XEROX CORP
Form 10-Q
May 02, 2019

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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: March 31, 2019
o 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 001-04471

XEROX CORPORATION
(Exact Name of Registrant as specified in its charter)

New York (State or other jurisdiction of incorporation or organization)		16-0468020 (IRS Employer Identification No.)
P.O. Box 4505, 201 Merritt 7 Norwalk, Connecticut 06851-1056 (Address of principal executive offices)		(203) 968-3000 (Registrant’s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:		
Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, $1 par value	XRX	New York Stock Exchange Chicago Stock Exchange
Securities registered pursuant to Section 12(g) of the Act:	None	

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 o
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o	Non-accelerated filer	o	Smaller reporting company	o	Emerging growth company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

Class	Outstanding at April 30, 2019
Common Stock, $1 par value	224,626,584 shares

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q and any exhibits to this Report contain “forward-looking statements” as defined in the Private Securities Litigation Reform Act of 1995. The words “anticipate”, “believe”, “estimate”, “expect”, “intend”, “will”, “should”, "targeting", "projecting", "driving" and similar expressions, as they relate to us, our performance and/or our technology, are intended to identify forward-looking statements. These statements reflect management’s current beliefs, assumptions and expectations and are subject to a number of factors that may cause actual results to differ materially. Such factors include but are not limited to: our ability to address our business challenges in order to reverse revenue declines, reduce costs and increase productivity so that we can invest in and grow our business; our ability to attract and retain key personnel; changes in economic and political conditions, trade protection measures, licensing requirements and tax laws in the United States and in the foreign countries in which we do business; the imposition of new or incremental trade protection measures such as tariffs and import or export restrictions; changes in foreign currency exchange rates; our ability to successfully develop new products, technologies and service offerings and to protect our intellectual property rights; the risk that multi-year contracts with governmental entities could be terminated prior to the end of the contract term and that civil or criminal penalties and administrative sanctions could be imposed on us if we fail to comply with the terms of such contracts and applicable law; the risk that partners, subcontractors and software vendors will not perform in a timely, quality manner; actions of competitors and our ability to promptly and effectively react to changing technologies and customer expectations; our ability to obtain adequate pricing for our products and services and to maintain and improve cost efficiency of operations, including savings from restructuring actions; the risk that confidential and/or individually identifiable information of ours, our customers, clients and employees could be inadvertently disclosed or disclosed as a result of a breach of our security systems due to cyber attacks or other intentional acts; reliance on third parties, including subcontractors, for manufacturing of products and provision of services; the exit of the United Kingdom from the European Union; our ability to manage changes in the printing environment and expand equipment placements; interest rates, cost of borrowing and access to credit markets; funding requirements associated with our employee pension and retiree health benefit plans; the risk that our operations and products may not comply with applicable worldwide regulatory requirements, particularly environmental regulations and directives and anti-corruption laws; the outcome of litigation and regulatory proceedings to which we may be a party; any potential termination or restructuring of our relationship with Fujifilm Holdings Corporation; the proposed holding company reorganization; the occurrence and timing of any closing of the proposed holding company reorganization; the shared services arrangements entered into by the Company as part of Project Own It; any potential strategic transaction involving our customer financing business and/or related assets; and other factors that are set forth in the “Risk Factors” section, the “Legal Proceedings” section, the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section and other sections of this Quarterly Report on Form 10-Q and our 2018 Annual Report on Form 10-K, as well as our Current Reports on Form 8-K filed with the Securities and Exchange Commission (SEC). Our forward-looking statements are also subject to the factors and other information set forth in the “Summary of the Holding Company Reorganization Proposal” section, the “Risk Factors” section and the “Proposal 1 - Approval of the Holding Company Reorganization” section of our definitive Joint Proxy Statement/Prospectus dated April 22, 2019 filed on Schedule 14A with the SEC. These forward-looking statements speak only as of the date of this report or as of the date to which they refer, and Xerox assumes no obligation to update any forward looking statements as a result of new information or future events or developments, except as required by law.

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For additional information about Xerox Corporation and access to our Annual Reports to Shareholders and SEC filings, free of charge, please visit our website at www.xerox.com/investor. Any information on or linked from the website is not incorporated by reference into this Form 10-Q.

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PART I — FINANCIAL INFORMATION
ITEM 1 — FINANCIAL STATEMENTS

XEROX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended March 31,	
(in millions, except per-share data)	2019	2018
Revenues		
Sales[1]	$750	$845
Services, maintenance and rentals[1]	1,393	1,519
Financing	63	71
Total Revenues	2,206	2,435
Costs and Expenses		
Cost of sales[1]	464	532
Cost of services, maintenance and rentals[1]	821	899
Cost of financing	32	34
Research, development and engineering expenses	92	100
Selling, administrative and general expenses	548	628
Restructuring and related costs	112	28
Amortization of intangible assets	15	12
Transaction and related costs, net	—	38
Other expenses, net	39	30
Total Costs and Expenses	2,123	2,301
Income before Income Taxes and Equity Income	83	134
Income tax (benefit) expense	(8)	40
Equity in net income (loss) of unconsolidated affiliates	45	(68)
Net Income	136	26
Less: Net income attributable to noncontrolling interests	3	3
Net Income Attributable to Xerox	$133	$23
Basic Earnings per Share	$0.57	$0.08
Diluted Earnings per Share	$0.55	$0.08

(1) Certain prior year amounts have been conformed to the current year presentation. Refer to Note 1 - Basis of Presentation for additional information.

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

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XEROX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended March 31,	
(in millions)	2019	2018
Net Income	$136	$26
Less: Net income attributable to noncontrolling interests	3	3
Net Income Attributable to Xerox	133	23
Other Comprehensive Income, Net[(1)]		
Translation adjustments, net	37	176
Unrealized gains, net	2	17
Changes in defined benefit plans, net	1	18
Other Comprehensive Income, Net Attributable to Xerox	40	211
Comprehensive Income, Net	176	237
Less: Comprehensive income, net attributable to noncontrolling interests	3	3
Comprehensive Income, Net Attributable to Xerox	$173	$234

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(1) Refer to Note 18 - Other Comprehensive Income for gross components of Other Comprehensive Income, reclassification adjustments out of Accumulated Other Comprehensive Loss and related tax effects.

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

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XEROX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in millions, except share data in thousands)	March 31, 2019	December 31, 2018
Assets		
Cash and cash equivalents	$ 723	$ 1,084
Accounts receivable, net	1,234	1,276
Billed portion of finance receivables, net	102	105
Finance receivables, net	1,191	1,218
Inventories	859	818
Other current assets	204	194
Total current assets	4,313	4,695
Finance receivables due after one year, net	2,080	2,149
Equipment on operating leases, net	414	442
Land, buildings and equipment, net	469	499
Investments in affiliates, at equity	1,452	1,403
Intangible assets, net	208	220
Goodwill	3,889	3,867
Deferred tax assets	753	740
Other long-term assets	1,221	859
Total Assets	$ 14,799	$ 14,874
Liabilities and Equity		
Short-term debt and current portion of long-term debt	$ 555	$ 961
Accounts payable	1,054	1,091
Accrued compensation and benefits costs	298	349
Accrued expenses and other current liabilities	1,022	850
Total current liabilities	2,929	3,251
Long-term debt	4,268	4,269
Pension and other benefit liabilities	1,481	1,482
Post-retirement medical benefits	348	350
Other long-term liabilities	496	269
Total Liabilities	9,522	9,621
Commitments and Contingencies (See Note 20)		
Convertible Preferred Stock	214	214
Common stock	230	232
Additional paid-in capital	3,282	3,321
Treasury stock, at cost	(103)	(55)
Retained earnings	5,270	5,072
Accumulated other comprehensive loss	(3,652)	(3,565)
Xerox shareholders' equity	5,027	5,005
Noncontrolling interests	36	34
Total Equity	5,063	5,039
Total Liabilities and Equity	$ 14,799	$ 14,874
Shares of common stock issued	229,732	231,690
Treasury stock	(3,321)	(2,067)

Shares of Common Stock Outstanding	226,411	229,623

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

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XEROX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three Months Ended March 31,	
(in millions)	2019	2018
Cash Flows from Operating Activities		
Net income	$136	$26
Adjustments required to reconcile Net income to Cash flows from operating activities		
Depreciation and amortization	118	138
Provisions	22	17
Net gain on sales of businesses and assets	(1)	(16)
Undistributed equity in net income of unconsolidated affiliates	(42)	68
Stock-based compensation	15	16
Restructuring and asset impairment charges	54	28
Payments for restructurings	(33)	(54)
Defined benefit pension cost	36	27
Contributions to defined benefit pension plans	(34)	(38)
Decrease in accounts receivable and billed portion of finance receivables	39	46
Increase in inventories	(50)	(87)
Increase in equipment on operating leases	(30)	(56)
Decrease in finance receivables	81	85
Increase in other current and long-term assets	(2)	(17)
(Decrease) increase in accounts payable	(34)	44
Decrease in accrued compensation	(73)	(32)
Increase in other current and long-term liabilities	46	1
Net change in income tax assets and liabilities	(21)	13
Net change in derivative assets and liabilities	8	(6)
Other operating, net	(9)	13
Net cash provided by operating activities	226	216
Cash Flows from Investing Activities		
Cost of additions to land, buildings, equipment and software	(15)	(18)
Proceeds from sale of businesses and assets	1	16
Acquisitions, net of cash acquired	(4)	—
Net cash used in investing activities	(18)	(2)
Cash Flows from Financing Activities		
Net proceeds (payments) on short-term debt	2	(1)
Proceeds from issuance of long-term debt	2	2
Payments on long-term debt	(406)	(38)
Dividends	(62)	(67)
Payments to acquire treasury stock, including fees	(103)	—
Other financing, net	(2)	(13)
Net cash used in financing activities	(569)	(117)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(1)	9
(Decrease) increase in cash, cash equivalents and restricted cash	(362)	106
Cash, cash equivalents and restricted cash at beginning of period	1,148	1,368
Cash, Cash Equivalents and Restricted Cash at End of Period	$786	$1,474

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

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XEROX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(in millions, except per-share data and where otherwise noted)

Note 1 – Basis of Presentation

References herein to “we,” “us,” “our,” the “company” and “Xerox” refer to Xerox Corporation and its consolidated subsidiaries unless the context suggests otherwise.

We have prepared the accompanying unaudited Condensed Consolidated Financial Statements in accordance with the accounting policies described in our 2018 Annual Report on Form 10-K ("2018 Annual Report") except as noted herein, and the interim reporting requirements of Form 10-Q. Accordingly, certain information and note disclosures normally included in our annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. You should read these Condensed Consolidated Financial Statements in conjunction with the Consolidated Financial Statements included in our 2018 Annual Report.

In our opinion, all adjustments, which are necessary for a fair statement of financial position, operating results and cash flows for the interim periods presented, have been made. These adjustments consist of normal recurring items. Interim results of operations are not necessarily indicative of the results of the full year.

For convenience and ease of reference, we refer to the financial statement caption “Income before Income Taxes and Equity Income” as “pre-tax income.”

Corporate Reorganization

On March 6, 2019, the Xerox Board of Directors approved a reorganization (the “Reorganization”) of the Company's corporate structure into a holding company structure, pursuant to which Xerox Corporation will become a direct, wholly-owned subsidiary of a new holding company. The purpose of the Reorganization is to provide the Company with strategic, operational and financial flexibility. The business operations, directors and executive officers of the Company will not change as a result of the Reorganization.

The Reorganization is intended to be implemented via a tax-free transaction for U.S. federal income tax purposes that will result in each holder of Xerox Corporation’s common stock owning the same number of shares of common stock in the new holding company and each holder of Xerox Corporation’s preferred stock owning the same number of shares of preferred stock in the new holding company. It is expected that the directors and executive officers of Xerox Corporation will also serve in the same capacities for the new holding company and that shares of the new holding company’s common stock will trade on the New York Stock Exchange under Xerox Corporation’s current ticker symbol “XRX.”

The Reorganization is subject to the approval of shareholders, who will be asked to vote on the Reorganization at the annual shareholders meeting scheduled to be held on May 21, 2019, as well as regulatory approval and other customary conditions and is expected to be implemented in mid-2019, though there can be no assurance as to its completion or timing. Upon the completion of the Reorganization, it is anticipated that the new holding company will become a guarantor of Xerox Corporation's existing Credit Facility.

Shared Services Arrangement with HCL Technologies

In March 2019, as part of Project Own It, we entered into a shared services arrangement with HCL Technologies (HCL) pursuant to which we are outsourcing certain global administrative and support functions, including, among others, selected information technology and finance functions (excluding accounting). The transition of these functions to HCL is expected to take up to 18 months. HCL is expected to make certain up-front and ongoing investments in software, tools and other technology to consolidate, optimize and automate the transferred functions with the goal of providing improved service levels and significant cost savings. The shared services arrangement with HCL includes a total aggregate spending commitment by us of approximately $1.3 billion over the next 7 years. However, we can terminate the arrangement at any time at our discretion, subject to payment of termination fees that decline over the term or for cause. The spending commitment excludes restructuring and related costs we are expected to incur in connection with the transition of the contemplated functions - refer to Note 11 - Restructuring Programs for additional information. The shared services arrangement with HCL is subject to compliance with European works council and employment regulatory requirements.

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Change in Presentation

During first quarter 2019, we realigned portions of our business to support our new revenue strategy. This realignment included the combination and consolidation of certain sales units to better service customers consistently across the company. In connection with that realignment, we changed the classification of revenues and related costs from certain service arrangements to consistently conform the presentation of those amounts among our various business units. Prior year amounts were also revised as follows to conform to the 2019 presentation.

	March 31, 2018		
	As Reported	Change	As Revised
Sales	$933	$ (88)	$ 845
Services, maintenance and rentals	1,431	88	1,519
Cost of sales	$563	$ (31)	$ 532
Cost of services, maintenance and rentals	868	31	899

The revised presentation does not impact Total Revenues, Total Costs and Expenses or Net Income.

Note 2 – Recent Accounting Pronouncements

Accounting Standard Updates to be Adopted:

Financial Instruments - Credit Losses

In June 2016, the FASB issued ASU 2016-13, Financial Instruments Credit Losses - Measurement of Credit Losses on Financial Instruments, with additional updates being issued in 2018. This update requires measurement and recognition of expected credit losses for financial assets. The update impacts financial assets and net investment in leases that are not accounted for at fair value through Net Income. This update is effective for our fiscal year beginning January 1, 2020. We are currently evaluating the impact of the adoption of ASU 2016-13 on our Condensed Consolidated Financial Statements.

Intangibles - Internal-Use Software

In August 2018, the FASB issued ASU 2018-15, Intangibles - Goodwill and Other - Internal Use Software (Subtopic 350-40), Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract. This update aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The update provides criteria for determining which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The capitalized implementation costs are required to be expensed over the term of the hosting arrangement. The update also clarifies the presentation requirements for reporting such costs in the entity's financial statements. This update is effective for our fiscal year beginning January 1, 2020. We are currently evaluating the impact of the adoption of ASU 2018-15 on our Condensed Consolidated Financial Statements.

Accounting Standard Updates Adopted in 2019:

Leases

On January 1, 2019, we adopted ASU 2016-02, Leases (ASC Topic 842). This update, as well as additional amendments and targeted improvements issued in 2018 and early 2019, supersedes existing lease accounting guidance found under ASC 840, Leases ("ASC 840") and requires the recognition of right-to-use assets and lease obligations by lessees for those leases originally classified as operating leases under prior lease guidance. Effective with the adoption, leases are classified as either finance or operating, with classification affecting the pattern of expense recognition. Short term leases with a term of 12 months or less are not required to be recognized. The update also requires qualitative and quantitative disclosure of key information regarding the amount, timing and uncertainty of cash flows arising from leasing arrangements to increase transparency and comparability among companies. The accounting for lessors does not fundamentally change with this update except for changes to conform and align guidance to the lessee guidance, as well as to the revenue recognition guidance in ASU 2014-09. Some of these conforming changes, such as those related to the definition of lease term and minimum lease payments, resulted in certain lease arrangements, that would have been previously accounted for as operating leases, to be classified and accounted for as sales-type leases with a corresponding up-front recognition of equipment sales revenue.

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Upon adoption we applied the transition option, whereby prior comparative periods are not retrospectively presented in the Condensed Consolidated Financial Statements. We also elected the package of practical expedients not to reassess prior conclusions related to contracts containing leases, lease classification and initial direct costs and the lessee practical expedient to combine lease and non-lease components for certain asset classes (real estate lease arrangements for offices and warehouses). Additionally, we made a policy election to not recognize right-of-use assets and lease liabilities for short-term leases for all asset classes. We elected the package of practical expedients from both the Lessee and Lessor prospective, to the extent applicable.

Lessee accounting - the adoption of this update resulted in an increase to assets and related liabilities of approximately $385 (approximately $440 undiscounted) primarily related to leases of facilities. Lessor accounting - the adoption of this update resulted in an increase to equipment sales by approximately $3 in 2019 as compared to 2018.

Refer to Note 3 - Adoption of New Leasing Standard - Xerox as a Lessee and Note 4 - Adoption of New Leasing Standard - Xerox as a Lessor for additional transitional disclosures related to the adoption of this standard.

Financial Instruments - Derivatives

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The amendments in this update expand and refine hedge accounting for both financial and non-financial risk components, align the recognition and presentation of the effects of hedging instruments with the same income statement line item that the hedged item is reported and include certain targeted improvements to ease the application of current guidance related to the assessment of hedge effectiveness. We adopted ASU 2017-12 effective for our fiscal year beginning January 1, 2019, and it did not have a material impact on our financial condition, results of operations or cash flows.

Income Taxes

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. We adopted ASU 2018-02 effective for our fiscal year beginning January 1, 2019 and upon adoption reclassified $127 from Accumulated other comprehensive loss (AOCL) to Retained earnings related to the stranded tax effects resulting from the Tax Cuts and Jobs Act ("Tax Act") enacted in December 2017. The reclassification was primarily related to the stranded tax effects associated with amounts in AOCL from our retirement-related benefit plans. Accordingly, the adoption of this update eliminated the stranded tax effects resulting from the Tax Act. However, because the update only relates to the reclassification of the income tax effects of the Tax Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in Income from continuing operations is not affected.

Other Updates

In 2018, the FASB also issued the following Accounting Standards Updates, which did not have or are not expected to have a material impact on our financial condition, results of operations or cash flows upon adoption. Those updates are as follows:

- Collaborative Arrangements: ASU 2018-18, (Topic 808) Clarifying the Interaction between Topic 808 and Topic 606. This update is effective for our fiscal year beginning January 1, 2020, early adoption is permitted.
- Compensation - Retirement Benefits - Defined Benefit Plans - General: ASU 2018-14, (Topic 715-20) Changes to the Disclosure Requirements for Defined Benefit Plans. This update is effective for our fiscal year beginning January 1, 2020, early adoption is permitted.
- Fair Value Measurement: ASU 2018-13, (Topic 820) Disclosure Framework. This update is effective for our fiscal year beginning January 1, 2020, early adoption is permitted.
- Investments - Debt Securities and Regulated Operations: ASU 2018-04, (Topics 320 and 980) Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273 (SEC Update).

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Note 3 – Adoption of New Leasing Standard - Xerox as a Lessee
Refer to Note 2 - Recent Accounting Pronouncements - Leases, for additional information related to the adoption of ASU 2016-02, Leases (ASC Topic 842).
Lessee Summary:
We determine at inception whether an arrangement is a lease. Our leases do not include assets of a specialized nature, nor the transfer of ownership at the end of the lease, and the exercise of end-of-lease purchase options, which are primarily in our equipment leases, is not reasonably assured at lease inception. Accordingly, the two primary criteria we use to classify transactions as operating or finance leases are: (i) a review of the lease term to determine if it is equal to or greater than 75% of the economic life of the asset, and (ii) a review of the present value of the minimum lease payments to determine if they are equal to or greater than 90% of the fair market value of the asset at the inception of the lease. Right-of-use ("ROU") assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. We also assess arrangements for goods or services to determine if the arrangement contains a lease at its inception. This assessment first considers whether there is an implicitly or explicitly identified asset in the arrangement and then whether there is a right to control the use of the asset. If there is an embedded lease within a contract, the company determines the classification of the lease at the lease inception date consistent with standalone leases of assets.
Operating leases are included in Other long-term assets, Accrued expenses and other current liabilities, and Other long-term liabilities in our Condensed Consolidated Balance Sheets. Finance leases are included in Land, buildings and equipment, net, Accrued expenses and other current liabilities, and Other long-term liabilities in our Condensed Consolidated Balance Sheets.
Operating lease ROU assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. Since the implicit rate for most of our leases is not readily determinable, we use our incremental borrowing rate based on the information available at the commencement date in determining the present value of lease payments. The incremental borrowing rate is the rate of interest that we would have to pay to borrow, on a collateralized basis, an amount equal to the lease payments, in a similar economic environment and over a similar term. The rate is dependent on several factors, including the lease term and currency of the lease payments. Lease terms used to calculate the present value of lease payments generally do not include any options to extend, renew, or terminate the lease, as we do not have reasonable certainty at lease inception that these options will be exercised. We generally consider the economic life of our operating lease ROU assets to be comparable to the useful life of similar owned assets. We have elected the short-term lease exception, therefore operating lease ROU assets and liabilities do not include leases with a lease term of twelve months or less. Our leases generally do not provide a residual guarantee. The operating lease ROU asset also excludes lease incentives.
Lease expense is recognized on a straight-line basis over the lease term. We have lease agreements with lease and non-lease components. These components are accounted for separately for vehicle and equipment leases. We account for the lease and non-lease components as a single lease component for real estate leases of offices and warehouses.
We review the impairment of our ROU assets consistent with the approach applied for our other long-lived assets. We review the recoverability of our long-lived assets when events or changes in circumstances occur that indicate that the carrying value of the asset may not be recoverable. The assessment of possible impairment is based on our ability to recover the carrying value of the asset from the expected undiscounted future pre-tax cash flows of the related operations. We have elected to include the carrying amount of operating lease liabilities in any tested asset group and include the associated operating lease payments in the undiscounted future pre-tax cash flows.
Operating Leases
We have operating leases for real estate and vehicles in our domestic and international operations and for certain equipment in our domestic operations. Additionally, we have identified embedded operating leases within certain supply chain contracts for warehouses, primarily within our domestic operations. Our leases have remaining terms of up to ten years and a variety of renewal and/or termination options. The components of lease expense are as follows:

Three
Months

	Ended March 31, 2019
Operating lease expense	$ 33
Short-term lease expense	5
Variable lease expense[(1)]	13
Total Lease expense	$ 51

(1) Variable lease expense is related to our leased real estate for offices and warehouses and primarily includes labor and operational costs as well as taxes and insurance.

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Operating leases ROU assets, net and operating lease liabilities were reported in the Condensed Consolidated Balance Sheets as follows:

	March 31, 2019
Other long-term assets	$ 341
Accrued expenses and other current liabilities	$ 97
Other long-term liabilities	265
Total Operating lease liabilities	$ 362

Supplemental information related to operating leases is as follows:

	March 31, 2019
Cash paid for amounts included in the measurement of lease liabilities - Operating cash flows	$ 32
Right-of-use assets obtained in exchange for new lease liabilities (1)	$ 9
Weighted-average remaining lease term	4 years
Weighted-average discount rate	5.64 %

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(1) Includes the impact of new leases as well as remeasurements and modifications to existing leases.

Maturities and additional information related to operating lease liabilities are as follows:

	March 31, 2019
2019(1)	$ 92
2020	101
2021	77
2022	63
2023	47
Thereafter	28
Total Lease payments	408
Less: Imputed interest	46
Total Operating lease liabilities	$ 362

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(1) Represents the future minimum operating lease payments expected to be made over the remaining balance of the year.

Finance Leases

Xerox has one finance lease for equipment and related infrastructure within an outsourced warehouse supply arrangement in the U.S. The lease expires in December 2023 and has a remaining lease obligation of $8 as of March 31, 2019 using a discount rate of 4.07%.

Prior Period Disclosures under ASC 840

For the years ended December 31, 2018 and 2017, operating lease rent expense, net of sublease income, were $147 and $161, respectively.

Future minimum operating lease commitments that have initial or remaining non-cancelable lease terms in excess of one year at December 31, 2018 were as follows:

	December 31, 2018
2019	$ 114
2020	88
2021	64
2022	50
2023	36
Thereafter	27
Total Operating lease commitments	$ 379

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Note 4 – Adoption of New Leasing Standard - Xerox as a Lessor
Refer to Note 2 - Recent Accounting Pronouncements - Leases, for additional information related to the adoption of ASU 2016-02, Leases (ASC Topic 842).
Lessor Summary:
The following represent updated disclosures to our Revenue Recognition policies as a result of the adoption of ASC Topic 842.
Bundled Lease Arrangements: A portion of our direct sales of equipment to end customers are made through bundled lease arrangements which typically include equipment, services (maintenance and managed services) and financing components where the customer pays a single negotiated fixed minimum monthly payment for all elements over the contractual lease term. These arrangements also typically include an incremental, variable component for page volumes in excess of the contractual page volume minimums, which are often expressed in terms of price-per-image or page. Revenues under these bundled lease arrangements are allocated considering the relative standalone selling prices of the lease and non-lease deliverables included in the bundled arrangement. Lease deliverables include the equipment and financing, while the non-lease deliverables generally consist of the services, which include supplies. Consistent with the guidance in ASC 842 and ASC 606, regarding the allocation of fixed and variable consideration, we only consider the fixed payments for purposes of allocation to the lease elements of the contract. The fixed minimum monthly payments are multiplied by the number of months in the contract term to arrive at the total fixed lease payments that the customer is obligated to make over the lease term. Amounts allocated to the equipment and financing elements are then subjected to the accounting estimates noted below under Leases to ensure the values reflect standalone selling prices.
The remainder of any fixed payments, as well as the variable payments, are allocated to non-lease elements because the variable consideration for incremental page volume or usage is considered attributable to the delivery of those elements. The consideration for the non-lease elements is not dependent on the consideration for equipment and vice versa and the consideration for the equipment and services is priced at the appropriate standalone values; therefore, the relative standalone selling price allocation method is not necessary. The revenue associated with the non-lease elements are normally accounted for as a single performance obligation being delivered in a series with delivery being measured as the usage billed to the customer. Accordingly, revenue from these agreements is recognized in a manner consistent with the guidance for Maintenance and Services agreements.
Leases: The two primary accounting provisions we use to classify transactions as sales-type or operating leases are: (i) a review of the lease term to determine if it is for the major part of the economic life of the underlying equipment (defined as greater than 75%); and (ii) a review of the present value of the lease payments to determine if they are equal to or greater than substantially all of the fair market value of the equipment at the inception of the lease (defined as greater than 90%). Equipment placements included in arrangements meeting these conditions are accounted for as sales-type leases and revenue is recognized in a manner consistent with Equipment. Equipment placements included in arrangements that do not meet these conditions are accounted for as operating leases and revenue is recognized over the term of the lease.
We consider the economic life of most of our products to be five years, since this represents the most frequent contractual lease term for our principal products and only a small percentage of our leases are for original terms longer than five years. There is no significant after-market for our used equipment. We believe five years is representative of the period during which the equipment is expected to be economically usable, with normal service, for the purpose for which it is intended.
We perform an analysis of the stand-alone selling price of equipment based on cash selling prices during the applicable period. The cash selling prices are compared to the range of values determined for our leases. The range of cash selling prices must be reasonably consistent with the lease selling prices in order for us to determine that such lease prices reflects stand-alone value.
Our lease pricing interest rates, which are used in determining customer payments in a bundled lease arrangement, are developed based upon a variety of factors including local prevailing rates in the marketplace and the customer's credit history, industry and credit class. We reassess our pricing interest rates quarterly based on changes in the local

prevailing rates in the marketplace. The pricing interest rates generally equal the implicit rates within the leases, as corroborated by our comparisons of cash to lease selling prices noted above.

Additional Lease Payments: Certain leases may require the customer to pay property taxes and insurance on the equipment. In these instances, the amounts for property taxes and insurance that we invoice to customers and pay to third parties are considered variable payments and are recorded as other revenues and other cost of revenues,

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respectively. Amounts related to property taxes and insurance are not material. We exclude from variable payments all lessor costs that are explicitly required to be paid directly by a lessee on behalf of the lessor to a third party.
Presentation: Revenue from sales-type leases is presented on a gross basis when the company enters into a lease to realize value from a product that it would otherwise sell in its ordinary course of business, whereas in transactions where the company enters into a lease for the purpose of generating revenue by providing financing, the profit or loss, if any, is presented on a net basis. In addition, we have elected to account for sales tax and other similar taxes collected from a lessee as lessee costs and therefore we exclude these costs from contract consideration and variable consideration and present revenue net of these costs.
The components of lease income is as follows:

	Three Months Ended March 31,	
	2019	2018
Lease income - sales type	$134	$160
Interest income on lease receivables	63	71
Lease income - operating leases	134	141
Variable lease income	27	30
Total Lease income	$358	$402

Note 5 – Revenue
Revenues disaggregated by primary geographic markets, major product lines, and sales channels are as follows:

	Three Months Ended March 31,	
	2019	2018
Primary geographical markets[1]:		
United States	$1,294	$