value in the above table reflects the total pretax intrinsic value (the difference between the company's closing stock price on the last trading day of the period and the exercise price of the options, multiplied by the number of in-the-money stock options) that would have been received by the option holders had all option holders exercised their options on September 30, 2006. The intrinsic value of the company's stock options changes based on the closing price of the company's stock. The total intrinsic value of options exercised for the nine months ended September 30, 2006 and September 30, 2005 was immaterial. As of September 30, 2006, $1.7 million of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.5 years.

A summary of restricted stock unit activity for the nine months ended September 30, 2006 follows (shares in thousands):

	Restricted Stock Units	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2005	352	$8.89
Granted	1,928	6.55

Vested	(128)	7.62
Forfeited and expired	(124)	8.11
Outstanding at September 30, 2006	2,028	6.65

The fair value of restricted stock units is determined based on the average of the high and low trading price of the company's common shares on the date of grant. The weighted-average grant-date fair value of restricted stock units granted during the nine months ended September 30, 2006 and 2005 was $6.55 and $7.55, respectively. As of September 30, 2006, there was $8.1 million of total unrecognized compensation cost related to outstanding restricted stock units granted under the company's plans. That cost is expected to be recognized over a weighted-average period of 1.6 years. The total fair value of restricted share units vested during the nine months ended September 30, 2006 was $.8 million. No restricted share units vested during the nine months ended September 30, 2005.

For the nine months ended September 30, 2005, the following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of SFAS No. 123 (in millions of dollars, except per share amounts):

	Nine Months Ended September 30
	2005
Net loss as reported	$(1,700.8)
Deduct total stock-based employee compensation expense determined under fair value method for all awards, net of tax	(65.2)
Pro forma net loss	$(1,766.0)
Loss per share	
Basic - as reported	$ (5.01)
Basic - pro forma	$ (5.20)
Diluted - as reported	$ (5.01)
Diluted - pro forma	$ (5.20)

Common stock issued upon exercise of stock options or upon lapse of restrictions on restricted stock units are newly-issued shares. Cash received from the exercise of stock options for the nine months ended September 30, 2006 and 2005 was $1.0 million and $.3 million, respectively. The company did not realize any tax benefits from the exercise of stock options or upon issuance of stock upon lapse of restrictions on restricted stock units in light of the company's tax position. Prior to the adoption of SFAS No. 123R, the company presented such tax benefits as operating cash flows. Upon the adoption of SFAS No. 123R, tax benefits resulting from tax deductions in excess of the compensation cost recognized are classified as financing cash flows.

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f. The company has two business segments: Services and Technology. Revenue classifications by segment are as follows: Services - consulting and systems integration, outsourcing, infrastructure services and core maintenance; Technology - enterprise-class servers and specialized technologies.

The accounting policies of each business segment are the same as those

followed by the company as a whole. Intersegment sales and transfers are priced as if the sales or transfers were to third parties. Accordingly, the Technology segment recognizes intersegment revenue and manufacturing profit on hardware and software shipments to customers under Services contracts. The Services segment, in turn, recognizes customer revenue and marketing profits on such shipments of company hardware and software to customers. The Services segment also includes the sale of hardware and software products sourced from third parties that are sold to customers through the company's Services channels. In the company's consolidated statements of income, the manufacturing costs of products sourced from the Technology segment and sold to Services customers are reported in cost of revenue for Services.

Also included in the Technology segment's sales and operating profit are sales of hardware and software sold to the Services segment for internal use in Services engagements. The amount of such profit included in operating income of the Technology segment for the three and nine months ended September 30, 2006 and 2005 was $9.7 million and $3.3 million, and $13.0 million and $13.0 million, respectively. The profit on these transactions is eliminated in Corporate.

The company evaluates business segment performance on operating income exclusive of restructuring charges and unusual and nonrecurring items, which are included in Corporate. All other corporate and centrally incurred costs are allocated to the business segments based principally on revenue, employees, square footage or usage.

A summary of the company's operations by business segment for the three and nine month periods ended September 30, 2006 and 2005 is presented below (in millions of dollars):

	Total	Corporate	Services	Technology
Three Months Ended September 30, 2006				
Customer revenue	$1,410.1		$1,217.6	$ 192.5
Intersegment		$ (76.5)	3.6	72.9
Total revenue	$1,410.1	$ (76.5)	$1,221.2	$ 265.4
Operating loss (profit)	$ (42.9)	$ (42.0)	$ (15.6)	$ 14.7
Three Months Ended September 30, 2005				
Customer revenue	$1,387.1		$1,174.0	$ 213.1
Intersegment		$(57.1)	4.5	52.6
Total revenue	$1,387.1	$(57.1)	$1,178.5	$ 265.7
Operating loss	$ (76.2)	$ (.4)	$ (60.2)	$ (15.6)
Nine Months Ended September 30, 2006				
Customer revenue	$4,205.2		$3,618.5	$ 586.7

Intersegment		$(172.3)	10.8	161.5
Total revenue	$4,205.2	$(172.3)	$3,629.3	$ 748.2
Operating loss	$ (395.4)	$(330.7)	$ (37.7)	$ (27.0)
Nine Months Ended September 30, 2005				
Customer revenue	$4,189.2		$3,517.7	$ 671.5
Intersegment		$(192.7)	14.2	178.5
Total revenue	$4,189.2	$(192.7)	$3,531.9	$ 850.0
Operating loss	$ (199.0)	$ (8.1)	$ (181.7)	$ (9.2)

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Presented below is a reconciliation of total business segment operating income (loss) to consolidated loss before income taxes (in millions of dollars):

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Total segment operating profit (loss)	$ (.9)	$ (75.8)	$ (64.7)	$(190.9)
Interest expense	(19.0)	(17.1)	(57.9)	(44.9)
Other income (expense), net	.4	13.3	153.1	45.8
Cost reduction charge	(36.4)		(323.5)	
Corporate and eliminations	(5.6)	(.4)	(7.2)	(8.1)
Total loss before income taxes	$ (61.5)	$ (80.0)	$(300.2)	$(198.1)

Customer revenue by classes of similar products or services, by segment, is presented below (in millions of dollars):

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Services				
Consulting and systems integration	$ 377.6	$ 392.1	$1,162.9	$1,205.4
Outsourcing	491.0	435.8	1,417.4	1,288.6
Infrastructure services	237.0	220.8	691.5	632.0
Core maintenance	112.0	125.3	346.7	391.7
	1,217.6	1,174.0	3,618.5	3,517.7
Technology				

Enterprise-class servers	146.2	170.9	459.9	534.8
Specialized technologies	46.3	42.2	126.8	136.7
	192.5	213.1	586.7	671.5
Total	$1,410.1	$1,387.1	$4,205.2	$4,189.2

g. Comprehensive income (loss) for the three and nine months ended September 30, 2006 and 2005 includes the following components (in millions of dollars):

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Net loss	$ (77.5)	$(1,628.2)	$(300.0)	$(1,700.8)
Other comprehensive income (loss)				
Cash flow hedges				
Income (loss), net of tax of $ -, $(.8), -, and $1.9	(.1)	(1.6)	(.3)	3.3
Reclassification adjustments, net of tax of $ -, $.6, $- and $-	.5	1.3	.5	.3
Foreign currency translation adjustments	6.0	4.6	(6.2)	21.8
Reversal of U.S. minimum pension liability	-	-	1,446.0	-
Total other comprehensive income (loss)	6.4	4.3	1,440.0	25.4
Comprehensive income (loss)	$ (71.1)	$(1,623.9)	$1,140.0	$(1,675.4)

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Accumulated other comprehensive income (loss) as of December 31, 2005 and September 30, 2006 is as follows (in millions of dollars):

	Total	Translation Adjustments	Cash Flow Hedges	Minimum Pension Liability
Balance at December 31, 2005	$(1,844.9)	$(627.3)	$ .1	$(1,217.7)
Change during period	1,440.0	(6.2)	.2	1,446.0
Balance at September 30, 2006	$ (404.9)	$(633.5)	$ .3	$ 228.3

h. For equipment manufactured by the company, the company warrants that it will substantially conform to relevant published specifications for 12 months after shipment to the customer. The company will repair or replace, at its option and expense, items of equipment that do not meet this warranty. For company software, the company warrants that it will conform substantially to

then-current published functional specifications for 90 days from customer's receipt. The company will provide a workaround or correction for material errors in its software that prevents its use in a production environment.

The company estimates the costs that may be incurred under its warranties and records a liability in the amount of such costs at the time revenue is recognized. Factors that affect the company's warranty liability include the number of units sold, historical and anticipated rates of warranty claims and cost per claim. The company quarterly assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. Presented below is a reconciliation of the aggregate product warranty liability (in millions of dollars):

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Balance at beginning of period	$ 8.9	$ 9.4	$ 8.0	$ 11.6
Accruals for warranties issued during the period	2.1	2.1	7.1	6.4
Settlements made during the period	(2.3)	(2.6)	(7.1)	(8.1)
Changes in liability for pre-existing warranties during the period, including expirations	(.1)	(.5)	.6	(1.5)
Balance at September 30	$ 8.6	$ 8.4	$ 8.6	$ 8.4

i. Cash paid during the nine months ended September 30, 2006 and 2005 for income taxes was $60.4 million and $32.4 million, respectively.

Cash paid during the nine months ended September 30, 2006 and 2005 for interest was $60.4 million and $61.7 million, respectively.

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j. Effective January 1, 2006, the company adopted SFAS No. 151, "Inventory Costs an amendment of ARB No. 43, Chapter 4" (SFAS No. 151). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, handling costs and wasted material (spoilage). Among other provisions, the new rule requires that such items be recognized as current-period charges, regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. Adoption of SFAS No. 151 did not have a material effect on the company's consolidated financial position, consolidated results of operations, or liquidity.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109," (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after

December 15, 2006. The company is currently evaluating what effect, if any, adoption of FIN 48 will have on the company's consolidated results of operations and financial position.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, SFAS No. 157 does not require any new fair value measurements. The provisions of SFAS No. 157 are to be applied prospectively and are effective for financial statements issued for fiscal years beginning after November 15, 2007. The company is currently evaluating what effect, if any, adoption of SFAS No. 157 will have on the company's consolidated results of operations and financial position.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)," (SFAS No. 158). SFAS No. 158 requires an employer to recognize in its statement of financial position the funded status of a benefit plan, measured as the difference between plan assets at fair value and the benefit obligation. For pension plans, the benefit obligation is the projected benefit obligation; for any other postretirement benefit plan, such as a retiree health care plan, the benefit obligation is the accumulated benefit obligation. If plan assets exceed plan liabilities, an asset would be recognized, and if plan liabilities exceed plan assets a liability would be recognized. In addition, SFAS No. 158 requires that changes in the funded status of a defined benefit postretirement plan be recognized in comprehensive income in the year in which the changes occur. SFAS No. 158 does not change the amount of expense recorded in a company's statement of income related to defined benefit postretirement plans. The requirement to recognize the funded status of a defined benefit postretirement plan and other disclosure requirements of SFAS No. 158 are effective for fiscal years ending after December 15, 2006. Adoption of SFAS No. 158 by the company on December 31, 2006 will result in the recognition of a material charge in the ending balance of accumulated other comprehensive income. This charge will have no effect on the company's net income, liquidity, cash flows, or financial ratio covenants in the company's credit agreements and debt securities.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," (SAB 108). SAB 108 requires companies to evaluate the materiality of identified unadjusted errors on each financial statement and related financial statement disclosure using both the rollover approach and the iron curtain approach. The rollover approach quantifies misstatements based on the amount of the error in the current year financial statement whereas the iron curtain approach quantifies misstatements based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement's year(s) of origin. Financial statements would require adjustment when either approach results in quantifying a misstatement that is material. Correcting prior year financial statements for immaterial errors would not require previously filed reports to be amended. SAB 108 is effective for interim periods of the first fiscal year ending after November 15, 2006. The company is currently evaluating what effect, if any, adoption of SAB 108 will have on the company's consolidated results of operations and financial position.

In September 2006, the Emerging Issues Task Force (EITF) of the FASB, reached a consensus on Issue 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements," (EITF 06-4). EITF 06-4 requires that, for split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods, an employer should recognize a liability for future benefits in accordance with SFAS No. 106. EITF 06-4 is effective for fiscal years beginning after December 15, 2007 and it requires that recognition of the effects of adoption should be either by (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The company is currently evaluating what effect, if any, adoption of EITF 06-4 will have on the company's consolidated results of operations and financial position.

In September 2006, the EITF reached a consensus on Issue 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4," (EITF 06-5). EITF 06-5 requires that a policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract on a policy by policy basis. EITF 06-5 is effective for fiscal years beginning after December 15, 2006 and it requires that recognition of the effects of adoption should be either by (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The company is currently evaluating what effect, if any, adoption of EITF 06-5 will have on the company's consolidated results of operations and financial position.

k. In 2002, the company and the Transportation Security Administration (TSA) entered into a competitively awarded contract providing for the establishment of secure information technology environments in airports. The Defense Contract Audit Agency (DCAA), at the request of TSA, reviewed contract performance and raised some government contracting issues. It is not unusual in complex government contracts for the government and the contractor to have issues arise regarding contract obligations. The company continues to work collaboratively with the DCAA and TSA to try to resolve these issues. While the company believes that it and the government will resolve the issues raised, there can be no assurance that these issues will be successfully resolved or that new issues will not be raised. It has been publicly reported that certain of these matters have been referred to the Inspector General's office of the Department of Homeland Security for investigation. The company has received no investigative requests from the Inspector General's office or any other government agency with respect to any such referral. The company does not know whether any such referral will be pursued or, if pursued, what effect it may have on the company or on the resolution of the issues with TSA.

l. In June 2006, the company retired at maturity all $57.9 million of its remaining 8-1/8% senior notes.

During the nine months ended September 30, 2005, the company (a) issued $400 million 8% senior notes due 2012 and $150 million 8-1/2% senior notes due 2015, (b) repaid $339.8 million of the company's $400 million 8-1/8% senior notes due 2006 pursuant to a September 2005 tender offer by the company and recorded a charge of $10.7 million related to the tender premium and amortization of deferred costs related to the notes, and (c) in January 2005 retired at maturity all of the company's $150.0 million 7-1/4% senior notes.

The company has a three-year, secured revolving credit facility which expires in 2009 that provides for loans and letters of credit up to an aggregate of $275 million. Borrowings under the facility bear interest based on short-term rates and the company's credit rating. The credit agreement contains customary representations and warranties, including no material adverse change in the company's business, results of operations or financial condition. It also contains financial covenants requiring the company to maintain certain interest coverage, leverage and asset coverage ratios and a minimum amount of liquidity, which could reduce the amount the company is able to borrow. The credit facility also includes covenants limiting liens, mergers, asset sales, dividends and the incurrence of debt. Events of default include non-payment, failure to perform covenants, materially incorrect representations and warranties, change of control and default under other debt aggregating at least $25 million. If an event of default were to occur under the credit agreement, the lenders would be entitled to declare all amounts borrowed under it immediately due and payable. The occurrence of an event of default under the credit agreement could also cause the acceleration of obligations under certain other agreements and the termination of the company's U.S. trade accounts receivable facility. The credit facility is secured by the company's assets, except that the collateral does not include accounts receivable that are subject to the receivable facility, U.S. real estate or the stock or indebtedness of the company's U.S. operating subsidiaries. As of September 30, 2006, there were letters of credit of $35.9 million issued under the facility and there were no cash borrowings.

m. During the financial close for the quarter ended September 30, 2005, the company performed its quarterly assessment of its net deferred tax assets. Up to that point in time, as previously disclosed in the company's critical accounting policies section of its Form 10-K, the company had principally relied on its ability to generate future taxable income (predominately in the U.S.) in its assessment of the realizability of its net deferred tax assets.

Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes" (SFAS No. 109), limits the ability to use future taxable income to support the realization of deferred tax assets when a company has experienced recent losses even if the future taxable income is supported by detailed forecasts and projections. After considering the company's pretax losses in 2004 and for the nine months ended September 30, 2005, the expectation of a pretax loss for the full year of 2005, and the company's plans to restructure its business model by divesting non-core assets, reducing its cost structure and shifting its focus to high growth markets, the company concluded that it could no longer rely on future taxable income as the basis for realization of its net deferred tax asset.

Accordingly, the company recorded a non-cash charge in the third quarter of 2005 of $1,573.9 million to increase the valuation allowance against deferred tax assets. With this increase the company has a full valuation allowance against its deferred tax assets for all of the U.S. and certain foreign subsidiaries. This non-cash charge did not affect the company's compliance with the financial covenants under its credit agreements. It was recorded in provision for income taxes in the accompanying consolidated statement of income. The company expects to continue to record a full valuation allowance on future tax benefits in such jurisdictions until other positive evidence is sufficient to justify realization.

The realization of the remaining deferred tax assets is primarily dependent on forecasted future taxable income within certain foreign jurisdictions. Any

reduction in estimated forecasted future taxable income may require the company to record an additional valuation allowance against the remaining deferred tax assets. Any increase or decrease in the valuation allowance would result in additional or lower income tax expense in such period and could have a significant impact on that period's earnings.

n. Certain prior year amounts have been reclassified to conform with the 2006 presentation.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

For the nine months ended September 30, 2006, the company reported a net loss of $300.0 million, or $.87 per share, compared with a net loss of $1,700.8 million, or $5.01 per share, for the nine months ended September 30, 2005. The current period includes pretax charges of $323.5 million relating to cost reduction actions and the prior-year period includes a non-cash charge of $1,573.9 million for the increase in the deferred tax asset valuation allowance discussed below.

During the first nine months of 2006, the company executed against its previously-announced plan to fundamentally reposition the company for profitable growth. During the period, the company:

* committed to a reduction of approximately 5,600 employees, which resulted in pretax charges of $323.5 million. In the first nine months, the company implemented approximately 3,600 of the employee reductions. See note (b) to the financial statements.

* adopted changes to its U.S. defined benefit pension plans effective December 31, 2006, and will increase matching contributions to its defined contribution savings plan beginning January 1, 2007. As a result of stopping the accruals for future benefits, the company recorded a pretax curtailment gain of $45.0 million. See note (c) to the financial statements.

* began its program to divest non-core assets. In March the company divested its stake in Nihon Unisys, Ltd. (NUL), a leading IT solutions provider in Japan. The company sold all of its 30.5 million shares in NUL, generating cash proceeds of approximately $378 million, which will be used to fund the company's cost reduction program. A pretax gain of $149.9 million was recorded on the sale. The company also sold certain assets of its Unigen semiconductor test equipment business for cash proceeds of $8 million. See note (d) to the financial statements.

* reached a definitive agreement with its partner banks on renegotiated terms for its iPSL payment processing joint venture in the United Kingdom. The terms of the new agreement, which went into effect on January 1, 2006, include new tariff arrangements that are expected to yield an additional approximately $150 million in revenue to the company over the 2006-2010 timeframe.

* reached a series of alliance agreements with NEC Corporation (NEC) to collaborate in server technology, research and development, manufacturing, and solutions delivery. Among the areas included in the agreements, the two companies will co-design and develop a common high-end, Intel-based server platform for customers of both companies, and NEC is recognizing the company as a preferred provider of technology support and maintenance services and managed security services in markets outside of Japan by offering the company the opportunity to bid these services.

Results of operations

Company results

For the three months ended September 30, 2006, the company reported a net loss of $77.5 million, or $.23 per share, compared with a net loss of $1,628.2 million, or $4.78 per share, for the three months ended September 30, 2005. The prior-year period includes a non-cash charge of $1,573.9 million for the increase in the deferred tax asset valuation allowance discussed below.

Revenue for the quarter ended September 30, 2006 was $1.41 billion compared with $1.39 billion for the third quarter of 2005, an increase of 2% from the prior year. Foreign currency fluctuations had a 2 percentage point positive impact on revenue in the current period compared with the year-ago period. Services revenue increased 4% which was offset in part by a decrease of 10% in Technology revenue. U.S. revenue declined 5% in the quarter compared with the year-ago period principally in the company's Federal business. Revenue in international markets increased 8% due to increases in Latin America, Asia and Europe offset in part by a decline in South Pacific and Japan. On a constant currency basis, international revenue increased 4% in the three months ended September 30, 2006 compared with the three months ended September 30, 2005.

Pension expense for the three months ended September 30, 2006 was $43.4 million compared with $44.2 million for the three months ended September 30, 2005. The company records pension income or expense, as well as other employee-related costs such as payroll taxes and medical insurance costs, in operating income in the following income statement categories: cost of sales; selling, general and administrative expenses; and research and development expenses. The amount allocated to each category is based on where the salaries of active employees are charged.

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Total gross profit margin was 18.3% in the three months ended September 30, 2006 compared with 17.7% in the three months ended September 30, 2005. The current year period includes a charge of $28.1 million related to cost reduction actions. Excluding the cost reduction charge, the gross margin improvement was principally due to operational improvements in several large BPO contracts as well as the benefits derived from the cost reduction actions.

Selling, general and administrative expenses were $256.1 million for the three months ended September 30, 2006 (18.2% of revenue) compared with $261.0 million (18.8% of revenue) in the year-ago period. The current year period includes a charge of $8.3 million related to cost reduction actions. Excluding the cost reduction charge, the improvement was principally due to the benefits derived from the cost reduction actions.

Research and development (R&D) expense in the third quarter of 2006 was $45.5 million compared with $61.2 million in the third quarter of 2005. The company continues to invest in proprietary operating systems, middleware and in key programs within its industry practices. The decline in R&D in the quarter was principally a result of cost reduction actions.

For the third quarter of 2006, the company reported a pretax operating loss of $42.9 million compared with a pretax operating loss of $76.2 million in the third quarter of 2005. The current year period includes a charge of $36.4 million related to cost reduction actions.

Interest expense for the three months ended September 30, 2006 was $19.0 million compared with $17.1 million for the three months ended September 30, 2005,

principally due to higher average debt.

Other income (expense), net, which can vary from period to period, was income of $.4 million in the third quarter of 2006 compared with income of $13.3 million in 2005. The difference in 2006 from 2005 was principally due to (a) an increase in NUL equity income from a loss of $7.8 million in the year-ago quarter to zero in the current quarter due to the sale of the company's investment in NUL in March 2006 (see note d), (b) expense of $2.3 million in the current quarter compared with income of $11.3 million in last year's third quarter related to minority shareholders' portion of earnings or losses of iPSL, a 51% owned subsidiary which is fully consolidated by the company, due to increased profit from iPSL resulting from the renegotiated contract in January 2006, (c) a gain on the sale of property of $15.8 million in the year-ago period, and (d) a charge of $10.7 million in the year-ago period related to the debt tender offer discussed below.

During the financial close for the quarter ended September 30, 2005, the company performed its quarterly assessment of its net deferred tax assets. Up to that point in time, as previously disclosed in the company's critical accounting policies section of its Form 10-K, the company had principally relied on its ability to generate future taxable income (predominately in the U.S.) in its assessment of the realizability of its net deferred tax assets.

Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes" (SFAS No. 109), limits the ability to use future taxable income to support the realization of deferred tax assets when a company has experienced recent losses even if the future taxable income is supported by detailed forecasts and projections. After considering the company's pretax losses in 2004 and for the nine months ended September 30, 2005, the expectation of a pre-tax loss for the full year of 2005, and the company's plans to restructure its business model by divesting non-core assets, reducing its cost structure and shifting its focus to high growth markets, the company concluded that it could no longer rely on future taxable income as the basis for realization of its net deferred tax asset.

Accordingly, the company recorded a non-cash charge in the third quarter of 2005 of $1,573.9 million to increase the valuation allowance against deferred tax assets. With this increase the company has a full valuation allowance against its deferred tax assets for all of the U.S. and certain foreign subsidiaries. This non-cash charge did not affect the company's compliance with the financial covenants under its credit agreements. It was recorded in provision for income taxes in the accompanying consolidated statement of income. The company expects to continue to record a full valuation allowance on future tax benefits in such jurisdictions until other positive evidence is sufficient to justify realization.

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The realization of the remaining deferred tax assets is primarily dependent on forecasted future taxable income within certain foreign jurisdictions. Any reduction in estimated forecasted future taxable income may require the company to record an additional valuation allowance against the remaining deferred tax assets. Any increase or decrease in the valuation allowance would result in additional or lower income tax expense in such period and could have a significant impact on that period's earnings.

Income (loss) before income taxes for the three months ended September 30, 2006 was a loss of $61.5 million compared with a loss of $80.0 million in 2005. The provision for income taxes was $16.0 million in the current quarter compared with a provision for income taxes of $1,548.2 million in the year-ago period. The prior year provision includes the increase in the deferred tax asset valuation allowance discussed above. Due to the fact that the company has a

full valuation allowance for all of its U.S. tax assets and certain international subsidiaries, which was recorded in the third quarter of 2005, the company no longer has a meaningful effective tax rate. The company will record a tax provision or benefit for those international subsidiaries that do not have a full valuation allowance against their deferred tax assets. Any profit or loss recorded for the company's U.S. operations will have no provision or benefit associated with it. As a result, the company's provision or benefit for taxes will vary significantly quarter to quarter depending on the geographic distribution of income.

For the nine months ended September 30, 2006, the company reported a net loss of $300.0 million, or $.87 per share, compared with a net loss of $1,700.8 million, or $5.01 per share, for the nine months ended September 30, 2005. The current period includes a pretax charge of $323.5 million relating to the cost reduction actions and the prior-year period includes a non-cash charge of $1,573.9 million for the increase in the deferred tax asset valuation allowance.

Total revenue for the nine months ended September 30, 2006 was $4.21 billion compared with $4.19 billion for the nine months ended September 30, 2005. Foreign currency translations had a negligible impact on revenue in the current nine months when compared with the year-ago period. In the current nine-month period, Services revenue increased 3% and Technology revenue decreased 13%.

U.S. revenue declined 4% in the current nine-month period compared with the year-ago period. Revenue in international markets increased 4% driven by increases in Europe and Latin America which was partially offset by a decrease in Pacific/Asia/Japan. On a constant currency basis, international revenue increased 5% in the nine months ended September 30, 2006.

Pension expense for the nine months ended September 30, 2006 was $91.8 million compared with $136.8 million of pension expense for the nine months ended September 30, 2005. The decrease in pension expense in 2006 from 2005 was principally due to the U.S. curtailment gain of $45.0 million recognized in March 2006, resulting from the freezing of U.S. plan benefits effective January 1, 2007.

Total gross profit margin was 14.8% in the nine months ended September 30, 2006 compared with 18.7% in the year-ago period. The current period included a $214.9 million charge related to the cost reduction actions.

For the nine months ended September 30, 2006, selling, general and administrative expense were $834.2 million (19.8% of revenue) compared with $790.0 million (18.9% of revenue) for the nine months ended September 30, 2005. Selling general and administrative expenses for the nine months ended September 30, 2006 included $82.0 million related to the cost reduction actions. Selling, general and administrative expense in the current nine-month period includes $19.5 million of pension expense compared with pension expense of $27.1 million in the year-ago period.

R&D expense for the nine months ended September 30, 2006 was $184.7 million compared with $192.7 million a year ago. R&D expense in the nine months of 2006 included $29.4 million related to the cost reduction actions. R&D in the current period includes $4.3 million of pension expense compared with pension expense of $14.7 million in the year-ago period.

For the nine months ended September 30, 2006, the company reported an operating loss of $395.4 million compared with an operating loss of $199.0 million for the nine months ended September 30, 2005. The current period includes a $323.5 million charge related to the cost reduction actions. The current period also includes pension expense of $91.8 million compared with pension expense of $136.8 million in the year-ago period.

Interest expense for the nine months ended September 30, 2006 was $57.9 million compared with $44.9 million for the nine months ended September 30, 2005, principally due to higher average debt.

Other income (expense), net was income of $153.1 million in the current nine-month period compared with income of $45.8 million in the year-ago period. The increase in income was principally due to the $149.9 million gain from the sale of all of the company's shares in NUL (see note (d)), offset in part by (a) a decline in NUL equity income from $3.7 million in the year-ago period to a loss of $4.2 million in the current nine month period, (b) an expense of $5.0 million in the current period compared with income of $27.4 million in the last year's nine month period related to minority shareholders' portion of earnings or losses of iPSL, a 51% owned subsidiary which is fully consolidated by the company, (c) a gain on the sale of property of $15.8 million in the year-ago period, and (d) a charge of $10.7 million in the year-ago period related to the debt tender offer.

Income (loss) before income taxes was a loss of $300.2 million in the nine months ended September 30, 2006 compared with a loss of $198.1 million last year. The benefit for income taxes was $.2 million in the current period compared with a provision for income taxes of $1,502.7 million in the year-ago period.

In 2002, the company and the Transportation Security Administration (TSA) entered into a competitively awarded contract providing for the establishment of secure information technology environments in airports. The Defense Contract Audit Agency (DCAA), at the request of TSA, reviewed contract performance and raised some government contracting issues. It is not unusual in complex government contracts for the government and the contractor to have issues arise regarding contract obligations. The company continues to work collaboratively with the DCAA and TSA to try to resolve these issues. While the company believes that it and the government will resolve the issues raised, there can be no assurance that these issues will be successfully resolved or that new issues will not be raised. It has been publicly reported that certain of these matters have been referred to the Inspector General's office of the Department of Homeland Security for investigation. The company has received no investigative requests from the Inspector General's office or any other government agency with respect to any such referral. The company does not know whether any such referral will be pursued or, if pursued, what effect it may have on the company or on the resolution of the issues with TSA.

Segment results

The company has two business segments: Services and Technology. Revenue classifications by segment are as follows: Services - consulting and systems integration, outsourcing, infrastructure services and core maintenance; Technology - enterprise-class servers and specialized technologies.

The accounting policies of each business segment are the same as those followed by the company as a whole. Intersegment sales and transfers are priced as if the sales or transfers were to third parties. Accordingly, the Technology segment recognizes intersegment revenue and manufacturing profit on hardware and software shipments to customers under Services contracts. The Services segment, in turn, recognizes customer revenue and marketing profit on such shipments of company hardware and software to customers. The Services segment also includes the sale of hardware and software products sourced from third parties that are sold to customers through the company's Services channels. In the company's consolidated statements of income, the manufacturing costs of products sourced from the Technology segment and sold to Services customers are reported in cost of revenue for Services.

Also included in the Technology segment's sales and operating profit are sales of hardware and software sold to the Services segment for internal use in Services agreements. The amount of such profit included in operating income of the Technology segment for the three and nine months ended September 30, 2006 and 2005 was $9.7 million and $3.3 million, and $13.0 million and $13.0 million, respectively. The profit on these transactions is eliminated in Corporate.

The company evaluates business segment performance on operating income exclusive of restructuring charges and unusual and nonrecurring items, which are included in Corporate. All other corporate and centrally incurred costs are allocated to the business segments, based principally on revenue, employees, square footage or usage. Therefore, the segment comparisons below exclude the cost reduction items mentioned above.

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Information by business segment is presented below (in millions of dollars):

	Total	Eliminations	Services	Technology
Three Months Ended September 30, 2006				
Customer revenue	$1,410.1		$1,217.6	$192.5
Intersegment		$(76.5)	3.6	72.9
Total revenue	$1,410.1	$(76.5)	$1,221.2	$265.4
Gross profit percent	18.3 %		13.9 %	46.3%
Operating (loss) profit percent	(3.0)%		(1.3)%	5.5%
Three Months Ended September 30, 2005				
Customer revenue	$1,387.1		$1,174.0	$213.1
Intersegment		$(57.1)	4.5	52.6
Total revenue	$1,387.1	$(57.1)	$1,178.5	$265.7
Gross profit percent	17.7%		11.3%	42.4%
Operating loss percent	(5.5)%		(5.1)%	(5.9)%

Gross profit percent and operating loss percent are as a percent of total revenue.

In the Services segment, customer revenue was $1.22 billion for the three months ended September 30, 2006 compared with $1.17 billion for the three months ended September 30, 2005. Foreign currency translation had a 2 percentage point positive impact on Services revenue in the current quarter compared with the year-ago period. Revenue in the third quarter of 2006 increased 4% compared with 2005, principally due to a 13% increase in outsourcing ($491.0 million in 2006 compared with $435.8 million in 2005), and a 7% increase in infrastructure services ($237.0 million in 2006 compared with $220.8 million in 2005), offset

in part by a 4% decrease in consulting and systems integration revenue ($377.6 million in 2006 compared with $392.1 million in 2005) and a 11% decrease in core maintenance ($112.0 million in 2006 compared with $125.3 million in 2005). Services gross profit was 13.9% in the third quarter of 2006 compared with 11.3% in the year-ago period. Services operating income (loss) percent was (1.3)% in the three months ended September 30, 2006 compared with (5.1)% in the three months ended September 30, 2005. The Services margin improvements were principally due to operational improvements in several large BPO contracts as well as the benefits derived from the cost reduction actions.

In the Technology segment, customer revenue was $193 million in the current quarter compared with $213 million in the year-ago period. Foreign currency translation had a 1 percentage point positive impact on Technology revenue in the current period compared with the prior-year period. Revenue in the three months ended September 30, 2006 was down 10% from the three months ended September 30, 2005, due to a 14% decrease in sales of enterprise-class servers ($146.2 million in 2006 compared with $170.9 million in 2005) offset in part by a 10% increase in sales of specialized technology products ($46.3 million in 2006 compared with $42.2 million in 2005). Technology gross profit was 46.3% in the current quarter compared with 42.4% in the year-ago quarter. Technology operating income percent was 5.5% in the three months ended September 30, 2006 compared with (5.9)% in the three months ended September 30, 2005. The decline in revenue in 2006 compared with 2005 primarily reflected the continuing secular decline in the proprietary mainframe industry. The Technology margin improvements were principally due to the benefits derived from the cost reduction actions.

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New accounting pronouncements

Effective January 1, 2006, the company adopted SFAS No. 151, "Inventory Costs an amendment of ARB No. 43, Chapter 4" (SFAS No. 151). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, handling costs and wasted material (spoilage). Among other provisions, the new rule requires that such items be recognized as current-period charges, regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. Adoption of SFAS No. 151 did not have a material effect on the company's consolidated financial position, consolidated results of operations, or liquidity.

Effective January 1, 2006, the company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), which replaces SFAS No. 123 and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The company adopted SFAS No. 123R using the modified-prospective transition method, which requires the company, beginning January 1, 2006 and thereafter, to expense the grant date fair value of all share-based awards over their remaining vesting periods to the extent the awards were not fully vested as of the date of adoption and to expense the fair value of all share-based awards granted subsequent to December 31, 2005 over their requisite service periods. During the nine months ended September 30, 2006, the company recorded $4.8 million of share-based compensation expense. Previous periods have not been restated. See note (e) for further details.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109," (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a

tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. The company is currently evaluating what effect, if any, adoption of FIN 48 will have on the company's consolidated results of operations and financial position.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, SFAS No. 157 does not require any new fair value measurements. The provisions of SFAS No. 157 are to be applied prospectively and are effective for financial statements issued for fiscal years beginning after November 15, 2007. The company is currently evaluating what effect, if any, adoption of SFAS No. 157 will have on the company's consolidated results of operations and financial position.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)," (SFAS No. 158). SFAS No. 158 requires an employer to recognize in its statement of financial position the funded status of a benefit plan, measured as the difference between plan assets at fair value and the benefit obligation. For pension plans, the benefit obligation is the projected benefit obligation; for any other postretirement benefit plan, such as a retiree health care plan, the benefit obligation is the accumulated benefit obligation. If plan assets exceed plan liabilities, an asset would be recognized, and if plan liabilities exceed plan assets a liability would be recognized. In addition, SFAS No. 158 requires that changes in the funded status of a defined benefit postretirement plan be recognized in comprehensive income in the year in which the changes occur. SFAS No. 158 does not change the amount of expense recorded in a company's statement of income related to defined benefit postretirement plans. The requirement to recognize the funded status of a defined benefit postretirement plan and other disclosure requirements of SFAS No. 158 are effective for fiscal years ending after December 15, 2006. Adoption of SFAS No. 158 by the company on December 31, 2006 will result in the recognition of a material charge in the ending balance of accumulated other comprehensive income. This charge will have no effect on the company's net income, liquidity, cash flows, or financial ratio covenants in the company's credit agreements and debt securities.

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In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," (SAB 108). SAB 108 requires companies to evaluate the materiality of identified unadjusted errors on each financial statement and related financial statement disclosure using both the rollover approach and the iron curtain approach. The rollover approach quantifies misstatements based on the amount of the error in the current year financial statement whereas the iron curtain approach quantifies misstatements based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement's year(s) of origin. Financial statements would require adjustment when either approach results in quantifying a misstatement that is material. Correcting prior year financial statements for immaterial errors would not require previously filed reports to be amended. SAB 108 is effective for interim periods of the first fiscal year ending after November 15, 2006. The company is currently evaluating what effect, if any, adoption of SAB 108 will have on the company's consolidated results of operations and financial position.

In September 2006, the Emerging Issues Task Force (EITF) of the FASB, reached a consensus on Issue 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements," (EITF 06-4). EITF 06-4 requires that, for split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods, an employer should recognize a liability for future benefits in accordance with SFAS No. 106. EITF 06-4 is effective for fiscal years beginning after December 15, 2007 and it requires that recognition of the effects of adoption should be either by (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The company is currently evaluating what effect, if any, adoption of EITF 06-4 will have on the company's consolidated results of operations and financial position.

In September 2006, the EITF reached a consensus on Issue 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4," (EITF 06-5). EITF 06-5 requires that a policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract on a policy by policy basis. EITF 06-5 is effective for fiscal years beginning after December 15, 2006 and it requires that recognition of the effects of adoption should be either by (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The company is currently evaluating what effect, if any, adoption of EITF 06-5 will have on the company's consolidated results of operations and financial position.

Financial condition

Cash and cash equivalents at September 30, 2006 were $612.0 million compared with $642.5 at December 31, 2005.

During the nine months ended September 30, 2006, cash used for operations was $138.7 million compared with cash provided of $22.5 million for the nine months ended September 30, 2005. The current-year period includes $112.5 million, which represents the final payment from NUL relating to the 2005 grant of a perpetual license to certain of the company's intellectual property. The prior-year period included a tax refund of approximately $39 million. Also contributing to the reduction in operating cash flow was a reduction in the amount of receivables sold in the company's U.S. securitization. At September 30, 2006 and December 31, 2005, receivables of $120 million and $225 million, respectively, were sold under the facility and therefore were removed from the accompanying consolidated balance sheets. Cash expenditures in the current period related to the current year and prior-year restructuring actions (which are included in operating activities) were approximately $110.2 million compared with $49.0 million for the prior-year period. Cash expenditures for the current-year and the prior-year restructuring actions are expected to be approximately $88 million for the remainder of 2006, resulting in an expected cash expenditure of approximately $198 million in 2006 compared with $57.8 million in 2005.

Cash provided by investing activities for the nine months ended September 30, 2006 was $179.4 million compared with $258.7 million of cash used during the nine months ended September 30, 2005. The principal reason for the increase in cash provided was that the company received net proceeds of $380.6 million from the sale of the NUL shares and other assets. Net purchases of investments were $2.9 million for the nine months ended September 30, 2006 compared with net proceeds of $12.7 million in the prior-year period. Proceeds from investments and purchases of investments represent derivative financial instruments used to manage the company's currency exposure to market risks from changes in foreign

currency exchange rates. In addition, in the current period, the investment in marketable software was $81.2 million compared with $93.7 million in the year-ago period, capital additions of properties were $48.2 million in 2006 compared with $84.9 million in 2005 and capital additions of outsourcing assets were $68.9 million in 2006 compared with $115.7 million in 2005.

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Cash used for financing activities during the nine months ended September 30, 2006 was $78.9 million compared with $57.9 million of cash provided during the nine months ended September 30, 2005. The current period includes a cash expenditure of $57.9 million to retire at maturity all of the company's remaining 8-1/8% senior notes. The prior period includes the following: (a) $541.5 million net proceeds from the September 2005 issuances of $400 million 8% senior notes due 2012 and $150 million 8-1/2% senior notes due 2015, (b) the cash expenditure of $349.2 million (including tender premium and expenses of $9.4 million) for the repayment of $339.8 million of the company's $400 million 8-1/8% senior notes due 2006 pursuant to a September 2005 tender offer by the company, and (c) the cash expenditure of $150.0 million to retire at maturity all of the company's 7-1/4% senior notes.

At September 30, 2006, total debt was $1.05 billion, a decrease of $75.3 million from December 31, 2005.

The company has various lending and funding arrangements as follows:

The company has a three-year, secured revolving credit facility which expires in 2009 that provides for loans and letters of credit up to an aggregate of $275 million. Borrowings under the facility bear interest based on short-term rates and the company's credit rating. The credit agreement contains customary representations and warranties, including no material adverse change in the company's business, results of operations or financial condition. It also contains financial covenants requiring the company to maintain certain interest coverage, leverage and asset coverage ratios and a minimum amount of liquidity, which could reduce the amount the company is able to borrow. The credit facility also includes covenants limiting liens, mergers, asset sales, dividends and the incurrence of debt. Events of default include non-payment, failure to perform covenants, materially incorrect representations and warranties, change of control and default under other debt aggregating at least $25 million. If an event of default were to occur under the credit agreement, the lenders would be entitled to declare all amounts borrowed under it immediately due and payable. The occurrence of an event of default under the credit agreement could also cause the acceleration of obligations under certain other agreements and the termination of the company's U.S. trade accounts receivable facility, discussed below. The credit facility is secured by the company's assets, except that the collateral does not include accounts receivable that are subject to the receivable facility, U.S. real estate or the stock or indebtedness of the company's U.S. operating subsidiaries. As of September 30, 2006, there were letters of credit of $35.9 million issued under the facility and there were no cash borrowings.

In addition, the company and certain international subsidiaries have access to uncommitted lines of credit from various banks. Other sources of short-term funding are operational cash flows, including customer prepayments, and the company's U.S. trade accounts receivable facility.

Under the accounts receivable facility, the company has agreed to sell, on an on-going basis, through Unisys Funding Corporation I, a wholly owned subsidiary, interests in up to $300 million of eligible U.S. trade accounts receivable. The receivables are sold at a discount that reflects a margin based on, among other things, the company's then-current S&P and Moody's credit rating. The facility is terminable by the purchasers if the company's corporate rating is below B by

S&P or B2 by Moody's and requires the maintenance of certain ratios related to the sold receivables. At September 30, 2006, the company's corporate rating was B+ and B2 by S&P and Moody's, respectively. The facility is renewable annually at the purchasers' option until November 2008.

At September 30, 2006, the company has met all covenants and conditions under its various lending and funding agreements. The company expects to continue to meet these covenants and conditions. The company believes that it will have adequate sources and availability of short-term funding to meet its expected cash requirements.

The company may, from time to time, redeem, tender for, or repurchase its securities in the open market or in privately negotiated transactions depending upon availability, market conditions and other factors.

The company has on file with the Securities and Exchange Commission a registration statement covering $650 million of debt or equity securities, which enables the company to be prepared for future market opportunities.

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Stockholders' equity increased $1,160.8 million during the nine months ended September 30, 2006, principally reflecting the reversal of the minimum pension liability adjustment of $1,446.0 million for the U.S. qualified defined benefit pension plan, offset in part by the net loss of $300.0 million.

Factors that may affect future results

From time to time, the company provides information containing "forward-looking" statements, as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements provide current expectations of future events and include any statement that does not directly relate to any historical or current fact. Words such as "anticipates," "believes," "expects," "intends," "plans," "projects" and similar expressions may identify such forward-looking statements. All forward-looking statements rely on assumptions and are subject to risks, uncertainties and other factors that could cause the company's actual results to differ materially from expectations. Factors that could affect future results include, but are not limited to, those discussed below. Any forward-looking statement speaks only as of the date on which that statement is made. The company assumes no obligation to update any forward-looking statement to reflect events or circumstances that occur after the date on which the statement is made.

Statements in this report regarding the company's cost reduction plan are subject to the risk that the company may not implement the planned headcount reductions or increase its offshore resources as quickly as currently planned, which could affect the timing of anticipated cost savings. The amount of anticipated cost savings is also subject to currency exchange rate fluctuations with regard to actions taken outside the U.S. Statements in this report regarding the revenue increases anticipated from the new iPSL tariff arrangements are based on assumptions regarding iPSL processing volumes and costs over the 2006-2010 time-frame. Because these volumes and costs are subject to change, the amount of anticipated revenue is not guaranteed. In addition, because iPSL is paid by its customers in British pounds, the U.S. dollar amount of revenue recognized by the company is subject to currency exchange rate fluctuations.

Other factors that could affect future results include the following:

The company's business is affected by changes in general economic and business conditions. The company continues to face a highly competitive business

environment. If the level of demand for the company's products and services declines in the future, the company's business could be adversely affected. The company's business could also be affected by acts of war, terrorism or natural disasters. Current world tensions could escalate, and this could have unpredictable consequences on the world economy and on the company's business.

The information services and technology markets in which the company operates include a large number of companies vying for customers and market share both domestically and internationally. The company's competitors include consulting and other professional services firms, systems integrators, outsourcing providers, infrastructure services providers, computer hardware manufacturers and software providers. Some of the company's competitors may develop competing products and services that offer better price-performance or that reach the market in advance of the company's offerings. Some competitors also have or may develop greater financial and other resources than the company, with enhanced ability to compete for market share, in some instances through significant economic incentives to secure contracts. Some also may be better able to compete for skilled professionals. Any of these factors could have an adverse effect on the company's business. Future results will depend on the company's ability to mitigate the effects of aggressive competition on revenues, pricing and margins and on the company's ability to attract and retain talented people.

The company operates in a highly volatile industry characterized by rapid technological change, evolving technology standards, short product life cycles and continually changing customer demand patterns. Future success will depend in part on the company's ability to anticipate and respond to these market trends and to design, develop, introduce, deliver or obtain new and innovative products and services on a timely and cost-effective basis. The company may not be successful in anticipating or responding to changes in technology, industry standards or customer preferences, and the market may not demand or accept its services and product offerings. In addition, products and services developed by competitors may make the company's offerings less competitive.

Future results will also depend in part on the success of the company's focused investment and sales and marketing strategies. These strategies are based on various assumptions, including assumptions regarding market segment growth, client demand, and the proper skill set of and training for sales and marketing management and personnel, all of which are subject to change.

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The company's future results will depend in part on its ability to grow outsourcing and infrastructure services. The company's outsourcing contracts are multiyear engagements under which the company takes over management of a client's technology operations, business processes or networks. In a number of these arrangements, the company hires certain of its clients' employees and may become responsible for the related employee obligations, such as pension and severance commitments. In addition, system development activity on outsourcing contracts may require the company to make significant upfront investments. The company will need to have available sufficient financial resources in order to take on these obligations and make these investments.

Recoverability of outsourcing assets is dependent on various factors, including the timely completion and ultimate cost of the outsourcing solution, and realization of expected profitability of existing outsourcing contracts. These risks could result in an impairment of a portion of the associated assets, which are tested for recoverability quarterly.

As long-term relationships, outsourcing contracts provide a base of recurring revenue. However, outsourcing contracts are highly complex and can involve the design, development, implementation and operation of new solutions and the transitioning of clients from their existing business processes to the new

environment. In the early phases of these contracts, gross margins may be lower than in later years when an integrated solution has been implemented, the duplicate costs of transitioning from the old to the new system have been eliminated and the work force and facilities have been rationalized for efficient operations. Future results will depend on the company's ability to effectively and timely complete these implementations, transitions and rationalizations. Future results will also depend on the company's ability to effectively address its challenging outsourcing operations through negotiations or operationally and to fully recover the associated outsourcing assets.

Future results will also depend in part on the company's ability to drive profitable growth in consulting and systems integration. The company's ability to grow profitably in this business will depend on the level of demand for systems integration projects. It will also depend on an improvement in the utilization of services delivery personnel. In addition, profit margins in this business are largely a function of the rates the company is able to charge for services and the chargeability of its professionals. If the company is unable to attain sufficient rates and chargeability for its professionals, profit margins will suffer. The rates the company is able to charge for services are affected by a number of factors, including clients' perception of the company's ability to add value through its services; introduction of new services or products by the company or its competitors; pricing policies of competitors; and general economic conditions. Chargeability is also affected by a number of factors, including the company's ability to transition employees from completed projects to new engagements, and its ability to forecast demand for services and thereby maintain an appropriate head count.

Future results will also depend, in part, on an improvement in the company's technology business. This will require, in part, an increase in market demand for the company's high-end enterprise servers and customer acceptance of the new models announced in the second quarter of 2006. In its technology business, the company continues to focus its resources on enhancing a common high-performance platform for both its proprietary operating environments and open standards-based operating environments such as Microsoft Windows and Linux. In addition, the company continues to apply its resources to develop value-added software capabilities and optimized solutions for these server platforms which provide competitive differentiation. Future results will depend, in part, on customer acceptance of new ClearPath systems and the company's ability to maintain its installed base for ClearPath and to develop next-generation ClearPath products that are purchased by the installed base. In addition, future results will depend, in part, on the company's ability to generate new customers and increase sales of the Intel-based ES7000 line. The company believes there is significant growth potential in the developing market for high-end, Intel-based servers running Microsoft and Linux operating system software. However, the company's ability to succeed will depend on its ability to compete effectively against enterprise server competitors with more substantial resources and its ability to achieve market acceptance of the ES7000 technology by clients, systems integrators and independent software vendors. Future results of the technology business will also depend, in part, on the successful implementation of the company's new arrangements with NEC.

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The company frequently enters into contracts with governmental entities. U.S. government agencies, including the Defense Contract Audit Agency and the Department of Labor, routinely audit government contractors. These agencies review a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. The U.S. government also may review the adequacy of, and a contractor's compliance with, its systems and policies, including the contractor's purchasing, property, estimating, accounting, compensation and management information systems. Any costs found to be overcharged or improperly allocated to a specific contract will be subject to

reimbursement to the government. If an audit uncovers improper or illegal activities, the company may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. government. Other risks and uncertainties associated with government contracts include the availability of appropriated funds and contractual provisions that allow governmental entities to terminate agreements at their discretion before the end of their terms. In addition, if the company's performance is unacceptable to the customer under a government contract, the government retains the right to pursue remedies under the affected contract, which remedies could include termination.

A number of the company's long-term contracts for infrastructure services, outsourcing, help desk and similar services do not provide for minimum transaction volumes. As a result, revenue levels are not guaranteed. In addition, some of these contracts may permit customer termination or may impose other penalties if the company does not meet the performance levels specified in the contracts.

Some of the company's systems integration contracts are fixed-price contracts under which the company assumes the risk for delivery of the contracted services and products at an agreed-upon fixed price. At times the company has experienced problems in performing some of these fixed-price contracts on a profitable basis and has provided periodically for adjustments to the estimated cost to complete them. Future results will depend on the company's ability to perform these services contracts profitably.

The success of the company's business is dependent on strong, long-term client relationships and on its reputation for responsiveness and quality. As a result, if a client is not satisfied with the company's services or products, its reputation could be damaged and its business adversely affected. In addition, if the company fails to meet its contractual obligations, it could be subject to legal liability, which could adversely affect its business, operating results and financial condition.

The company has commercial relationships with suppliers, channel partners and other parties that have complementary products, services or skills. The company has announced that alliance partnerships with select IT companies are a key factor in the development and delivery of the company's refocused portfolio. Future results will depend, in part, on the performance and capabilities of these third parties, on the ability of external suppliers to deliver components at reasonable prices and in a timely manner, and on the financial condition of, and the company's relationship with, distributors and other indirect channel partners.

More than half of the company's total revenue derives from international operations. The risks of doing business internationally include foreign currency exchange rate fluctuations, changes in political or economic conditions, trade protection measures, import or export licensing requirements, multiple and possibly overlapping and conflicting tax laws, new tax legislation, and weaker intellectual property protections in some jurisdictions.

The company cannot be sure that its services and products do not infringe on the intellectual property rights of third parties, and it may have infringement claims asserted against it or against its clients. These claims could cost the company money, prevent it from offering some services or products, or damage its reputation.

Item 4. Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2006. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective for gathering, analyzing and disclosing the information the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms. Such evaluation did not identify any change in the Company's internal controls over financial reporting that occurred during the quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II - OTHER INFORMATION

Item 1A. Risk Factors

See "Factors that may affect future results" in Management's Discussion and Analysis of Financial Condition and Results of Operations for a discussion of risk factors.

Item 5. Other Information

See note (b) of the notes to consolidated financial statements for information on the restructuring charge taken in the third quarter of 2006.

Effective October 26, 2006, Randall J. Hogan has resigned from the company's Board of Directors.

Item 6. Exhibits

(a) Exhibits

See Exhibit Index

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

UNISYS CORPORATION

Date: October 26, 2006

By: /s/ Janet Brutschea Haugen

Janet Brutschea Haugen
Senior Vice President and

Chief Financial Officer
(Principal Financial Officer)

By: /s/ Joseph M. Munnelly

Joseph M. Munnelly
Vice President and
Corporate Controller
(Chief Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description
3.1	Restated Certificate of Incorporation of Unisys Corporation (incorporated by reference to Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999)
3.2	Bylaws of Unisys Corporation, as amended through December 1, 2005 (incorporated by reference to Exhibit 3 to the registrant's Current Report on Form 8-K dated December 1, 2005)
12	Statement of Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Joseph W. McGrath required by Rule 13a-14(a) or Rule 15d-14(a)
31.2	Certification of Janet Brutschea Haugen required by Rule 13a-14(a) or Rule 15d-14(a)
32.1	Certification of Joseph W. McGrath required by Rule 13a-14(b) or Rule 15d-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
32.2	Certification of Janet Brutschea Haugen required by Rule 13a-14(b) or Rule 15d-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350