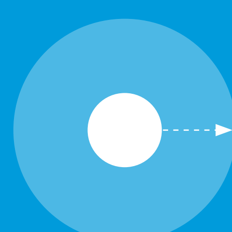
Financial Overview

	2010	2009
Total revenue	$21,633	$15,179
Equipment sales	3,857	3,550
Annuity revenue	17,776	11,629
Net income – Xerox	606	485
Adjusted net income* – Xerox	1,296	613
Diluted earnings per share	0.43	0.55
Adjusted earnings per share*	0.94	0.70
Net cash provided by operating activities	2,726	2,208
Adjusted operating margin*	9.6%	8.6%

* See Page 7 for the reconciliation of the difference between this financial measure that is not in compliance with Generally Accepted Accounting Principles (GAAP) and the most directly comparable financial measure calculated in accordance with GAAP.

With ACS, we now serve a $500 Billion market.



$150+ billion
Business Process Outsourcing

$130 billion
Traditional Technology-driven Market

$250 billion
Information Technology Outsourcing

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the results of operations and financial condition of Xerox Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying notes.

Throughout this document, references to "we," "our," the "Company" and "Xerox" refer to Xerox Corporation and its subsidiaries. References to "Xerox Corporation" refer to the stand-alone parent company and do not include its subsidiaries.

Executive Overview

We are a $22 billion leading global enterprise for business process and document management. We provide the industry's broadest portfolio of document systems and services for businesses of any size. This includes printers, multifunction devices, production publishing systems, managed print services ("MPS") and related software. We also offer financing, service and supplies, as part of our document technology offerings. In 2010, we acquired Affiliated Computer Services, Inc. ("ACS"). Through ACS we offer extensive business process outsourcing and information technology outsourcing services, including data processing, HR benefits management, finance support and customer relationship management services for commercial and government organizations worldwide. We operate in a market that is estimated to be $500 billion. We have 136,500 employees and serve customers in more than 160 countries. Approximately 36% of our revenue is generated from customers outside the U.S.

We organize our business around two segments: Technology and Services.

- Our Technology segment comprises our business of providing customers with document technology and related supplies, technical service and equipment financing. Our product categories within this segment include Entry, Mid-range and High-End products.
- Our Services segment is comprised of our business process outsourcing, information technology outsourcing and document outsourcing services. Because we participate in all three of these lines of business, we are uniquely positioned in the industry, and we believe this allows us to provide a differentiated solution and deliver greater value to our customers.

The fundamentals of our business rest upon an annuity model that drives significant recurring revenue and cash generation. Over 80% of our 2010 total revenue was annuity-based revenue that includes contracted services, equipment maintenance and consumable supplies, among other elements. Some of the key indicators of annuity revenue growth include:

- The number of page-producing machines-in-the-field ("MIF"), which is impacted by equipment installations
- Page volume and the mix of color pages, as color pages generate more revenue per page than black-and-white
- Services signings growth, which reflects the year-over-year increase in estimated future revenues from contracts signed during the period as measured on a trailing12-month basis
- Services pipeline growth, which measures the year-over-year increase in new business opportunities

Subsequent to the acquisition of ACS, we acquired three additional service companies, further expanding our BPO capabilities:

- In July 2010, we acquired ExcellerateHRO, LLP ("EHRO"), a global benefits administration and relocation services provider
- In October 2010, we acquired TMS Health ("TMS"), a U.S.-based teleservices company that provides customer care services to the pharmaceutical, biotech and healthcare industries
- In November 2010, we acquired Spur Information Solutions ("Spur"), one of the United Kingdom's leading providers of computer software used for parking enforcement

Additionally, in 2010 we acquired two companies to further expand our distribution capacity:

- In January 2010, we acquired Irish Business Systems Limited ("IBS") to expand our reach into the small and mid-size business market in Ireland
- In September 2010, we acquired Georgia Duplicating Products ("Georgia"), an office equipment supplier

Financial Overview

During 2010, despite the continued economic weakness, we began to see improvement in our markets. Results remained strong in our developing markets countries as well as in the small to mid-size business market. We began to see increased demand and usage activity in large enterprise customers, particularly in the fourth quarter 2010. We closed 2010 with strong revenue growth, operating margin expansion and excellent cash generation, reflecting the strength of our business model and the benefits of our expanded technology and service offerings.

The following is a summary of key 2010 highlights:

- Exceeded on earnings and cash generation commitments
- Strong services performance, realizing benefits from the ACS acquisition
- Technology revenue and activity growth; innovative products launched in key segments
- Disciplined cost and expense management yielding operating margin improvement

We completed the acquisition of ACS on February 5, 2010, and its results subsequent to that date are included in our results. Total revenue of $21.6 billion in 2010 increased 43% from the prior year, primarily as a result of the ACS acquisition. Currency had a negligible impact on 2010 total revenues. In order to provide a clearer comparison of our results to the prior year, we are also providing a discussion and analysis on a pro-forma basis, where we include ACS's 2009 estimated results from February 6 through December 31 in our historical 2009 results(1). On a pro-forma(1) basis, total revenue increased 3% in 2010, including a negligible impact from currency.

2010 Annuity Revenue(2) increased 53% from the prior year, or 1% on a pro-forma(1) basis. Currency had a 1-percentage point unfavorable impact on pro-forma annuity revenue. 2010 Equipment Revenue increased 9% from the prior year, including a 1-percentage point negative impact from currency.

Net income attributable to Xerox for 2010 was $606 million and included $690 million of after-tax costs and expenses related to restructuring, intangibles amortization, acquisition-related costs and other discrete and unusual items. Net income attributable to Xerox for 2009 was $485 million and included $128 million of similar after-tax costs and expenses.

Cash flow from operations was $2.7 billion for 2010, primarily as a result of increased earnings and working capital cash generation. Cash used in investing activities of $2.2 billion primarily reflects the net cash consideration of $1.5 billion for the ACS acquisition. Cash used in financing activities was $3.1 billion, primarily reflecting the repayment of ACS's debt of $1.7 billion as well as net payments on other debt during 2010, including the early redemption of $660 million of debt.

Our 2011 priorities include:

- Strengthening our leadership in Technology through competitively advantaged products and increased distribution
- Accelerating our services business – capture significant BPO opportunity and continue improvements in ITO and document outsourcing
- Continued cost and expense discipline to enable operating margin expansion
- Driving cash flow, reducing debt and returning cash to shareholders

Our 2011 balance sheet and cash flow strategy includes: sustaining our working capital improvements; continued reductions in non-financing debt; leveraging of our financing assets (finance receivables and equipment on operating leases); achieving an optimal cost of capital; and effectively deploying cash to maximize shareholder value through share repurchase, acquisitions and dividends.

In addition, as a result of providing lease equipment financing to our customers, we expect to continue to make investments in lease contracts (finance receivables and equipment on operating leases). Since we maintain a certain level of debt to support this investment, we expect to continue to leverage this investment in 2011 (see "Customer Financing Activities" for additional information).

(1) The pro-forma information included within this MD&A is different from the pro-forma information provided in Note 3 – Acquisitions. The pro-forma information included in Note 3 presents the combined results for 2010 and 2009 as if the acquisition was completed January 1st of each respective year. See the "Non-GAAP Financial Measures" section for a further explanation and discussion of this non-GAAP measure.

(2) Annuity revenue = Service, outsourcing and rentals + Supplies, paper and other sales + Finance income.

Currency Impacts

To understand the trends in our business, we believe that it is helpful to analyze the impact of changes in the translation of foreign currencies into U.S. Dollars on revenues and expenses. We refer to this analysis as "currency impact" or "the impact from currency." This impact is calculated by translating current-period activity in local currency using the comparable prior-year period's currency translation rate. This impact is calculated for all countries where the functional currency is the local-country currency. Revenues and expenses from our developing market countries (Latin America, Brazil, the Middle East, India, Eurasia and Central-Eastern Europe) are analyzed at actual exchange rates for all periods presented, since these countries generally have unpredictable currency and inflationary environments, and our operations in these countries have historically implemented pricing actions to recover the impact of inflation and devaluation. We do not hedge the translation effect of revenues or expenses denominated in currencies where the local currency is the functional currency.

Approximately 36% of our consolidated revenues are derived from operations outside of the United States where the U.S. Dollar is not the functional currency. When compared with the average of the major European currencies and Canadian Dollar on a revenue-weighted basis, the U.S. Dollar was 2% stronger in 2010 and 7% stronger in 2009, each compared to the prior year. As a result, the foreign currency translation impact on revenue was negligible in 2010 and a 3% detriment in 2009.

Refer to the "Gross Margin" section for additional information regarding the impact of currency on our product costs.

Summary Results

Revenue

Revenues for the three years ended December 31, 2010 were as follows:

(in millions)	Revenues 2010	Revenues 2009	Revenues 2008	Percent Change 2010	Percent Change 2009	Pro-forma[3] Change 2010	Percent of Total Revenue 2010	Percent of Total Revenue 2009	Percent of Total Revenue 2008
Revenue:									
Equipment sales	$ 3,857	$ 3,550	$ 4,679	9%	(24)%	9%	18%	24%	26%
Supplies, paper and other	3,377	3,096	3,646	9%	(15)%	4%	15%	20%	21%
Sales	7,234	6,646	8,325	9%	(20)%	7%	33%	44%	47%
Service, outsourcing and rentals	13,739	7,820	8,485	76%	(8)%	1%	64%	51%	48%
Finance income	660	713	798	(7)%	(11)%	(7)%	3%	5%	5%
Total Revenues	**$21,633**	$15,179	$ 17,608	**43%**	(14)%	**3%**	**100%**	100%	100%
Segments:									
Technology	$ 10,349	$ 10,067	$ 11,714	3%	(14)%	3%	48%	66%	66%
Services	9,637	3,476	3,828	177%	(9)%	3%	44%	23%	22%
Other	1,647	1,636	2,066	1%	(21)%	1%	8%	11%	12%
Total Revenues	**$21,633**	$15,179	$ 17,608	**43%**	(14)%	**3%**	**100%**	100%	100%
Memo:									
Annuity Revenue [1]	$ 17,776	$ 11,629	$ 12,929	53%	(10)%	1%	82%	77%	73%
Color [2]	$ 6,397	$ 5,972	$ 6,669	7%	(10)%	7%	30%	39%	38%

Revenue 2010

Total revenues increased 43% compared to the prior year. Our consolidated 2010 results include ACS results subsequent to February 5, 2010, the effective date of the acquisition. On a pro-forma[3] basis, total revenue grew 3%. Currency had a negligible impact on total revenues during 2010. Total revenues included the following:

- 53% increase in annuity revenue[1], or 1% on a pro-forma[3] basis, with a 1-percentage point negative impact from currency. The components of annuity revenue were as follows:
  - Service, outsourcing and rentals revenue of $13,739 million increased 76%, or 1% on a pro-forma[3] basis, and included a negligible impact from currency. The increase was driven by Business Process Outsourcing ("BPO") revenue that partially offset the declines in technical service revenue which were driven by a continued but stabilizing decline in pages. Total digital pages declined 4%, while color pages increased 9%. During 2010 digital MIF increased by 1% and color MIF increased by 15%.
  - Supplies, paper and other sales of $3,377 million increased 9%, or 4% on a pro-forma[3] basis, with a 1-percentage point negative impact from currency. Growth in supplies revenues was partially offset by a decline in paper sales.
- 9% increase in equipment sales revenue, including a 1-percentage point negative impact from currency. Growth in install activity was partially offset by price declines of approximately 5% and mix.
- 7% increase in color revenue[2], including a 1-percentage point negative impact from currency reflecting:
  - 5% increase in color annuity revenue, including a 1-percentage point negative impact from currency. The increase was driven by higher printer supplies sales and higher page volumes.
  - 12% increase in color equipment sales revenue, including a 2-percentage point negative impact from currency. The increase was driven by higher installs of new products.
  - 9% growth in color pages[4]. Color pages[4] represented 23% of total pages in 2010, while color MIF represented 31% of total MIF.

Revenue 2009

- Revenue decreased 14% compared to the prior year, including a 3-percentage point negative impact from currency. Although moderating in the fourth quarter 2009, worldwide economic weakness negatively impacted our major market segments during the year. Total revenues included the following:

- 10% decrease in annuity revenue[1] including a 3-percentage point negative impact from currency. The components of the annuity revenue decreased as follows:
  - 8% decrease in service, outsourcing and rentals revenue to $7,820 million, reflecting a 3-percentage point negative impact from currency and an overall decline in page volume. Total digital pages declined 6% despite an increase in color pages of 10%. Additionally, during 2009 digital MIF increased by 2% and color MIF increased by 21%.
  - Supplies, paper and other sales of $3,096 million decreased 15% due primarily to currency, which had a 2-percentage point negative impact, and declines in channel supplies purchases, including lower purchases within developing markets, and lower paper sales.
- 24% decrease in equipment sales revenue, including a 1-percentage point negative impact from currency. The overall decline in install activity was the primary driver, along with price declines of approximately 5%.
- 10% decrease in color revenue[2] including a 2-percentage point negative impact from currency reflecting:
  - 5% decrease in color annuity revenue including a 3-percentage point negative impact from currency. The decline was partially driven by lower channel color printer supplies purchases. Color represented 40% and 37% of annuity revenue in 2009 and 2008, respectively.
  - 22% decrease in color equipment sales revenue including a 2-percentage point negative impact from currency and lower installs driven by the impact of the economic environment. Color sales represented 53% and 50% of total equipment sales in 2009 and 2008, respectively.
  - 10% growth in color pages[4]. Color pages[4] represented 21% and 18% of total pages in 2009 and 2008, respectively.

Net Income

Net income and diluted earnings per share, as well as the adjustments to net income[5] for the three years ended December 31, 2010, were as follows:

	2010		2009		2008	
(in millions, except per-share amounts)	Net Income	EPS	Net Income	EPS	Net Income	EPS
As Reported	$ 606	$ 0.43	$ 485	$ 0.55	$ 230	$ 0.26
Adjustments:						
Xerox and Fuji Xerox restructuring charges	355	0.26	41	0.05	308	0.34
Acquisition-related costs	58	0.04	49	0.06	—	—
Amortization of intangible assets	194	0.14	38	0.04	35	0.04
ACS shareholders' litigation settlement	36	0.03	—	—	—	—
Venezuela devaluation costs	21	0.02	—	—	—	—
Medicare subsidy tax law change	16	0.01	—	—	—	—
Provision for litigation matters	—	—	—	—	491	0.54
Equipment write-off	—	—	—	—	24	0.03
Loss on early extinguishment of debt	10	0.01	—	—	—	—
Settlement of unrecognized tax benefits	—	—	—	—	(41)	(0.05)
As Adjusted[5]	**$1,296**	**$ 0.94**	$ 613	$ 0.70	$1,047	$ 1.16
Weighted average shares for reported EPS		1,351		880		895
Weighted average shares for adjusted EPS		1,378		880		897

Average shares for the calculation of adjusted EPS for 2010 of 1,378 million include a pro-rata portion of 27 million shares associated with the Series A convertible preferred stock and therefore the 2010 dividends of $21 million are excluded. In addition, average shares for the calculation of adjusted EPS for both 2010 and 2008 include 2 million shares associated with other convertible securities. We evaluate the dilutive effect of our convertible securities on an "if-converted" basis. Refer to Note 20 – Earnings Per Share in the Consolidated Financial Statements for additional information.

(1) Annuity revenue equals Service, outsourcing and rentals plus Supplies, paper and other sales plus Finance income.
(2) Color revenues represent a subset of total revenue and exclude the impact of GIS's revenues.
(3) Growth on a pro-forma basis reflects the inclusion of ACS's adjusted results from February 6 through December 31, 2009. Refer to the "Non-GAAP Financial Measures" section for an explanation of this non-GAAP financial measure.
(4) Pages include estimates for developing markets, GIS and printers.
(5) Refer to the "Non-GAAP Financial Measures" section for an explanation of this non-GAAP financial measure.

Application of Critical Accounting Policies

In preparing our Consolidated Financial Statements and accounting for the underlying transactions and balances, we apply various accounting policies. Senior management has discussed the development and selection of the critical accounting policies, estimates and related disclosures included herein with the Audit Committee of the Board of Directors. We consider the policies discussed below as critical to understanding our Consolidated Financial Statements, as their application places the most significant demands on management's judgment, since financial reporting results rely on estimates of the effects of matters that are inherently uncertain. In instances where different estimates could have reasonably been used, we disclosed the impact of these different estimates on our operations. In certain instances, like revenue recognition for leases, the accounting rules are prescriptive; therefore, it would not have been possible to reasonably use different estimates. Changes in assumptions and estimates are reflected in the period in which they occur. The impact of such changes could be material to our results of operations and financial condition in any quarterly or annual period.

Specific risks associated with these critical accounting policies are discussed throughout the MD&A, where such policies affect our reported and expected financial results. For a detailed discussion of the application of these and other accounting policies, refer to Note 1 – Summary of Significant Accounting Policies in the Consolidated Financial Statements.

Revenue Recognition for Leases

Our accounting for leases involves specific determinations under applicable lease accounting standards. These determinations affect the timing of revenue recognition for our equipment. If a lease qualifies as a sales-type capital lease, equipment revenue is recognized as sale revenue upon delivery or installation of the equipment as opposed to ratably over the lease term. The critical elements that we consider with respect to our lease accounting are the determination of the economic life and the fair value of equipment, including the residual value. For purposes of determining the economic life, we consider the most objective measure to be the original contract term, since most equipment is returned by lessees at or near the end of the contracted term. The economic life of most of our products is 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.

Revenue Recognition for Bundled Lease Arrangements

We sell our products and services under bundled lease arrangements, which typically include equipment, service, supplies and financing components for which the customer pays a single negotiated monthly fixed price for all elements over the contractual lease term. Approximately 40% of our equipment sales revenue is related to sales made under bundled lease arrangements. Typically these arrangements include an incremental, variable component for page volumes in excess of contractual page volume minimums, which are often expressed in terms of price per page. Revenues under these arrangements are allocated, considering the relative fair values of the lease and non-lease deliverables included in the bundled arrangement, based upon the estimated fair values of each element. Lease deliverables include maintenance and executory costs, equipment and financing, while non-lease deliverables generally consist of supplies and non-maintenance services. The allocation for lease deliverables begins by allocating revenues to the maintenance and executory costs plus profit thereon. These elements are generally recognized over the term of the lease as services revenue. The remaining amounts are allocated to the equipment and financing elements, which are subjected to the accounting estimates noted above under "Revenue Recognition for Leases." We perform analyses of available verifiable objective evidence of equipment fair value based on cash selling prices during the applicable period. The cash selling prices are compared to the range of values included in our lease accounting systems. The range of cash selling prices must be reasonably consistent with the lease selling prices, taking into account residual values, in order for us to determine that such lease prices are indicative of fair value.

Our pricing interest rates, which are used in determining customer payments, 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. These interest rates have generally been adjusted if the rates vary by twenty-five basis points or more, cumulatively, from the last rate in effect. The pricing interest rates generally equal the implicit rates within the leases, as corroborated by our comparisons of cash to lease selling prices.

Revenue Recognition for Services – Percentage-of-Completion

A significant portion of our services revenue is recognized based on objective criteria that do not require significant estimates or uncertainties. For example, transaction volume, time and materials and cost-reimbursable arrangements are based on specific, objective criteria under the contracts. Accordingly, revenues recognized under these contracts do not require the use of significant estimates that are susceptible to change. However, revenue recognized using the percentage-of-completion accounting method does require the use of estimates and judgment as discussed below. During 2010, we recognized approximately $270 million of revenue using the percentage-of-completion accounting method.

Revenues on certain fixed-price contracts where we provide information technology system development and implementation services are recognized using the percentage-of-completion approach. Revenue is recognized over the contract term based on the percentage of development and implementation services that are provided during the period compared with the total estimated development and implementation services to be provided over the entire contract. These contracts require that we perform significant, extensive and complex design, development, modification and implementation activities for our clients' systems. Performance will often extend over long periods, and our right to receive future payment depends on our future performance in accordance with the agreement.

The percentage-of-completion methodology involves recognizing probable and reasonably estimable revenue using the percentage of services completed, on a current cumulative cost to estimated total cost basis, using a reasonably consistent profit margin over the period. Due to the longer-term nature of these projects, developing the estimates of costs often requires significant judgment. Factors that must be considered in estimating the progress of work completed and ultimate cost of the projects include, but are not limited to, the availability of labor and labor productivity, the nature and complexity of the work to be performed and the impact of delayed performance. If changes occur in delivery, productivity or other factors used in developing the estimates of costs or revenues, we revise our cost and revenue estimates, which may result in increases or decreases in revenues and costs. Such revisions are reflected in income in the period in which the facts that give rise to that revision become known. If at any time these estimates indicate the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately in cost. We perform ongoing profitability analyses of our services contracts in order to determine whether the latest estimates require updating.

Allowance for Doubtful Accounts and Credit Losses

We perform ongoing credit evaluations of our customers and adjust credit limits based upon customer payment history and current creditworthiness. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience adjusted for current conditions. We cannot guarantee that we will continue to experience credit loss rates similar to those we have experienced in the past.

Measurement of such losses requires consideration of historical loss experience, including the need to adjust for current conditions, and judgments about the probable effects of relevant observable data, including present economic conditions such as delinquency rates and financial health of specific customers. We recorded bad debt provisions of $188 million, $291 million and $188 million in SAG expenses in our Consolidated Statements of Income for the years ended December 31, 2010, 2009 and 2008, respectively.

Historically, the majority of the bad debt provision related to our finance receivables portfolio. This provision is inherently more difficult to estimate than the provision for trade accounts receivable because the underlying lease portfolio has an average maturity, at any time, of approximately two to three years and contains past due billed amounts, as well as unbilled amounts. The estimated credit quality of any given customer and class of customer or geographic location can significantly change during the life of the portfolio. We consider all available information in our quarterly assessments of the adequacy of the provision for doubtful accounts.

Bad debt provisions decreased by $103 million in 2010 and reserves as a percentage of trade and finance receivables decreased to 3.3% at December 31, 2010 as compared to 4.1% at December 31, 2009 and 3.4% at December 31, 2008. The decline in 2010 reflects the improving trend in write-offs over the past year as well as the acquisition of ACS. We continue to assess our receivable portfolio in light of the current economic environment and its impact on our estimation of the adequacy of the allowance for doubtful accounts. Refer to Note 4 – Receivables in the Consolidated Financial Statements for additional information.

As discussed above, in preparing our Consolidated Financial Statements for the three years ended December 31, 2010, we estimated our provision for doubtful accounts based on historical experience and customer-specific collection issues. This methodology was consistently applied for all periods presented. During the five-year period ended December 31, 2010, our reserve for doubtful accounts ranged from 3.0% to 4.1% of gross receivables. Holding all assumptions constant, a 1-percentage point increase or decrease in the reserve from the December 31, 2010 rate of 3.3% would change the 2010 provision by approximately $98 million.

Pension and Retiree Health Benefit Plan Assumptions

We sponsor defined benefit pension plans in various forms in several countries covering employees who meet eligibility requirements. Retiree health benefit plans cover U.S. and Canadian employees for retirement medical costs. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense, liability and asset values related to our pension and retiree health benefit plans. These factors include assumptions we make about the discount rate, expected return on plan assets, rate of increase in healthcare costs, the rate of future compensation increases and mortality. Differences between these assumptions and actual experiences are reported as net actuarial gains and losses and are subject to amortization to net periodic benefit cost generally over the average remaining service lives of the employees participating in the plans.

Cumulative actuarial losses for our defined benefit pension plans of $1.9 billion as of December 31, 2010 were essentially unchanged from December 31, 2009. Positive returns on plan assets in 2010 as compared to expected returns offset a decrease in discount rates. The total actuarial loss will be amortized over future periods, subject to offsetting gains or losses that will impact the future amortization amounts.

We used a weighted average expected rate of return on plan assets of 7.3% for 2010, 7.4% for 2009 and 7.6% for 2008, on a worldwide basis. During 2010, the actual return on plan assets was $846 million, reflecting an improvement in the equity markets during the year. When estimating the 2011 expected rate of return, in addition to assessing recent performance, we considered the historical returns earned on plan assets, the rates of return expected in the future and our investment strategy and asset mix with respect to the plans' funds. The weighted average expected rate of return on plan assets we will use in 2011 is 7.2%.

For purposes of determining the expected return on plan assets, we use a calculated value approach to determine the value of the pension plan assets, rather than a fair market value approach. The primary difference between these two methods relates to a systematic recognition of changes in fair value over time (generally two years) versus immediate recognition of changes in fair value. Our expected rate of return on plan assets is applied to the calculated asset value to determine the amount of the expected return on plan assets to be used in the determination of the net periodic pension cost. The calculated value approach reduces the volatility in net periodic pension cost that can result from using the fair market value approach. The difference between the actual return on plan assets and the expected return on plan assets is added to, or subtracted from, any cumulative differences from prior years. This amount is a component of the net actuarial gain or loss.

Another significant assumption affecting our pension and retiree health benefit obligations and the net periodic benefit cost is the rate that we use to discount our future anticipated benefit obligations. The discount rate reflects the current rate at which the benefit liabilities could be effectively settled considering the timing of expected payments for plan participants. In estimating this rate, we consider rates of return on high-quality fixed-income investments included in published bond indices, adjusted to eliminate the effects of call provisions and differences in the timing and amounts of cash outflows related to the bonds. In the U.S. and the U.K., which comprise approximately 75% of our projected benefit obligations, we consider the Moody's Aa Corporate Bond Index and the International Index Company's iBoxx Sterling Corporate AA Cash Bond Index, respectively, in the determination of the appropriate discount rate assumptions. The weighted average discount rate we used to measure our pension obligations as of December 31, 2010 and to calculate our 2011 expense was 5.2%, which is lower than 5.7% that was used to calculate our 2010 expense. The weighted average discount rate we used to measure our retiree health obligation as of December 31, 2010 and to calculate our 2011 expense was 4.9%, which is lower than 5.4% that was used to calculate our 2010 expense.

On a consolidated basis, we recognized net periodic pension cost of $355 million, $270 million and $254 million for the years ended December 31, 2010, 2009 and 2008, respectively. The costs associated with our defined contribution plans, which are included in net periodic pension cost, were $51 million, $38 million and $80 million for the years ended December 31, 2010, 2009 and 2008, respectively. The increase in 2010 was primarily due to our partial resumption of the 401(k) match in the U.S. On a consolidated basis, we recognized net retiree health benefit cost of $32 million, $26 million and $77 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Assuming settlement losses in 2011 are consistent with 2010, our 2011 net periodic defined benefit pension cost is expected to be approximately $30 million lower than 2010, primarily driven by the U.S. as a result of a reduction in the amortization of actuarial losses and an increase in expected asset returns from higher asset values and expected contributions to the plan. Our 2011 retiree health benefit cost is expected to be approximately $17 million lower than 2010, primarily as a result of amendments to the U.S. plan in 2010.

Benefit plan costs are included in several income statement components based on the related underlying employee costs. Pension and retiree health benefit plan assumptions are included in Note 15 – Employee Benefit Plans in the Consolidated Financial Statements. Holding all other assumptions constant, a 0.25% increase or decrease in the discount rate would change the 2011 projected net periodic pension cost by $17 million. Likewise, a 0.25% increase or decrease in the expected return on plan assets would change the 2011 projected net periodic pension cost by $17 million.

Income Taxes and Tax Valuation Allowances

We record the estimated future tax effects of temporary differences between the tax bases of assets and liabilities and amounts reported in our Consolidated Balance Sheets, as well as operating loss and tax credit carryforwards. We follow very specific and detailed guidelines in each tax jurisdiction regarding the recoverability of any tax assets recorded in our Consolidated Balance Sheets and provide valuation allowances as required. We regularly review our deferred tax assets for recoverability considering historical profitability, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. If we continue to operate at a loss in certain jurisdictions or are unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time period within which the underlying temporary differences become taxable or deductible, we could be required to increase the valuation allowance against all or a significant portion of our deferred tax assets resulting in a substantial increase in our effective tax rate and a material adverse impact on our operating results. Conversely, if and when our operations in some jurisdictions become sufficiently profitable to recover previously reserved deferred tax assets, we would reduce all or a portion of the applicable valuation allowance in the period when such determination is made. This would result in an increase to reported earnings in such period. Adjustments to our valuation allowance, through charges (credits) to income tax expense, were $22 million, $(11) million and $17 million for the years ended December 31, 2010, 2009 and 2008, respectively. There were other (decreases) increases to our valuation allowance, including the effects of currency, of $11 million, $55 million and $(136) million for the years ended December 31, 2010, 2009 and 2008, respectively. These did not affect income tax expense in total, as there was a corresponding adjustment to deferred tax assets or other comprehensive income. Gross deferred tax assets of $3.8 billion and $3.7 billion had valuation allowances of $735 million and $672 million at December 31, 2010 and 2009, respectively.

We are subject to ongoing tax examinations and assessments in various jurisdictions. Accordingly, we may incur additional tax expense based upon our assessment of the more-likely-than-not outcomes of such matters. In addition, when applicable, we adjust the previously recorded tax expense to reflect examination results. Our ongoing assessments of the more-likely-than-not outcomes of the examinations and related tax positions require judgment and can materially increase or decrease our effective tax rate, as well as impact our operating results.

We file income tax returns in the U.S. Federal jurisdiction and in various foreign jurisdictions. In the U.S., with the exception of ACS, we are no longer subject to U.S. Federal income tax examinations for years before 2007. ACS is no longer subject to such examination for years before 2004. With respect to our major foreign jurisdictions, we are no longer subject to tax examinations by tax authorities for years before 2000.

Legal Contingencies

We are involved in a variety of claims, lawsuits, investigations and proceedings concerning securities law, intellectual property law, environmental law, employment law and ERISA, as discussed in Note 17 – Contingencies in the Consolidated Financial Statements. We determine whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. We assess our potential liability by analyzing our litigation and regulatory matters using available information. We develop our views on estimated losses in consultation with outside counsel handling our defense in these matters, which involves an analysis of potential results, assuming a combination of litigation and settlement strategies. Should developments in any of these matters cause a change in our determination as to an unfavorable outcome and result in the need to recognize a material accrual, or should any of these matters result in a final adverse judgment or be settled for significant amounts, they could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such change in determination, judgment or settlement occurs.

Business Combinations and Goodwill

The application of the purchase method of accounting for business combinations requires the use of significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration between assets that are depreciated and those that are amortized from goodwill. Our estimates of the fair values of assets and liabilities acquired are based upon assumptions believed to be reasonable, and when appropriate, include assistance from independent third-party appraisal firms.

As a result of our acquisition of ACS, as well as other acquisitions including GIS, we have a significant amount of goodwill. Goodwill is tested for impairment annually or more frequently if an event or circumstance indicates that an impairment loss may have been incurred. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units and determination of the fair value of each reporting unit. We estimate the fair value of each reporting unit using a discounted cash flow methodology. This requires significant judgment including: estimation of future cash flows, which is dependent on internal forecasts; estimation of the long-term rate of growth for our business; the useful life over which cash flows will occur; determination of our weighted average cost of capital for purposes of establishing a discount rate; and consideration of relevant market data.

Our annual impairment test of goodwill is performed in the fourth quarter of each year. The estimated fair values of our reporting units were based on discounted cash flow models derived from internal earnings forecasts and assumptions. The assumptions and estimates used in those valuations considered the current economic environment. In performing our 2010 impairment test, the following were the overall composite assumptions regarding revenue and expense growth, which formed the basis for estimating future cash flows used in the discounted cash flow model: (1) revenue growth 3–5%; (2) gross margin 33–35%; (3) RD&E 3%; (4) SAG 19–20%; and (5) return on sales 10–12%. We believe these assumptions are appropriate because they are consistent with historical results (inclusive of ACS), generally consistent with our forecasted long-term business model and give appropriate consideration to the current economic environment.

Based on these valuations, we determined that the fair values of our reporting units exceeded their carrying values and no goodwill impairment charge was required during the fourth quarter 2010.

Refer to Note 1 – Summary of Significant Accounting Policies – "Goodwill and Intangible Assets" for additional information regarding our goodwill impairment testing, as well as Note 8 – Goodwill and Intangible Assets, Net in the Consolidated Financial Statements for additional information regarding goodwill by operating segment.

Operations Review of Segment Revenue and Operating Profit

Our reportable segments are consistent with how we manage the business and view the markets we serve. Our reportable segments are Technology, Services and Other.

2010 Segment Reporting Change

In 2010, as a result of our acquisition of ACS, we realigned our internal financial reporting structure and began reporting our financial performance based on two primary segments – Technology and Services. The Technology segment represents the combination of our former Production and Office segments excluding the document outsourcing business. The Services segment represents the combination of our document outsourcing business, which includes Xerox's historic business process services, and ACS's business process outsourcing and information technology outsourcing businesses. We believe this realignment improves our view of the expanded markets we now serve and will help us to better manage our business which is primarily centered around equipment systems and outsourcing services. Our Technology segment operations involve the sale and support of a broad range of document systems from entry level to the high-end. Our Services segment operations involve delivery of a broad range of outsourcing services including document, business processing and IT. Our 2009 and 2008 segment disclosures have been restated to reflect our new 2010 internal reporting structure. Refer to Note 2 – Segment Reporting in the Consolidated Financial Statements for further description of these segments.

Revenues by segment for the three years ended December 31, 2010 were as follows:

(in millions)	Total Revenue	Segment Profit (Loss)	Segment Margin
2010			
Technology	$ 10,349	$ 1,085	10.5%
Services	9,637	1,132	11.7%
Other	1,647	(342)	(20.8)%
Total	**$21,633**	**$ 1,875**	**8.7%**
2009			
Technology	$ 10,067	$ 949	9.4%
Services	3,476	231	6.6%
Other	1,636	(342)	(20.9)%
Total	$ 15,179	$ 838	5.5%
2009 Pro-forma[1]			
Technology	$ 10,067	$ 949	9.4%
Services	9,379	1,008	10.7%
Other	1,636	(447)	(27.3)%
Total	$ 21,082	$ 1,510	7.2%
2008			
Technology	$ 11,714	$ 1,288	11.0%
Services	3,828	302	7.9%
Other	2,066	(245)	(11.9)%
Total	$ 17,608	$ 1,345	7.6%

[1] Results include ACS's 2009 estimated results February 6 through December 31. Refer to the "Non-GAAP Financial Measures" section for an explanation of this non-GAAP financial measure.

Technology

Our technology segment includes the sale of document systems and supplies, provision of technical service and financing of products.

	Year Ended December 31,			Percent Change	
(in millions)	2010	2009	2008	2010	2009
Equipment sales	$ 3,404	$ 3,137	$ 4,079	9%	(23)%
Post sale revenue[1]	6,945	6,930	7,635	—%	(9)%
Total Revenue	**$10,349**	$10,067	$ 11,714	**3%**	(14)%

[1] Post sale revenue does not include outsourcing revenue, which is reported in our Services segment.

Revenue 2010

Technology revenue of $10,349 million increased 3%, including a negligible impact from currency and reflected solid install and related equipment revenue growth including the launch of 21 new products in 2010. Total revenues included the following:

- 9% increase in equipment sales revenue, with a 1-percentage point negative impact from currency, driven primarily by install growth across all color product categories.
- Post sale revenue was flat compared to prior year, with a 1-percentage point negative impact from currency, as increased supplies sales were offset by lower service revenues reflecting decreased but stabilizing page volumes.
- Technology revenue mix was 22% Entry, 56% Mid-range and 22% High-end.

Segment Profit 2010

Technology segment profit of $1,085 million increased $136 million from 2009, reflecting an increase in gross profit due to higher revenues and lower bad debt expense, as well as cost and expense savings from restructuring actions.

Installs 2010

Entry

- 46% increase in installs of A4 black-and-white multifunction devices, driven by growth in developing markets and indirect channels.
- 39% increase in installs of A4 color multifunction devices, driven by demand for new products.
- 4% increase in installs of color printers.

Mid-range

- 4% increase in installs of mid-range black-and-white devices.
- 27% increase in installs of mid-range color devices, primarily driven by demand for new products such as the Xerox Color 550/560, WorkCentre® 7545/7556 and WorkCentre® 7120/7700, and the continued strong demand for the ColorQube™.

High-end

- 8% decrease in installs of high-end black-and-white systems, reflecting declines across most product areas.
- 26% increase in installs of high-end color systems, reflecting strong demand for the recently launched Xerox Color 800 and 1000.
- Install activity percentages include installations for document outsourcing and the Xerox-branded product shipments to GIS. Descriptions of "Entry," "Mid-range" and "High-end" can be found in Note 2 – Segment Reporting in the Consolidated Financial Statements.

Revenue 2009

Technology revenue of $10,067 million decreased 14%, including a 3-percentage point negative impact from currency. Total revenue included the following:

- 23% decrease in equipment sales revenue, with a 2-percentage point negative impact from currency. The decline reflects lower installs driven by the weak economic environment during the year and delays in customer spending on technology.
- 9% decrease in post sale revenue, with a 3-percentage point negative impact from currency, reflecting lower page volumes and supplies primarily as a result of the weak economic environment.
- Technology revenue mix was 21% Entry, 56% Mid-range and 23% High-end.

Segment Profit 2009

Technology profit of $949 million decreased $339 million from 2008. The decrease is primarily the result of lower gross profit reflecting decreased revenue partially offset by lower costs and expenses reflecting the benefits from restructuring and favorable currency.

Installs 2009

Entry

- 40% decrease in installs of A4 black-and-white multifunction devices, primarily reflecting lower activity in developing markets.
- 22% decrease in installs of A4 color multifunction devices, driven by lower overall demand.
- 34% decrease in installs of color printers due to lower demand and lower sales to OEM partners.

Mid-range

- 31% decrease in installs of mid-range black-and-white devices.
- 19% decrease in installs of mid-range color devices, driven by lower overall demand which more than offset the impact of new products including the ColorQube and a mid-range version of the Xerox® 700.

High-end

- 29% decrease in installs of high-end black-and-white systems, reflecting declines in all product areas.
- 37% decrease in installs of high-end color systems as entry production color declines were partially offset by increased iGen4 installs.

Services

Our Services segment comprises three service offerings: Business Process Outsourcing ("BPO"), Document Outsourcing ("DO") and Information Technology Outsourcing ("ITO").

Services total revenue and segment profit for the year ended December 31, 2010 increased 177% and 390%, respectively, primarily due to the inclusion of ACS. Since these comparisons are not meaningful, results for the Services segment are primarily discussed on a pro-forma basis, with ACS's 2009 estimated results from February 6 through December 31 included in our historical 2009 results (see "Non-GAAP Financial Measures" section for discussion of this non-GAAP measure).

Revenue 2010

Services revenue of $9,637 million increased 177%, or 3% on a pro-forma(1) basis, including a negligible impact from currency.

- BPO delivered pro-forma(1) revenue growth of 8% and represented 53% of total Services revenue. BPO growth was driven by healthcare services, customer care, transportation solutions, healthcare payer services and 2010 acquisitions.
- DO revenue decreased 3%, including a negligible impact from currency, and represented 34% of total Services revenue. The decrease primarily reflects the continued impact of the weak economy on usage levels and renewal rates.
- ITO revenue was flat on a pro-forma(1) basis and represented 13% of total Services revenue.

Management's Discussion

Segment Profit 2010

Services operating profit of $1,132 million increased $901 million or $124 million on a pro-forma[1] basis from 2009, driven primarily by BPO growth and lower G&A expenses.

Metrics

Pipeline

Our BPO and ITO revenue pipeline including synergy opportunities grew 25% over the fourth quarter 2009. The sales pipeline includes the Total Contract Value ("TCV") of new business opportunities that could potentially be contracted within the next six months and excludes business opportunities with estimated annual recurring revenue in excess of $100 million. The DO sales pipeline grew approximately 17% over the fourth quarter 2009. The DO sales pipeline includes all active deals with $10 million or greater in TCV.

Signings

Signings ("Signings") are defined as estimated future revenues from contracts signed during the period, including renewals of existing contracts. Services signings were an estimated $14.6 billion in TCV in 2010 and increased 13% as compared to the comparable prior-year period. TCV represents estimated total revenue for future contracts for pipeline or signed contracts for signings as applicable.

Signings were as follows:

(in billions)	Year Ended December 31, 2010
BPO	$ 10.0
DO	3.3
ITO	1.3
Total Signings	**$ 14.6**

Signings growth was driven by strong signings in both our BPO and DO businesses. In 2010 we signed significant new business in the following areas:

- Child support payment processing
- Commercial healthcare
- Customer care
- Electronic payment cards
- Enterprise print services
- Government healthcare
- Telecom and hardware services
- Transportation

Revenue 2009

Services revenue of $3,476 million decreased 9% including a 2-percentage point negative impact from currency. Services revenue for 2009 and 2008 primarily reflects revenue from DO services. The decrease in revenue is primarily due to lower usage, primarily in black-and-white devices.

Segment Profit 2009

Services operating profit of $231 million decreased $71 million from 2008. The decrease was primarily due to lower gross profit reflecting a decrease in revenues partially offset by lower cost and expenses reflecting benefits from restructuring and favorable currency.

Other

Revenue 2010

Other revenue of $1,647 million increased 1%, including a negligible impact from currency. Increases in GIS's network integration and electronic presentation systems and Wide Format sales offset a decline in paper sales. Paper comprised approximately 58% of the Other segment revenue.

Segment Loss 2010

Other segment loss of $342 million was flat with 2009, as higher gross profit reflecting an increase in gross margins from the mix of revenues was partially offset by higher interest expense associated with funding for the ACS acquisition.

Revenue 2009

Other revenue of $1,636 million decreased 21%, including a 2-percentage point negative impact from currency, primarily driven by declines in revenue from paper, wide format systems, and licensing and royalty arrangements. Paper comprised approximately, 60% of the Other segment revenue.

Segment Loss 2009

Other operating loss of $342 million increased $97 million from 2008, primarily due to lower revenue, as well as lower interest and equity income.

[1] Refer to the "Non-GAAP Financial Measures" section for an explanation of the Pro-forma non-GAAP financial measure.

Costs, Expenses and Other Income

Gross Margin

Gross margins by revenue classification were as follows:

	Year Ended December 31,			Change		Pro-forma[1] Change
	2010	2009	2008	2010	2009	2010
Sales	34.5 %	33.9 %	33.7 %	0.6 pts	0.2 pts	1.1 pts
Service, outsourcing and rentals	33.1 %	42.6 %	41.9 %	(9.5) pts	0.7 pts	(0.7) pts
Finance income	62.7 %	62.0 %	61.8 %	0.7 pts	0.2 pts	0.7 pts
Total Gross Margin	**34.4%**	39.7 %	38.9 %	**(5.3) pts**	0.8 pts	**(0.2) pts**

Gross Margin 2010

The 2010 total gross margin decreased 5.3-percentage points, and service, outsourcing and rentals gross margin decreased 9.5-percentage points, on an actual basis primarily due to the ACS acquisition. ACS, as a services-based company, had a lower gross margin as compared to a technology-based company, which typified Xerox before the acquisition. Since actual comparisons are not meaningful, gross margins for these two categories are primarily discussed below on a pro-forma basis with ACS's 2009 estimated results from February 6 through December 31 included in our historical 2009 results (see "Non-GAAP Financial Measures" section for a further discussion of this non-GAAP measure).

- Total gross margin decreased 5.3-percentage points or 0.2-percentage points on a pro-forma[1] basis, as compared to 2009. The decline was primarily due to the unfavorable impact of year-over-year transaction currency.
- Sales gross margin increased 0.6-percentage points or 1.1-percentage points on a pro-forma[1] basis, as compared to 2009. Cost improvements and positive mix more than offset a 0.5-percentage point adverse impact from transaction currency and price declines of about 1-percentage point.
- Service, outsourcing and rentals gross margin decreased 9.5-percentage points or 0.7-percentage points on a pro-forma[1] basis, as compared to 2009, as price declines and the higher rate of growth in lower-margin BPO revenue were only partially offset by cost improvements.
- Financing income gross margin of 62.7 % remained comparable to 2009.

Since a large portion of our inventory is procured from Japan, the strengthening of the Yen versus the U.S. Dollar and Euro in 2010 and 2009 has significantly impacted our product costs. In 2010, the Yen strengthened approximately 6 % against the U.S. Dollar and 10 % against the Euro as compared to 2009. In 2009, the Yen strengthened approximately 10 % against the U.S. Dollar and 15 % against the Euro as compared to 2008. We expect product costs and gross margins to continue to be negatively impacted in 2011, particularly in the first half, if Yen exchange rates remain at January 2011 levels.

[1] Refer to the "Non-GAAP Financial Measures" section for an explanation of the Pro-forma non-GAAP financial measure.

Gross Margin 2009

- Total gross margin increased 0.8-percentage points compared to 2008, primarily driven by cost improvements, enabled by restructuring and our cost actions, which were partially offset by the 0.5-percentage point unfavorable impact of transaction currency, primarily the Yen, and price declines of 1.0-percentage point.
- Sales gross margin increased 0.2-percentage points, primarily due to the cost improvements and the positive mix of revenues partially offset by the adverse impact of transaction currency on our inventory purchases of 1.0-percentage point and price declines of 1.2-percentage points.
- Service, outsourcing and rentals margin increased 0.7-percentage points primarily due to the positive impact from the reduction in costs driven by our restructuring and cost actions of 1.5-percentage points. These cost improvements more than offset the approximate 0.9-percentage point impact of pricing.
- Financing income margin of 62 % remained comparable to 2008.

Research, Development and Engineering Expenses ("RD&E")

We invest in technological research and development, particularly in color, software and services. We believe our R&D spending is sufficient to remain technologically competitive. Our R&D is strategically coordinated with that of Fuji Xerox.

	Year Ended December 31,			Change		Pro-forma[1] Change
(in millions)	2010	2009	2008	2010	2009	2010
R&D	$ 653	$ 713	$ 750	$ (60)	$ (37)	$ (60)
Sustaining Engineering	128	127	134	1	(7)	1
Total RD&E Expenses	**$ 781**	$ 840	$ 884	**$ (59)**	$ (44)	**$ (59)**
RD&E % Revenue	3.6%	5.5%	5.0%	(1.9) pts	0.5 pts	(0.4) pts
R&D Investment by Fuji Xerox[2]	$ 821	$ 796	$ 788	$ 25	$ 8	n/a

[1] Refer to the "Non-GAAP Financial Measures" section for an explanation of the Pro-forma non-GAAP financial measure.
[2] Increase in Fuji Xerox R&D was primarily due to changes in foreign exchange rates.

RD&E 2010
The decrease in RD&E spending for 2010 primarily reflects the savings from restructuring and productivity improvements.

RD&E 2009
The decrease in RD&E spending for 2009 reflects our restructuring and cost actions which consolidated the development and engineering infrastructures within our Technology segment.

Selling, Administrative and General Expenses ("SAG")

	Year Ended December 31,			Change		Pro-forma[1] Change
(in millions)	2010	2009	2008	2010	2009	2010
Total SAG	$ 4,594	$ 4,149	$ 4,534	$ 445	$ (385)	$ (57)
SAG as a % of revenue	21.2%	27.3%	25.7%	(6.1) pts	1.6 pts	(0.9) pts
Bad Debt Expense	$ 188	$ 291	$ 188	$ (103)	$ 103	$ (108)
Bad Debt as a % of revenue	**0.9%**	1.9%	1.1%	**(1.0) pts**	0.8 pts	**(0.5) pts**

[1] Refer to the "Non-GAAP Financial Measures" section for an explanation of the Pro-forma non-GAAP financial measure.

SAG 2010
SAG as a percent of revenue decreased 6.1-percentage points on an actual basis, primarily due to the ACS acquisition. ACS, as a typical services-based company, had lower SAG as a percent of revenue as compared to a technology-based company, which typified Xerox before the acquisition. Since actual comparisons are not meaningful, SAG is primarily discussed on a pro-forma basis, with ACS's 2009 estimated results from February 6 through December 31 included in our historical 2009 results (see "Non-GAAP Financial Measures" section for additional discussion of this non-GAAP measure).

SAG of $4,594 million was $445 million higher than 2009, or $57 million lower on a pro-forma[1] basis, including a negligible impact from currency. The pro-forma[1] SAG decrease reflects the following:

- $137 million increase in selling expenses, reflecting increased demand generation and brand advertising and higher commissions, partially offset by restructuring savings and productivity improvements
- $86 million decrease in general and administrative expenses, reflecting benefits from restructuring and operational improvements
- $108 million decrease in bad debt expense, reflecting an improving write-off trend

SAG 2009

SAG of $4,149 million was $385 million lower than 2008, including a $126 million benefit from currency. The SAG decrease was the result of the following:

- $311 million decrease in selling expenses, reflecting favorable currency; benefits from restructuring, an overall reduction in marketing spend and lower commissions
- $177 million decrease in general and administrative expenses, reflecting favorable currency and benefits from restructuring and cost actions, partially offset by higher compensation accruals
- $103 million increase in bad debt expense, reflecting increased write-offs in North America and Europe

Summary Costs and Expenses

The following is a summary of key metrics used to assess our performance:

	Year Ended December 31,			Change		Pro-forma[1] Change
(in millions)	2010	2009	2008	2010	2009	2010
Total Gross Margin	34.4 %	39.7 %	38.9 %	(5.3) pts	0.8 pts	(0.2) pts
RD&E % of revenue	3.6 %	5.5 %	5.0 %	(1.9) pts	0.5 pts	(0.4) pts
SAG % of revenue	21.2 %	27.3 %	25.7 %	(6.1) pts	1.6 pts	(0.9) pts
Operating Margin[1]	9.6 %	6.8 %	8.4 %	2.8 pts	(1.6) pts	1.0 pts
Pre-tax income (loss) margin	**3.8%**	4.1 %	(0.4) %	**(0.3) pts**	4.5 pts	**(2.2) pts**

(1) See the "Non-GAAP Measures" section for additional information.

As previously noted, the acquisition of ACS increased the proportion of revenues from Services. Consistent with services companies, this portion of our operations has a lower gross margin than our Technology segment, but also has both lower SAG and R&D as a percent of revenue. Accordingly, in 2010 we began to assess our performance using an operating margin metric, which neutralizes this mix differential. Operating margin is an internal measurement metric and represents gross margin minus RD&E percentage of revenue and SAG percentage of revenue. (Refer to the "Non-GAAP Financial Measures" section for further information and the reconciliation of operating margin to pre-tax income (loss) margin.)

During 2010, operating margin increased 2.8-percentage points or 1.0-percentage-point on a pro-forma[1] basis, as compared to 2009. The improvement reflects strong revenue growth and continued disciplined cost and expense management. During 2009, operating margin decreased 1.6-percentage points largely due to lower revenue as a result of the worldwide recession, as well as the negative effects of currency on our product costs, which were only partially offset by savings from prior-year restructuring actions.

Restructuring and Asset Impairment Charges

2010 Activity

During 2010 we recorded $483 million of net restructuring and asset impairment charges which included the following:

- $470 million of severance costs related to headcount reductions of approximately 9,000 employees. The costs associated with these actions applied about equally to North America and Europe, with approximately 20 % related to our developing market countries. Approximately 50 % of the costs were focused on gross margin improvements, 40 % on SAG and 10 % on the optimization of RD&E investments, and impacted the following functional areas:
  - Services
  - Supply chain and manufacturing
  - Back-office administration
  - Development and engineering
- $28 million for lease termination costs, primarily reflecting the continued rationalization and optimization of our worldwide operating locations, including consolidations with ACS.

- $19 million loss associated with the sale of our Venezuelan subsidiary. The loss primarily reflects the write-off our Venezuelan net assets including working capital and long-lived assets. We will continue to sell equipment, parts and supplies to the acquiring company through a distribution arrangement but will no longer have any direct or local operations in Venezuela. The sale of our operations and change in business model follows a decision by management in the fourth quarter 2010 to reduce the Company's future exposure and risk associated with operating in this unpredictable economy.

The above charges were partially offset by $41 million of net reversals for changes in estimated reserves from prior-period initiatives.

We expect 2011 pre-tax savings of approximately $270 million from our 2010 restructuring actions and approximately $475 million of annualized savings once all actions are fully implemented.

2009 Activity

Restructuring activity was minimal in 2009, and the related charges primarily reflected changes in estimates in severance costs from previously recorded actions.

2008 Activity

During 2008, we recorded $357 million of net restructuring charges predominantly consisting of severance and costs related to the elimination of approximately 4,900 positions primarily in North America and Europe. Focus areas for these actions include the following:

- Improving efficiency and effectiveness of infrastructure including: marketing, finance, human resources and training
- Capturing efficiencies in technical services, managed services, and supply chain and manufacturing infrastructure
- Optimizing product development and engineering resources

In addition, related to these activities, we also recorded lease cancellation and other costs of $19 million and asset impairment charges of $53 million. The lease termination and asset impairment charges primarily related to: (i) the relocation of certain manufacturing operations including the closing of our toner plant in Oklahoma City and the consolidation of our manufacturing operations in Ireland; and (ii) the exit from certain leased and owned facilities as a result of the actions noted above.

Restructuring Summary

The restructuring reserve balance as of December 31, 2010 for all programs was $323 million, of which approximately $309 million is expected to be spent over the next 12 months. Refer to Note 9 – Restructuring and Asset Impairment Charges in the Consolidated Financial Statements for additional information regarding our restructuring programs.

Acquisition-Related Costs

Costs of $77 million were incurred during 2010 in connection with our acquisition of ACS. These costs include $53 million of transaction costs, which represent external costs directly related to completing the acquisition of ACS and primarily include expenditures for investment banking, legal, accounting and other similar services. Legal costs include costs associated with the ACS shareholders litigation which was settled in 2010. The remainder of the acquisition-related costs represents external incremental costs directly related to the integration of ACS and Xerox. These costs include expenditures for consulting, systems integration, corporate communication services and the consolidation of facilities, as well as the expense associated with the performance shares that were granted to ACS management in connection with existing change-in-control agreements.

Costs of $72 million were incurred during 2009, in connection with our acquisition of ACS. $58 million of the costs relate to the write-off of fees associated with the Bridge Loan Facility commitment which was terminated as a result of securing permanent financing to fund the acquisition. The remainder of the costs represents transaction costs such as banking, legal and accounting fees, as well as some pre-integration costs such as external consulting services.

Amortization of Intangible Assets

During 2010, we recorded $312 million for the amortization of intangibles assets, which was $252 million higher than 2009. The increase primarily reflects the amortization of intangibles associated with our acquisition of ACS. Refer to Note 3 – Acquisitions in the Consolidated Financial Statements for additional information regarding the ACS acquisition.

Amortization of intangibles was $60 million in 2009 which was an increase of $6 million over 2008, primarily as a result of the full-year amortization of the assets acquired as part of our acquisitions in 2008.

Worldwide Employment

Worldwide employment of 136,500 as of December 31, 2010 increased approximately 83,000 from December 31, 2009, primarily due to the additional headcount related to the ACS acquisition partially offset by restructuring reductions. Worldwide employment was approximately 53,600 and 57,100 at December 31, 2009 and 2008, respectively.

Other Expenses, Net

Other expenses, net for the three years ended December 31, 2010 were as follows:

(in millions)	2010	2009	2008
Non-financing interest expense	$ 346	$ 256	$ 262
Interest income	(19)	(21)	(35)
Gain on sales of businesses and assets	(18)	(16)	(21)
Currency losses, net	11	26	34
ACS shareholders litigation settlement	36	—	—
Litigation matters	(4)	9	781
Loss on early extinguishment of debt	15	—	—
All Other expenses, net	22	31	12
Total Other Expenses, Net	**$ 389**	$ 285	$ 1,033

Non-financing interest expense: 2010 non-financing interest expense of $346 million increased $90 million from 2009 due to higher average debt balances, primarily resulting from the funding of the ACS acquisition, partially offset by the early extinguishment of certain debt instruments as well as the scheduled repayments of other debt.

In 2009 non-financing interest expense decreased compared to 2008, as interest expense associated with our $2.0 billion Senior Note offering for the funding of the ACS acquisition was more than offset by lower interest rates on the remaining debt.

Interest income: Interest income is derived primarily from our invested cash and cash equivalent balances. The decline in interest income in 2010 and 2009 was primarily due to lower average cash balances and rates of return.

Gain on sales of businesses and assets: Gains on sales of business and assets primarily consisted of the sales of certain surplus facilities in Latin America.

Currency losses, net: Currency losses primarily result from the re-measurement of foreign currency-denominated assets and liabilities, the cost of hedging foreign currency-denominated assets and liabilities, the mark-to-market of foreign exchange contracts utilized to hedge those foreign currency-denominated assets and liabilities and the mark-to-market impact of hedges of anticipated transactions, primarily future inventory purchases, for those that we do not apply cash flow hedge accounting treatment.

The 2010 net currency losses were primarily due to the currency devaluation in Venezuela. In January 2010, Venezuela announced a devaluation of the Bolivar to an official rate of 4.30 Bolivars to the U.S. Dollar for a majority of our products. As a result of this devaluation, we recorded a currency loss of $21 million in the first quarter of 2010 for the re-measurement of our net Bolivar-denominated monetary assets. This loss was partially offset by a cumulative translation gain of $6 million that was recognized upon the repatriation of cash and liquidation of a foreign subsidiary.

The 2009 net currency losses were primarily due to the significant movement in exchange rates among the U.S. Dollar, Euro and Yen in the first quarter of 2009, as well as the increased cost of hedging, particularly in developing markets.

The 2008 currency losses were primarily due to net re-measurement losses associated with our Yen-denominated payables, foreign currency-denominated assets and liabilities in our developing markets and the cost of hedging. The currency losses on Yen-denominated payables were largely limited to the first quarter 2008 as a result of the significant and rapid weakening of the U.S. Dollar and Euro versus the Yen.

ACS Shareholders' Litigation Settlement: Represents litigation expense of $36 million for the settlement of claims by ACS shareholders arising from our acquisition of ACS. The total settlement for all defendants was approximately $69 million, with Xerox paying approximately $36 million net of insurance proceeds.

Litigation matters: The 2010 and 2009 amounts for litigation matters primarily relate to changes in estimated probable losses for various legal matters.

In 2008 legal matters consisted of the following:

- $721 million reflecting provisions for the $670 million court approved settlement of *Carlson v. Xerox Corporation* and other pending securities-related cases, net of insurance recoveries.
- $36 million for probable losses on Brazilian labor-related contingencies. Following an assessment of the most recent trend in the outcomes of these matters, we reassessed the probable estimated loss and, as a result, recorded an additional reserve of $36 million in the fourth quarter of 2008.
- $24 million associated with probable losses from various other legal matters.

Refer to Note 17 – Contingencies in the Consolidated Financial Statements for additional information regarding litigation against the Company.

All other expenses, net: All Other expenses in 2010 decreased primarily due to lower interest expense on the Brazil tax and labor contingencies.

All Other expenses, net in 2009 were $19 million higher than 2008, primarily due to fees associated with the sale of receivables, as well as an increase in interest expense related to Brazil tax and labor contingencies.

Income Taxes

	Year Ended December 31,								
	2010			2009			2008		
(in millions)	Pre-Tax Income	Income Tax Expense	Effective Tax Rate	Pre-Tax Income	Income Tax Expense	Effective Tax Rate	Pre-Tax Income	Income Tax Expense	Effective Tax Rate
Reported	$ 815	$ 256	31.4 %	$ 627	$ 152	24.2 %	$ (79)	$ (231)	292.4 %
Adjustments:									
Xerox restructuring charge[1]	483	166		(8)	(3)		426	134	
Acquisition-related costs	77	19		72	23		—	—	
Amortization of intangible assets	312	118		60	22		54	19	
Venezuela devaluation costs	21	—		—	—		—	—	
Medicare subsidy tax law change	—	(16)		—	—		—	—	
Equipment write-off	—	—		—	—		39	15	
Provision for securities litigation	—	—		—	—		774	283	
ACS Shareholders' litigation settlement	36	—		—	—		—	—	
Loss on early extinguishment of debt	15	5		—	—		—	41	
Adjusted[2]	**$ 1,759**	**$ 548**	**31.2%**	$ 751	$ 194	25.8 %	$1,214	$ 261	21.5 %

The 2010 effective tax rate was 31.4 %, or 31.2 %[2] on an adjusted basis, which was lower than the U.S. statutory rate primarily due to the geographical mix of income before taxes and the related effective tax rates in those jurisdictions as well as the U.S. tax impacts on certain foreign income and tax law changes.

The 2009 effective tax rate was 24.2 %, or 25.8 %[2] on an adjusted basis, which was lower than the U.S. statutory tax rate primarily reflecting the benefit to taxes from the geographical mix of income before taxes and the related effective tax rates in those jurisdictions and the settlement of certain previously unrecognized tax benefits partially offset by a reduction in the utilization of foreign tax credits.

The 2008 effective tax rate was 292.4 %, or 21.5 %[2] on an adjusted basis, which was lower than the U.S. statutory tax rate primarily reflecting the benefit to taxes from the geographical mix of income before taxes and the related effective tax rates in those jurisdictions, the utilization of foreign tax credits and tax law changes.

Our effective tax rate will change based on nonrecurring events as well as recurring factors including the geographical mix of income before taxes and the related effective tax rates in those jurisdictions and the U.S. tax impacts on certain foreign income. In addition, our effective tax rate will change based on discrete or other nonrecurring events (such as audit settlements) that may not be predictable. We anticipate that our effective tax rate for 2011 will be approximately 31 %, excluding the effects of any discrete events.

Refer to Note 16 – Income and Other Taxes in the Consolidated Financial Statements for additional information.

[1] Income tax benefit from restructuring in 2010 includes a $19 million benefit from the sale of our Venezuelan operations.
[2] See the "Non-GAAP Measures" section for additional information.

Equity in Net Income of Unconsolidated Affiliates

	Year Ended December 31,		
(in millions)	2010	2009	2008
Total equity in net income of unconsolidated affiliates	$ 78	$ 41	$ 113
Fuji Xerox after-tax restructuring costs[1]	38	46	16

[1] Represents our 25 % share of Fuji Xerox after-tax restructuring costs. Amounts are included in Total equity in net income of unconsolidated affiliates.

Equity in net income of unconsolidated affiliates primarily reflects our 25 % share in Fuji Xerox.

The 2010 increase of $37 million from 2009 was primarily due to an increase in Fuji Xerox's net income, which was primarily driven by higher revenue and cost improvements, as well as lower restructuring costs.

The 2009 decrease of $72 million from 2008 was primarily due to Fuji Xerox's lower net income, which was negatively impacted by the weakness in the worldwide economy, as well as $46 million related to our share of Fuji Xerox after-tax restructuring costs.

Recent Accounting Pronouncements

Refer to Note 1 – Summary of Significant Accounting Policies in the Consolidated Financial Statements for a description of recent accounting pronouncements including the respective dates of adoption and the effects on results of operations and financial condition.

Capital Resources and Liquidity

Cash Flow Analysis

The following summarizes our cash flows for the three years ended December 31, 2010, as reported in our Consolidated Statements of Cash Flows in the accompanying Consolidated Financial Statements:

	Year Ended December 31,			Change	
(in millions)	2010	2009	2008	2010	2009
Net cash provided by operating activities	$ 2,726	$ 2,208	$ 939	$ 518	$ 1,269
Net cash used in investing activities	(2,178)	(343)	(441)	(1,835)	98
Net cash (used in) provided by financing activities	(3,116)	692	(311)	(3,808)	1,003
Effect of exchange rate changes on cash and cash equivalents	(20)	13	(57)	(33)	70
(Decrease) increase in cash and cash equivalents	(2,588)	2,570	130	(5,158)	2,440
Cash and cash equivalents at beginning of year	3,799	1,229	1,099	2,570	130
Cash and Cash Equivalents at End of Year	**$ 1,211**	$ 3,799	$ 1,229	**$(2,588)**	$ 2,570

Cash Flows from Operating Activities

Net cash provided by operating activities was $2,726 million for the year ended December 31, 2010 and includes $113 million of cash outflows for acquisition-related expenditures. The $518 million increase in cash from 2009 was primarily due to the following:

- $1,173 million increase in pre-tax income before depreciation and amortization, stock-based compensation, litigation, restructuring and the Venezuelan currency devaluation.
- $458 million increase due to higher accounts payable and accrued compensation primarily related to higher inventory purchases and the timing of accounts payable payments as well as increased compensation, benefit and other accruals.
- $141 million increase primarily from the early termination of certain interest rate swaps.
- $57 million increase due to lower restructuring payments.
- $470 million decrease as a result of higher inventory levels reflecting increased activity.
- $367 million decrease due to an increase in accounts receivable, net of collections of deferred proceeds from the sale of receivables, primarily as a result of higher revenues and a lower impact from receivable sales.
- $216 million decrease as a result of up-front costs and other customer related spending associated with our services contracts.
- $140 million decrease due to higher finance receivables of $119 million and equipment on operating leases of $21 million, both reflective of increased equipment placements.
- $115 million decrease primarily due to higher contributions to our U.S. pension plans. No contributions were made in 2009 to our U.S. pension plans due to the availability of prior years' credit balances.

Net cash provided by operating activities was $2,208 million for the year ended December 31, 2009. The $1,269 million increase in cash from 2008 was primarily due to the following:

- $587 million increase due to the absence of payments for securities-related litigation settlements.
- $433 million increase as a result of lower inventory levels reflecting aggressive supply chain actions in light of lower sales volume.
- $410 million increase from accounts receivables reflecting the benefits from sales of accounts receivables, lower revenue and strong collection effectiveness.
- $177 million increase due to lower contributions to our defined pension benefit plans. The lower contributions are primarily in the U.S., as no contributions were required due to the availability of prior years' credit balances.
- $116 million increase due to lower net tax payments.
- $84 million increase due to higher net run-off of finance receivables.
- $64 million increase due to lower placements of equipment on operating leases, reflecting lower install activity.
- $440 million decrease in pre-tax income before litigation, restructuring and acquisition costs.
- $139 million decrease due to higher restructuring payments related to prior years' actions.
- $54 million decrease due to lower accounts payable and accrued compensation, primarily related to lower purchases and the timing of payments to suppliers.

Cash Flows from Investing Activities

Net cash used in investing activities was $2,178 million for the year ended December 31, 2010. The $1,835 million increase in the use of cash from 2009 was primarily due to the following:

- $1,571 million increase primarily due to the acquisitions of ACS for $1,495 million, EHRO for $125 million, TMS Health for $48 million, IBS for $29 million, Georgia for $21 million and Spur for $12 million.
- $326 million increase due to higher capital expenditures (including internal use software) primarily as a result of the inclusion of ACS in 2010.
- $35 million decrease due to higher cash proceeds from asset sales.

Net cash used in investing activities was $343 million for the year ended December 31, 2009. The $98 million decrease in the use of cash from 2008 was primarily due to the following:

- $142 million decrease due to lower capital expenditures (including internal use software), reflecting very stringent spending controls.
- $21 million increase due to lower cash proceeds from asset sales.

Cash Flows from Financing Activities

Net cash used in financing activities was $3,116 million for the year ended December 31, 2010. The $3,808 million decrease in cash from 2009 was primarily due to the following:

- $3,980 million decrease due to net debt activity. 2010 includes the repayments of $1,733 million of ACS's debt on the acquisition date, $950 million of Senior Notes, $550 million early redemption of the 2013 Senior Notes, net payments of $110 million on other debt and $14 million of debt issuance costs for the Bridge Loan Facility commitment, which was terminated in 2009. These payments were offset by net proceeds of $300 million from Commercial Paper issued under a program we initiated during the fourth quarter 2010. 2009 reflects the repayment of $1,029 million for Senior Notes due in 2009, net payments of $448 million for Zero Coupon Notes, net payments of $246 million on the Credit Facility, net payments of $35 million primarily for foreign short-term borrowings and $44 million of debt issuance costs for the Bridge Loan Facility commitment which was terminated. These payments were partially offset by net proceeds of $2,725 million from the issuance of Senior Notes in May and December 2009.
- $66 million decrease, reflecting dividends on an increased number of outstanding shares as a result of the acquisition of ACS.
- $182 million increase due to proceeds from the issuance of common stock primarily as a result of the exercise of stock options issued under the former ACS plans as well as the exercise of stock options from several expiring grants.
- $58 million increase from lower net repayments on secured debt.

Net cash provided by financing activities was $692 million for the year ended December 31, 2009. The $1,003 million increase in cash from 2008 was primarily due to the following:

- $812 million increase because no purchases were made under our share repurchase program in 2009.
- $170 million increase from lower net repayments on secured debt.
- $21 million increase due to lower share repurchases related to employee withholding taxes on stock-based compensation vesting.
- $3 million decrease due to lower net debt proceeds. 2009 reflects the repayment of $1,029 million for Senior Notes due in 2009, net payments of $448 million for Zero Coupon Notes, net payments of $246 million on the Credit Facility, net payments of $35 million primarily for foreign short-term borrowings and $44 million of debt issuance costs for the Bridge Loan Facility commitment which was terminated. These payments were partially offset by net proceeds of $2,725 million from the issuance of Senior Notes in May and December 2009. 2008 reflects the issuance of $1.4 billion in Senior Notes, $250 million in Zero Coupon Notes and net payments of $354 million on the Credit Facility and $370 million on other debt.

ACS Acquisition

On February 5, 2010 we acquired all of the outstanding equity of ACS in a cash-and-stock transaction valued at approximately $6.2 billion, net of cash acquired. The consideration transferred to acquire ACS was as follows:

(in millions)	February 5, 2010
Xerox common stock issued	$ 4,149
Cash consideration, net of cash acquired	1,495
Value of exchanged stock options	168
Series A convertible preferred stock	349
Net Consideration – Cash and Non-cash	**$ 6,161**

In addition, we also repaid $1.7 billion of ACS's debt at acquisition and assumed an additional $0.6 billion.

Refer to Note 3 – Acquisitions in the Consolidated Financial Statements for additional information regarding the ACS acquisition.

Financing Activities, Credit Facility and Capital Markets

Customer Financing Activities

We provide lease equipment financing to the majority of our customers, primarily in our Technology segment. Our lease contracts permit customers to pay for equipment over time rather than at the date of installation. Our investment in these contracts is reflected in Total finance assets, net. We currently fund our customer financing activity through cash generated from operations, cash on hand, borrowings under bank credit facilities and proceeds from capital markets offerings.

We have arrangements in certain international countries and domestically through GIS, where third-party financial institutions independently provide lease financing, on a non-recourse basis to Xerox, directly to our customers. In these arrangements, we sell and transfer title of the equipment to these financial institutions. Generally, we have no continuing ownership rights in the equipment subsequent to its sale; therefore, the unrelated third-party finance receivable and debt are not included in our Consolidated Financial Statements.

The following represents our investment in lease contracts as of December 31:

(in millions)	2010	2009
Total Finance receivables, net [(1)]	$ 6,620	$7,027
Equipment on operating leases, net	530	551
Total Finance Assets, net	**$7,150**	$7,578

(1) Includes (i) billed portion of finance receivables, net, (ii) finance receivables, net and (iii) finance receivables due after one year, net as included in the Consolidated Balance Sheets as of December 31, 2010 and 2009.

$134 million of the $428 million decrease in Total finance assets, net is due to currency.

We maintain a certain level of debt, referred to as financing debt, in order to support our investment in our lease contracts. We maintain an assumed 7:1 leverage ratio of debt to equity as compared to our finance assets for this financing aspect of our business. Based on this leverage, the following represents the breakdown of Total debt between financing debt and core debt as of December 31:

(in millions)	2010	2009
Financing debt[(1)]	$ 6,256	$6,631
Core debt	2,351	2,633
Total Debt	**$ 8,607**	$9,264

(1) Financing debt includes $5,793 million and $6,149 million as of December 2010 and 2009, respectively, of debt associated with Total finance receivables, net and is the basis for our calculation of "equipment financing interest" expense. The remainder of the financing debt is associated with Equipment on operating leases.

The following summarizes our debt as of December 31:

(in millions)	2010	2009
Principal debt balance[(1)]	$ 8,380	$ 9,122
Net unamortized discount	(1)	(11)
Fair value adjustments	228	153
Total Debt	8,607	9,264
Less: Current maturities and short-term debt[(1)]	(1,370)	(988)
Total Long-term Debt[(1)]	**$ 7,237**	$ 8,276

(1) December 31, 2010 includes Commercial Paper of $300 million.

Sales of Accounts Receivable

We have facilities in the U.S., Canada and several countries in Europe that enable us to sell to third parties, on an ongoing basis, certain accounts receivable without recourse. The accounts receivable sold are generally short-term trade receivables with payment due dates of less than 60 days. Accounts receivable sales were as follows:

	Year Ended December 31,		
(in millions)	2010	2009	2008
Accounts receivable sales	$2,374	$1,566	$717
Deferred proceeds	307	—	—
Fees associated with sales	15	13	4
Estimated increase on operating cash flows[(1)]	106	309	51

(1) Represents the difference between current and prior-year fourth-quarter accounts receivable sales adjusted for the effects of: (i) the deferred proceeds, (ii) collections prior to the end of the year and (iii) currency.

Refer to Note 4 – Receivables, Net in the Consolidated Financial Statements for additional information.

Financial Instruments

Refer to Note 13 – Financial Instruments in the Consolidated Financial Statements for additional information regarding our derivative financial instruments.

Share Repurchase Programs

Refer to Note 19 – Shareholders' Equity – "Treasury Stock" in the Consolidated Financial Statements for additional information regarding our share repurchase programs.

Dividends

The Board of Directors declared aggregate dividends of $243 million and $152 million on common stock in 2010 and 2009, respectively. The increase in 2010 is primarily due to the common stock issued in connection with the ACS acquisition.

The Board of Directors declared aggregate dividends of $21 million on the Series A Convertible Preferred Stock in 2010. The preferred shares were issued in connection with the acquisition of ACS.

Refer to Note 3 – Acquisitions in the Consolidated Financial Statements for additional information regarding the ACS acquisition.

Capital Market Activity

In 2010, we redeemed our $550 million 7.625% Senior Notes due in 2013. We incurred a loss on extinguishment of approximately $15 million, representing the call premium of approximately $7 million, as well as the write-off of unamortized debt costs of $8 million.

Refer to Note 11 – Debt in the Consolidated Financial Statements for additional information regarding 2010 Debt activity.

Liquidity and Financial Flexibility

We manage our worldwide liquidity using internal cash management practices, which are subject to (1) the statutes, regulations and practices of each of the local jurisdictions in which we operate, (2) the legal requirements of the agreements to which we are a party and (3) the policies and cooperation of the financial institutions we utilize to maintain and provide cash management services.

Our liquidity is a function of our ability to successfully generate cash flows from a combination of efficient operations and access to capital markets. Our ability to maintain positive liquidity going forward depends on our ability to continue to generate cash from operations and access to financial markets, both of which are subject to general economic, financial, competitive, legislative, regulatory and other market factors that are beyond our control.

The following is a discussion of our liquidity position as of December 31, 2010:

- Total cash and cash equivalents was $1.2 billion and there were no outstanding borrowings or letters of credit under our $2 billion Credit Facility. The Credit Facility provides backup for our Commercial Paper ("CP") borrowings which amounted to $300 million at December 31, 2010.
- In October 2010, Xerox's Board of Directors authorized the company to issue Commercial Paper, a liquidity vehicle that the Company has not used for several years. Aggregate CP and Credit Facility borrowings may not exceed $2 billion outstanding at any time. Under the company's private placement CP program as of December 31, 2010, we could issue CP up to a maximum amount of $1 billion. In February 2011 this amount was increased to $2 billion to be consistent with the Board authorization.
- Over the past three years we have consistently delivered strong cash flow from operations, driven by the strength of our annuity-based revenue model. Cash flows from operations were $2,726 million, $2,208 million and $939 million for the years ended December 31, 2010, 2009 and 2008, respectively. Cash flows from operations in 2008 included $615 million in net payments for securities litigation.
- Our principal debt maturities are in line with historical and projected cash flows and are spread over the next 10 years as follows and includes $300 million of Commercial Paper in 2011 (in millions):

Year	Amount
2011	$1,370
2012	1,126
2013	412
2014	771
2015	1,251
2016	950
2017	501
2018	1,001
2019	650
2020 and thereafter	348
Total Debt	$8,380

Loan Covenants and Compliance

At December 31, 2010, we were in full compliance with the covenants and other provisions of our Credit Facility and Senior Notes. We have the right to prepay outstanding loans or to terminate the Credit Facility without penalty. Failure to comply with material provisions or covenants of the Credit Facility and Senior Notes could have a material adverse effect on our liquidity and operations and our ability to continue to fund our customers' purchase of Xerox equipment.

Refer to Note 11 – Debt in the Consolidated Financial Statements for additional information regarding debt arrangements.

Contractual Cash Obligations and Other Commercial Commitments and Contingencies

At December 31, 2010, we had the following contractual cash obligations and other commercial commitments and contingencies:

(in millions)	2011	2012	2013	2014	2015	Thereafter
Total debt, including capital lease obligations [1]	$ 1,370	$1,126	$412	$ 771	$1,251	$3,450
Minimum operating lease commitments[2]	669	486	337	171	118	106
Liability to subsidiary trust issuing preferred securities[3]	—	—	—	—	—	650
Defined benefit pension plans	500	—	—	—	—	—
Retiree health payments	87	86	85	85	84	396
Estimated Purchase Commitments:						
Flextronics[4]	670	—	—	—	—	—
Fuji Xerox[5]	2,100	—	—	—	—	—
HPES Contracts[6]	69	23	6	—	—	—
Other IM service contracts[7]	150	140	122	89	12	36
Other[8]	7	7	1	—	—	—
Other Commitments[9]:						
Surety Bonds	636	20	7	1	1	1
Letters of Credit	96	15	—	4	—	155
Total	$ 6,354	$1,903	$970	$1,121	$1,466	$4,794

[1] Refer to Note 11 – Debt in the Consolidated Financial Statements for additional information and interest payments related to total debt. Amounts above include principal portion only and $300 million of Commercial Paper in 2011.

[2] Refer to Note 6 – Land, Buildings and Equipment, Net in the Consolidated Financial Statements for additional information related to minimum operating lease commitments.

[3] Refer to Note 12 – Liability to Subsidiary Trust Issuing Preferred Securities in the Consolidated Financial Statements for additional information and interest payments (amounts above include principal portion only).

[4] Flextronics: We outsource certain manufacturing activities to Flextronics and are currently in the first of two one-year extensions of the Master Supply Agreement. The term of this agreement is three years, with two additional one-year extension periods. The amount included in the table reflects our estimate of purchases over the next year and is not a contractual commitment.

[5] Fuji Xerox: The amount included in the table reflects our estimate of purchases over the next year and is not a contractual commitment.

[6] HPES contract: We have an information management contract with HP Enterprise Services ("HPES"), legal successor to Electronic Data Systems Corp., through March 2014. Services to be provided under this contract include support for European mainframe system processing, as well as workplace, service desk, voice and data network management. Although the HPES contract runs through March 2014, we may choose to transfer some of the services to internal Xerox providers before the HPES contract ends. There are no minimum payments required under this contract. The amounts disclosed in the table reflect our estimate of minimum payments for the periods shown. We can terminate the contract for convenience by providing 60 day's prior notice without paying a termination fee. Should we terminate the contract for convenience, we have an option to purchase the assets placed in service under the HPES contract.

[7] IM ("Information Management") services: During 2010 and 2009, we terminated certain information management services provided under the HPES contract. Terminated services were either discontinued or we entered into new agreements for similar services with other providers. Services provided under these contracts include mainframe application processing, development and support; and mid-range applications processing and support. The contracts have various terms through 2015. Some of the contracts require minimum payments and require early termination penalties. The amounts disclosed in the table reflect our estimate of minimum payments.

[8] Other purchase commitments: We enter into other purchase commitments with vendors in the ordinary course of business. Our policy with respect to all purchase commitments is to record losses, if any, when they are probable and reasonably estimable. We currently do not have, nor do we anticipate, material loss contracts.

[9] Certain contracts, primarily governmental, require surety bonds or letters of credit as guarantee of performance. Generally these commitments have one-year terms which are typically renewed annually. Refer to Note 17 – Contingencies in the Consolidated Financial Statements for additional information.

Pension and Other Post-retirement Benefit Plans

We sponsor defined benefit pension plans and retiree health plans that require periodic cash contributions. Our 2010 contributions for these plans were $237 million for our defined benefit pension plans and $92 million for our retiree health plans. In 2011 we expect, based on current actuarial calculations, to make contributions of approximately $500 million to our worldwide defined benefit pension plans and approximately $90 million to our retiree health benefit plans. Contributions to our defined benefit pension plans have increased from the prior year due to a decrease in the discount rate, prior years' investment performance as well as the requirement in the U.S. to make quarterly contributions for the current plan year. Contributions in subsequent years will depend on a number of factors, including the investment performance of plan assets and discount rates as well as potential legislative and plan changes. We currently expect contributions to our defined benefit pension plans to decline in years subsequent to 2011.

Our retiree health benefit plans are non-funded and are almost entirely related to domestic operations. Cash contributions are made each year to cover medical claims costs incurred during the year. The amounts reported in the above table as retiree health payments represent our estimate of future benefit payments.

Fuji Xerox

We purchased products, including parts and supplies, from Fuji Xerox totaling $2.1 billion, $1.6 billion and $2.1 billion in 2010, 2009 and 2008, respectively. Our purchase commitments with Fuji Xerox are entered into in the normal course of business and typically have a lead time of three months. Related party transactions with Fuji Xerox are discussed in Note 7 – Investments in Affiliates, at Equity in the Consolidated Financial Statements.

Brazil Tax and Labor Contingencies

Our Brazilian operations are involved in various litigation matters and have received or been the subject of numerous governmental assessments related to indirect and other taxes, as well as disputes associated with former employees and contract labor. The tax matters, which comprise a significant portion of the total contingencies, principally relate to claims for taxes on the internal transfer of inventory, municipal service taxes on rentals and gross revenue taxes. We are disputing these tax matters and intend to vigorously defend our positions. Based on the opinion of legal counsel and current reserves for those matters deemed probable of loss, we do not believe that the ultimate resolution of these matters will materially impact our results of operations, financial position or cash flows. The labor matters principally relate to claims made by former employees and contract labor for the equivalent payment of all social security and other related labor benefits, as well as consequential tax claims, as if they were regular employees. As of December 31, 2010, the total amounts related to the unreserved portion of the tax and labor contingencies, inclusive of any related interest, amounted to approximately $1,274 million, with the increase from the December 31, 2009 balance of $1,225 million primarily related to currency and current-year interest indexation partially offset by matters that have been closed. With respect to the unreserved balance of $1,274 million, the majority has been assessed by management as being remote as to the likelihood of ultimately resulting in a loss to the Company. In connection with the above proceedings, customary local regulations may require us to make escrow cash deposits or post other security of up to half of the total amount in dispute. As of December 31, 2010 we had $276 million of escrow cash deposits for matters we are disputing and there are liens on certain Brazilian assets with a net book value of $19 million and additional letters of credit of approximately $160 million. Generally, any escrowed amounts would be refundable and any liens would be removed to the extent the matters are resolved in our favor. We routinely assess these matters as to probability of ultimately incurring a liability against our Brazilian operations and record our best estimate of the ultimate loss in situations where we assess the likelihood of an ultimate loss as probable.

Other Contingencies and Commitments

As more fully discussed in Note 17 – Contingencies in the Consolidated Financial Statements, we are involved in a variety of claims, lawsuits, investigations and proceedings concerning securities law, intellectual property law, environmental law, employment law and the Employee Retirement Income Security Act. In addition, guarantees, indemnifications and claims may arise during the ordinary course of business from relationships with suppliers, customers and nonconsolidated affiliates. Nonperformance under a contract including a guarantee, indemnification or claim could trigger an obligation of the Company.

We determine whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. Should developments in any of these areas cause a change in our determination as to an unfavorable outcome and result in the need to recognize a material accrual, or should any of these matters result in a final adverse judgment or be settled for significant amounts, they could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such change in determination, judgment or settlement occurs.

Unrecognized Tax Benefits

As of December 31, 2010, we had $186 million of unrecognized tax benefits. This represents the tax benefits associated with various tax positions taken, or expected to be taken, on domestic and international tax returns that have not been recognized in our financial statements due to uncertainty regarding their resolution. The resolution or settlement of these tax positions with the taxing authorities is at various stages and therefore we are unable to make a reliable estimate of the eventual cash flows by period that may be required to settle these matters. In addition, certain of these matters may not require cash settlement due to the existence of credit and net operating loss carryforwards, as well as other offsets, including the indirect benefit from other taxing jurisdictions that may be available.

Off-Balance Sheet Arrangements

Although we rarely utilize off-balance sheet arrangements in our operations, we enter into operating leases in the normal course of business. The nature of these lease arrangements is discussed in Note 6 – Land, Buildings and Equipment, Net in the Consolidated Financial Statements. In addition, we have facilities in the U.S., Canada and several countries in Europe that enable us to sell to third parties, on an ongoing basis, certain accounts receivable without recourse. Refer to Note 4 – Receivables, Net in the Consolidated Financial Statements for further additional information.

See the table above for the Company's contractual cash obligations and other commercial commitments and Note 17 – Contingencies in the Consolidated Financial Statements for additional information regarding our guarantees, indemnifications and warranty liabilities.

Financial Risk Management

We are exposed to market risk from foreign currency exchange rates and interest rates, which could affect operating results, financial position and cash flows. We manage our exposure to these market risks through our regular operating and financing activities and, when appropriate, through the use of derivative financial instruments. We utilized derivative financial instruments to hedge economic exposures, as well as reduce earnings and cash flow volatility resulting from shifts in market rates.

Recent market events have not caused us to materially modify or change our financial risk management strategies with respect to our exposures to interest rate and foreign currency risk. Refer to Note 13 – Financial Instruments in the Consolidated Financial Statements for additional discussion on our financial risk management.

Foreign Exchange Risk Management

Assuming a 10% appreciation or depreciation in foreign currency exchange rates from the quoted foreign currency exchange rates at December 31, 2010, the potential change in the fair value of foreign currency-denominated assets and liabilities in each entity would not be significant because all material currency asset and liability exposures were economically hedged as of December 31, 2010. A 10% appreciation or depreciation of the U.S. Dollar against all currencies from the quoted foreign currency exchange rates at December 31, 2010 would have a $528 million impact on our cumulative translation adjustment portion of equity. The net amount invested in foreign subsidiaries and affiliates, primarily Xerox Limited, Fuji Xerox, Xerox Canada Inc. and Xerox do Brasil, and translated into U.S. Dollars using the year-end exchange rates, was $5.3 billion at December 31, 2010.

Interest Rate Risk Management

The consolidated weighted-average interest rates related to our total debt and liability to subsidiary trust issuing preferred securities for 2010, 2009 and 2008 approximated 5.8%, 6.1% and 6.6%, respectively. Interest expense includes the impact of our interest rate derivatives.

Virtually all customer-financing assets earn fixed rates of interest. The interest rates on a significant portion of the Company's term debt are fixed.

As of December 31, 2010, $952 million of our total debt carried variable interest rates, including the effect of pay variable interest rate swaps we use to reduce the effective interest rate on our fixed coupon debt.

The fair market values of our fixed-rate financial instruments are sensitive to changes in interest rates. At December 31, 2010, a 10% change in market interest rates would change the fair values of such financial instruments by approximately $194 million.

Non-GAAP Financial Measures

We have reported our financial results in accordance with generally accepted accounting principles ("GAAP"). Additionally, we have discussed our results using non-GAAP measures.

Management believes that these non-GAAP financial measures provide an additional means of analyzing the current periods' results against the corresponding prior periods' results. However, these non-GAAP financial measures should be viewed in addition to, and not as a substitute for, the Company's reported results prepared in accordance with GAAP. Our non-GAAP financial measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures and should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. Our management regularly uses our supplemental non-GAAP financial measures internally to understand, manage and evaluate our business and make operating decisions. These non-GAAP measures are among the primary factors management uses in planning for and forecasting future periods. Compensation of our executives is based in part on the performance of our business based on these non-GAAP measures.

A reconciliation of these non-GAAP financial measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are set forth below.

Adjusted Earnings Measures

To better understand the trends in our business and the impact of the ACS acquisition, we believe it is necessary to adjust the following amounts determined in accordance with GAAP to exclude the effects of the certain items as well as their related income tax effects:

- Net income and Earnings per share ("EPS"),
- Pre-tax income (loss) margin, and
- Effective tax rate.

The above have been adjusted for the following items:

- Restructuring and asset impairment charges (including those incurred by Fuji Xerox): Restructuring and asset impairment charges consist of costs primarily related to severance and benefits for employees terminated pursuant to formal restructuring and workforce reduction plans. We exclude these charges because we believe that these historical costs do not reflect expected future operating expenses and do not contribute to a meaningful evaluation of our current or past operating performance. In addition, such charges are inconsistent in amount and frequency. Such charges are expected to yield future benefits and savings with respect to our operational performance.
- Acquisition-related costs: We incurred significant expenses in connection with our acquisition of ACS which we generally would not have otherwise incurred in the periods presented as a part of our continuing operations. Acquisition-related costs include transaction and integration costs, which represent external incremental costs directly related to completing the acquisition and the integration of ACS and Xerox. We believe it is useful for investors to understand the effects of these costs on our total operating expenses.
- Amortization of intangible assets: The amortization of intangible assets is driven by our acquisition activity which can vary in size, nature and timing as compared to other companies within our industry and from period to period. Accordingly, due to the incomparability of acquisition activity among companies and from period to period, we believe exclusion of the amortization associated with intangible assets acquired through our acquisitions allows investors to better compare and understand our results. The use of intangible assets contributed to our revenues earned during the periods presented and will contribute to our future period revenues as well. Amortization of intangible assets will recur in future periods.
- Other discrete, unusual or infrequent costs and expenses: In addition, we have also excluded the following items given the discrete, unusual or infrequent nature of these items on our results of operations:
  - 2010 (1) loss on early extinguishment of debt; (2) ACS shareholders litigation settlement; (3) Venezuela devaluation and (4) Medicare subsidy tax law change (income tax effect only); and
  - 2008 (1) provision for litigation matters; (2) equipment write-off and (3) settlement of unrecognized tax benefits.

We believe the exclusion of these items allows investors to better understand and analyze the results for the period as compared to prior periods as well as expected trends in our business.

See "Net Income" and "Income Taxes" sections in the MD&A for the reconciliation of these Non-GAAP measures for net Income/ Earnings per share and the Effective tax rate, respectively, to the most directly comparable measures calculated and presented in accordance with GAAP.

The following is a reconciliation of the Non-GAAP measure of Operating margin to Pre-tax income margin, which is the most directly comparable measure calculated and presented in accordance with GAAP.

(in millions)	As Reported 2010	As Reported 2009	Pro-forma 2009[1]	As Reported 2008	'10 vs. '09 Change	Pro-forma Change	'09 vs. '08 Change
Total Revenues	$21,633	$ 15,179	$ 21,082	$17,608	43 %	3 %	(14) %
Pre-tax Income	815	627	1,267	(79)	30 %	(36) %	*
Adjustments:							
Xerox restructuring charge	483	(8)	(8)	429			
Acquisition-related costs	77	72	104	—			
Amortization of intangible assets	312	60	60	54			
Equipment write-off	—	—	—	39			
Other expenses, net[2]	389	285	382	1,033			
Adjusted Operating Income	**$ 2,076**	$ 1,036	$ 1,805	$ 1,476	100 %	15 %	(30) %
Pre-tax Income (Loss) Margin	3.8 %	4.1 %	6.0 %	(0.4) %	(0.3) pts	(2.2) pts	4.5 pts
Adjusted Operating Margin	9.6 %	6.8 %	8.6 %	8.4 %	2.8 pts	1.0 pts	(1.6) pts

* Percent change not meaningful.

(1) Pro-forma reflects ACS's 2009 estimated results from February 6 through December 31 adjusted to reflect fair value adjustments related to property, equipment and computer software as well as customer contract costs. In addition, adjustments were made for deferred revenue, exited businesses, certain non-recurring product sales and other material non-recurring costs associated with the acquisition.

(2) 2008 includes provision for litigation matters of $774 million.

Pro-forma Basis

To better understand the trends in our business, we discuss our 2010 operating results by comparing them against adjusted 2009 results which include ACS historical results for the comparable period. Accordingly, we have included ACS's 2009 estimated results for the comparable period February 6, 2009 through December 31, 2009 in our reported 2009 results. We refer to comparisons against these adjusted 2009 results as "pro-forma" basis comparisons. ACS 2009 historical results have been adjusted to reflect fair value adjustments related to property, equipment and computer software as well as customer contract costs. In addition, adjustments were made for deferred revenue, exited businesses and other material non-recurring costs associated with the acquisition. We believe comparisons on a pro-forma basis are more meaningful than the actual comparisons, given the size and nature of the ACS acquisition. We believe the pro-forma basis comparisons allow investors to have better understanding and additional perspective of the expected trends in our business as well as the impact of the ACS acquisition on the Company's operations.

A reconciliation of these non-GAAP financial measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are set forth below.

Total Xerox

(in millions)	As Reported 2010	As Reported 2009	Pro-forma 2009(1)	Change	Pro-forma Change
	Year Ended December 31,				
Revenue:					
Equipment sales	$ 3,857	$ 3,550	$ 3,550	9 %	9 %
Supplies, paper and other	3,377	3,096	3,234	9 %	4 %
Sales	7,234	6,646	6,784	9 %	7 %
Service, outsourcing and rentals	13,739	7,820	13,585	76 %	1 %
Finance income	660	713	713	(7) %	(7) %
Total Revenues	**$21,633**	$15,179	$21,082	43 %	3 %
Service, outsourcing and rentals	$13,739	$ 7,820	$13,585	76 %	1 %
Add: Finance income	660	713	713		
Add: Supplies, paper and other sales	3,377	3,096	3,234		
Annuity Revenue	**$17,776**	$11,629	$17,532	53 %	1 %
Gross Profit:					
Sales	$ 2,493	$ 2,251	$ 2,269		
Service, outsourcing and rentals	4,544	3,332	4,585		
Finance income	414	442	442		
Total	**$ 7,451**	$ 6,025	$ 7,296		
Gross Margin:					
Sales	34.5 %	33.9 %	33.4 %	0.6 pts	1.1 pts
Service, outsourcing and rentals	33.1 %	42.6 %	33.8 %	(9.5) pts	(0.7) pts
Finance income	62.7 %	62.0 %	62.0 %	0.7 pts	0.7 pts
Total	34.4 %	39.7 %	34.6 %	(5.3) pts	(0.2) pts
RD&E	$ 781	$ 840	$ 840		
RD&E % Revenue	3.6 %	5.5 %	4.0 %	(1.9) pts	(0.4) pts
SAG	$ 4,594	$ 4,149	$ 4,651		
SAG % Revenue	21.2 %	27.3 %	22.1 %	(6.1) pts	(0.9) pts

Services Segment

(in millions)	Year Ended December 31, As Reported 2010	As Reported 2009	Pro-forma 2009[1]	Change	Pro-forma Change
Document outsourcing	$ 3,297	$3,382	$ 3,382	(3)%	(3)%
Business processing outsourcing	5,112	94	4,751	*	8%
Information technology outsourcing	1,249	—	1,246	*	—%
Less: Intra-segment eliminations	(21)	—	—	*	*
Total Revenue – Services	**$ 9,637**	$3,476	$ 9,379	177%	3%
Segment Profit – Services	**$ 1,132**	$ 231	$ 1,008	390%	12%
Segment Margin – Services	**11.7%**	6.6%	10.7%	5.1 pts	1.0 pts

* Percent change not meaningful.

[1] Pro-forma reflects ACS's 2009 estimated results from February 6 through December 31 adjusted to reflect fair value adjustments related to property, equipment and computer software as well as customer contract costs. In addition, adjustments were made for deferred revenue, exited businesses, certain non-recurring product sales and other material non-recurring costs associated with the acquisition.

Forward-Looking Statements

This Annual Report contains forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The words "anticipate," "believe," "estimate," "expect," "intend," "will," "should" and similar expressions, as they relate to us, 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. Information concerning these factors is included in our 2010 Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC"). We do not intend to update these forward-looking statements, except as required by law.