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

With sales approaching $23 billion, we are the world’s leading global enterprise for business process and document management. Our services, technology and expertise enable customers – from small businesses to large global enterprises – to focus on their core business and operate more effectively. Headquartered in Norwalk, Connecticut, we offer business process outsourcing, document outsourcing and IT outsourcing services, including data processing, healthcare solutions, HR benefits management, finance support, transportation solutions and customer relationship management services for commercial and government organizations worldwide. We also provide extensive leading-edge document technology, services, software and genuine Xerox supplies for graphic communication and office printing environments of any size. Through our business process and IT outsourcing services as well as our document technology and managed print services, we operate in a market estimated at over $600 billion. The 147,600 people of Xerox serve customers in more than 160 countries. Approximately 34% of our revenue is generated outside the U.S.

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

- Our Services segment is comprised of business process outsourcing, information technology outsourcing and document outsourcing. The diversity of our offerings gives us a differentiated solution and delivers greater value to our customers.

  A key priority in 2012 was continued growth in our services business. Revenue from services grew 6%, reflecting growth from all three lines of business, business process outsourcing ("BPO"), information technology outsourcing ("ITO") and document outsourcing services ("DO"). Growth in BPO benefited from recent modestly-sized acquisitions, consistent with our strategy to continue diversifying our services portfolio and to expand our business globally. In 2012, total business signings were nearly $11 billion and revenue from services represented 52% of our total 2012 revenue. Segment margin began to improve during 2012 and was up 0.9 points in the fourth quarter 2012 as compared to the prior year.

- Our Document Technology segment is comprised of our document technology and related supplies, technical service and equipment financing (excluding contracts related to document outsourcing).

Our product groups within this segment include Entry, Mid-range and High-end products.

In 2012, as a result of economic uncertainties in several regions and secular shifts in the marketplace, we focused our efforts on productivity improvements and reductions in our cost base, as well as steadily expanding distribution through indirect channels. As a result, we maintained market leadership in the fastest growing, most attractive segments of this market and segment margin remained comparable with 2011. During the first quarter of 2013, we will launch new and refreshed products that enhance our portfolio of mid-range and production color document systems. In addition, we are launching a new operating system and software for our line of multifunction printers ("MFPs") that add extensive cloud-based functionality and embedded security protection from McAfee. We expect that this operating system integrated with new products will help drive improved installs and sales of Xerox equipment throughout the year.

Approximately 84% of our 2012 total revenue was annuity-based revenue that includes contracted services, equipment maintenance, consumable supplies and financing, among other elements. Our annuity revenue significantly benefits from growth in Services. Some of the key indicators of annuity revenue growth include:

- New Services business signings growth, which reflects the year-over-year increase in estimated future revenues from contracts signed during the period.

- Services renewal rate, which is defined as the annual recurring revenue ("ARR") on contracts that are renewed during the period, calculated as a percentage of ARR on all contracts that were up for renewal during the period.

- Services pipeline growth, which measures the year-over-year increase in new business opportunities.

- Installations of printers and multifunction printers as well as the number of page-producing machines in the field ("MIF") and the page volume and mix of pages printed on color devices, where available.

Consistent with our strategy to expand our Services offerings through acquisitions, we acquired the following companies in 2012:

- Wireless Data Services ("WDS"), a telecommunications technical support and consultancy firm headquartered in the United Kingdom.

- Lateral Data, a leading e-discovery technology provider based in the United States.

- LaserNetworks Inc., a Canada-based provider of managed print services solutions that include print device tracking, centralized service and supply management and document routing.

- XL World, a multi-lingual customer care firm based in Italy that will further expand our BPO capabilities across Europe.
Management’s Discussion

In addition, during 2012 we acquired companies that expand our distribution capacity for Xerox document technology to small and mid-sized businesses (“SMB”) and in under-penetrated markets. These acquisitions include R.K. Dixon, a leading provider of IT services, printers and managed print services, with locations in seven Iowa and Illinois cities. We also enhanced our distribution capabilities by acquiring office products distributors in Wisconsin, California and Illinois.

Financial Overview

During 2012 we focused on aligning our costs, investments, diverse portfolio and operations with our services-led strategy that is designed to accelerate growth in Services while maximizing the profitability of our Document Technology business.

Total revenue of $22.4 billion in 2012 declined 1% from the prior year, with a 1-percentage point negative impact from currency. Total revenue reflected 6% growth in our Services segment as a result of strong performance in BPO, ITO and DO services. Document Technology revenues in 2012 declined 8% from the prior year and included a 2-percentage point negative impact from currency. Document Technology revenues in 2012 continued to be impacted by the weak macro-economic environment as well as an increasing migration of customers to our managed print services.

Net income attributable to Xerox for 2012 was $1,195 million and included $316 million of after-tax costs and expenses related to the amortization of intangible assets and restructuring. Net income for 2012 reflects continued pressure on margins, as we scale our revenue in Services and ramp-up new contracts, partially offset by operational improvements and cost reductions from restructing actions. We incurred additional pre-tax restructuring charges of $120 million in 2012 as compared to 2011 as we actively manage our cost structure to improve profitability and better align it with our services-focused business model. Net income attributable to Xerox for 2011 was $1,295 million and included $305 million of after-tax costs and expenses related to the amortization of intangible assets, restructuring and the loss on the early extinguishment of a long-term liability, which were partially offset by an after-tax curtailment gain of $66 million.

Cash flow from operations was $2.6 billion in 2012 as compared to $2.0 billion in 2011. The increase in cash was primarily due to the sales of receivables as well as a higher net runoff of finance receivables as a result of lower equipment sales. This increase was partially offset by higher accounts receivables primarily due to the growth in Services revenue. Cash used in investing activities of $761 million primarily reflects capital expenditures of $513 million and acquisitions of $276 million. Cash used in financing activities was $1.5 billion, which primarily reflects $1.1 billion for the repurchase of common stock, $255 million for dividends and a $100 million reduction in Commercial Paper. We also issued approximately $1.1 billion in new Senior Notes to fund the May 2012 maturity of our $1.1 billion 5.59% Senior Notes.

We expect 2013 revenue in the range of flat to growing 2%, excluding the impact of currency. In our Services business, we expect continued revenue growth in the mid-to-high single digits. Services margins are expected to be in the 10%-12% range as the Company places a heightened focus on operational efficiencies and applying innovation to automate more business processes. In our Document Technology business, we expect a mid-single digit revenue decline, an improvement from the prior year. The Company expects to benefit from product launches and the expansion of indirect channels plus the acceleration of color printing in key markets, all of which partially offset declines primarily related to black-and-white printing. Margins in Document Technology are expected to be flat on a year-over-year basis, continuing to support the strong profitability of this mature business and providing flexibility to accelerate growth in the digital color and SMB markets.

Europe

As of and for the year ended December 31, 2012, approximately $3.1 billion of our total revenues and $4.1 billion of our total assets are based in countries where the Euro is the functional currency. Approximately $1.8 billion of those assets are finance receivables and approximately 15% of those receivables are with governmental entities. Accordingly, we are impacted by the challenges facing the Euro zone economies and governments, and we expect those challenges to continue into 2013.

Currency Impact

To understand the trends in the business, we believe that it is helpful to analyze the impact of changes in the translation of foreign currencies into U.S. Dollars on revenue 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 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 34% of our consolidated revenues are derived from operations outside of the United States where the U.S. Dollar is normally 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 5% stronger in 2012 and 5% weaker in 2011, each compared to the prior year. As a result, the foreign currency translation impact on revenue was a 1% detriment in 2012 and a 2% benefit in 2011.
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

Application of the various accounting principles in GAAP related to the measurement and recognition of revenue requires us to make judgments and estimates. Complex arrangements with nonstandard terms and conditions may require significant contract interpretation to determine the appropriate accounting. Refer to Note 1 – Summary of Significant Accounting Policies – Revenue Recognition in the Consolidated Financial Statements for additional information regarding our revenue recognition policies. Specifically, the revenue related to the following areas involves significant judgments and estimates:

- Bundled Lease Arrangements
- Sales to Distributors and Resellers
- Services – Percentage-of-completion

Bundled Lease Arrangements – We sell our equipment under bundled lease arrangements, which typically include the equipment, service, supplies and a financing component for which the customer pays a single negotiated monthly fixed price for all elements over the contractual lease term. Approximately 35% of our equipment sales revenue is related to sales made under bundled lease arrangements. Recognizing revenues under these arrangements requires us to allocate the total consideration received to the lease and non-lease deliverables included in the bundled arrangement, based upon the estimated fair values of each element.

Sales to Distributors and Resellers – We utilize distributors and resellers to sell many of our Document Technology products to end-user customers. Sales to distributors and resellers are generally recognized as revenue when products are sold to such distributors and resellers. Distributors and resellers participate in various rebate, price-protection, cooperative marketing and other programs, and we record provisions and allowances for these programs as a reduction to revenue when the sales occur. Similarly, we also record estimates for sales returns and other discounts and allowances when the sales occur. We consider various factors, including a review of specific transactions and programs, historical experience and market and economic conditions when calculating these provisions and allowances. Approximately 10% of our revenues include sales to distributors and resellers, and provisions and allowances recorded on these sales are approximately 20% of the associated gross revenues.

Revenue Recognition for Services – Percentage-of-Completion – A portion of our Services revenue is recognized using the percentage-of-completion (“POC”) accounting method. This method requires the use of estimates and judgment. Approximately 3% of our Services revenue uses the POC accounting method. Although not significant to total Services revenue, the percentage-of-completion methodology is normally applied to certain of our larger and longer term outsourcing contracts involving system development and implementation services.

The POC accounting methodology involves recognizing probable and reasonably estimable revenue using the percentage of services completed based on a current cumulative cost to estimated total cost basis and a reasonably consistent profit margin over the period. Due to the long-term nature of these arrangements, developing the estimates of cost 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. We perform ongoing profitability analysis of our POC services contracts in order to determine whether the latest estimates require updating. Key factors reviewed by the company to estimate the future costs to complete each contract are future labor costs, future product costs and expected productivity efficiencies. If at any time these estimates indicate the POC contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately in cost of services.
Management’s Discussion

Allowance for Doubtful Accounts and Credit Losses

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 recorded bad debt provisions of $120 million, $157 million and $188 million in SAG expenses in our Consolidated Statements of Income for the years ended December 31, 2012, 2011 and 2010, respectively.

Bad debt provisions decreased by $37 million in 2012. Reserves, as a percentage of trade and finance receivables, were 3.3% at December 31, 2012, which was consistent with the percentage at December 31, 2011 and 2010. The decrease in bad debt provisions was primarily related to improvements in Europe, reflecting a stabilization of credit issues noted in the prior year. 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. In addition, although our bad debt provisions improved in Europe, this region continues to be a focus of our credit review and analysis.

As discussed above, 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, 2012, our reserve for doubtful accounts ranged from 3.3% to 4.1% of gross receivables. Holding all assumptions constant, a 1-percentage point increase or decrease in the reserve from the December 31, 2012 rate of 3.3% would change the 2012 provision by approximately $85 million.

Refer to Note 4 – Accounts Receivables, Net and Note 5 – Finance Receivables, Net in the Consolidated Financial Statements for additional information regarding our allowance for doubtful accounts.

Pension Plan Assumptions

We sponsor defined benefit pension plans in various forms in several countries covering employees who meet eligibility requirements. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense, liability and asset values related to our defined benefit pension plans. These factors include assumptions we make about the expected return on plan assets, discount rates, 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 over future periods. We used a consolidated weighted average expected rate of return on plan assets of 6.9% for 2012, 7.2% for 2011 and 7.3% for 2010, on a worldwide basis. During 2012, the actual return on plan assets was $792 million as compared to an expected return of $613 million. When estimating the 2013 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, particularly in light of current economic conditions, 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 2013 is 6.7%. The reduction in the expected rate of return in 2013 as compared to 2012 primarily reflects an expected slight decrease in long-term capital market returns.

Another significant assumption affecting our defined benefit pension obligations and the net periodic benefit cost is the rate that we use to discount our future anticipated benefit obligations. In the U.S. and the U.K., which comprise approximately 75% of our projected benefit obligation, 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 consolidated weighted average discount rate we used to measure our pension obligations as of December 31, 2012 and to calculate our 2013 expense was 3.9%, which is lower than the 4.7% that was used to calculate our obligations as of December 31, 2011 and our 2012 expense. The weighted average discount rate we used to measure our retiree health obligation as of December 31, 2012 and to calculate our 2013 expense was 3.6%, which is lower than the 4.5% that was used to calculate our obligation at December 31, 2011 and our 2012 expense.

Holding all other assumptions constant, a 0.25% increase or decrease in the discount rate would change the 2013 projected net periodic pension cost by $31 million. Likewise, a 0.25% increase or decrease in the expected return on plan assets would change the 2013 projected net periodic pension cost by $19 million.

One of the most significant and volatile elements of our net periodic defined benefit pension plan expense is settlement losses. Our primary domestic plans allow participants the option of settling their vested benefits through either the receipt of a lump-sum payment or the purchase of a non-participating annuity contract with an insurance company. Annuity purchases represent benefits to be provided via contracts under which an insurance company is obligated to pay the benefits. Accordingly, under either option, the participant’s vested benefit is considered fully settled upon payment of the lump-sum or the purchase of the annuity. Approximately two-thirds of participants elect to receive a lump-sum payment.

We have elected to apply settlement accounting and, therefore, we recognize the losses associated with these settlements immediately upon the settlement of the vested benefits. Settlement accounting requires us to recognize a pro rata portion of the aggregate
Benefit plan costs are included in several income statement components based on the related underlying employee costs.

### Benefit Plan Funding:

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<tr>
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<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
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<tbody>
<tr>
<td>Defined benefit pension plans:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$195</td>
<td>$364</td>
<td>$426</td>
<td>$237</td>
</tr>
<tr>
<td>Stock</td>
<td>–</td>
<td>130</td>
<td>130</td>
<td>–</td>
</tr>
<tr>
<td>Total</td>
<td>195</td>
<td>494</td>
<td>556</td>
<td>237</td>
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<tr>
<td>Defined contribution plans</td>
<td>113</td>
<td>63</td>
<td>66</td>
<td>51</td>
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<tr>
<td>Retiree health benefit plans</td>
<td>80</td>
<td>84</td>
<td>73</td>
<td>92</td>
</tr>
<tr>
<td><strong>Total Benefit Plan Funding</strong></td>
<td><strong>$388</strong></td>
<td><strong>$641</strong></td>
<td><strong>$695</strong></td>
<td><strong>$380</strong></td>
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The decrease in required contributions to our worldwide defined benefit pension plans is largely in the U.S. and reflects the expected benefits from the pension funding legislation enacted in the U.S. during 2012. This decrease is partially offset by an expected increase in contributions to our defined contribution plans.

Refer to Note 15 – Employee Benefit Plans in the Consolidated Financial Statements for additional information regarding expense and funding.

### Income Taxes

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. Adjustments to our valuation allowance, through (credits) charges to income tax expense, were $(9) million, $(5) million and $22 million for the years ended December 31, 2012, 2011 and 2010, respectively. There were other (decreases) increases to our valuation allowance, including the effects of currency, of $(14) million, $(53) million and $11 million for the years ended December 31, 2012, 2011 and 2010, 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 $3.8 billion had valuation allowances of $654 million and $677 million at December 31, 2012 and 2011, respectively.

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**Notes:**

1. Estimated 2013 assumes settlement losses are consistent with 2012.
2. Refer to the “Plan Amendment” section in Note 15 – Employee Benefit Plans in the Consolidated Financial Statements for further information.

Our estimated 2013 defined benefit pension plan cost is expected to be approximately $100 million lower than 2012, primarily driven by the U.S. defined benefit plan freeze at December 31, 2012, which eliminated approximately $100 million of service costs and reduced the amortization of actuarial losses by $47 million. These impacts were partially offset by the worldwide 80 bps decrease in the discount rate. Offsetting the decrease in our defined benefit pension plan expense is an increase in expense associated with our defined contribution plans as employees from those defined benefit pension plans that have been amended to freeze future service accruals are transitioned to enhanced defined contribution plans.
Management’s Discussion

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. Unrecognized tax benefits were $201 million, $225 million and $186 million at December 31, 2012, 2011 and 2010, respectively. Refer to Note 16 – Income and Other Taxes in the Consolidated Financial Statements for additional information regarding deferred income taxes and unrecognized tax benefits.

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 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. Refer to Note 3 – Acquisitions in the Consolidated Financial Statements for additional information regarding the allocation of the purchase price consideration for our acquisitions.

As a result of our acquisition of ACS, as well as other acquisitions including GIS, we have a significant amount of goodwill. Goodwill at December 31, 2012 was $9.1 billion. Goodwill is not amortized but rather is tested for impairment annually or more frequently if an event or circumstance indicates that an impairment may have been incurred.

Application of the annual 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 the assessment – qualitatively or quantitatively – of the fair value of each reporting unit against its carrying value. At December 31, 2012, $6.8 billion and $2.3 billion of goodwill was allocated to reporting units within our Services and Document Technology segments, respectively. Our Services segment is comprised of three reporting units while our Document Technology segment is comprised of one reporting unit for a total of four reporting units with goodwill balances.

Our annual impairment test of goodwill was performed in the fourth quarter of 2012. As a result of market and business conditions, we elected to utilize a quantitative assessment of the recoverability of our goodwill balances for each of our reporting units.

In our quantitative test, we estimate the fair value of each reporting unit using a discounted cash flow methodology. This valuation approach requires significant judgment and considers a number of factors that include, but are not limited to, expected future cash flows, growth rates and discount rates, and it requires us to make certain assumptions and estimates regarding the current economic environment, industry factors and the future profitability of our business.

When performing our discounted cash flow analysis for each reporting unit, we incorporate the use of projected financial information and discount rates that are developed using market participant-based assumptions. The cash-flow projections are based on five-year financial forecasts developed by management that include revenue and expense projections, capital spending trends, and investment in working capital to support anticipated revenue growth or other changes in the business. The selected discount rates consider the risk and nature of the respective reporting units’ cash flows and an appropriate capital structure and rates of return that market participants would require to invest their capital in our reporting units.

In performing our 2012 impairment test, the following were the long-term assumptions for Document Technology and the three reporting units within our Services segment with respect to revenue, operating income and margins, which formed the basis for estimating future cash flows used in the discounted cash flow model:

- **Document Technology** – revenue decline: 2%-3%, operating income: flat, operating margin: 10%-12% – as we continue to manage costs as a result of an expected decline in revenues.
- **Services** – revenue growth: 4%-6%, operating income growth: 7%-10%, operating margin: 10%-12% – as we benefit from recurring revenue and strong signings growth in recent years while maintaining costs and expenses.

We believe these assumptions are appropriate because they are consistent with historical results as well as our forecasted long-term business model and give appropriate consideration to the current economic environment and markets that we serve. The average discount rate applied to our projected cash flows was approximately 10%, which we considered reasonable based on the estimated capital costs of applicable market participants. Although the sum of the fair values of our reporting units was in excess of our market capitalization, we believe the difference is reasonable when market-based control premiums and other factors are taken into consideration, including the evolution of our business to be predominantly services-based. We also compared our reporting unit and consolidated valuations against market multiples and likewise concluded that our valuations were reasonable.

The results of our testing indicated that each of our reporting units has a fair value in excess of its carrying value and no impairment charge was required. The excess of reporting unit fair values over carrying values for our Document Technology reporting unit and the BPO/ITO Government reporting unit within our Services segment (which has approximately $2.0 billion of goodwill) are significantly less than in prior years with excess of fair value over carrying value of approximately 20% and 10%, respectively.
We will continue to monitor the impact of economic, market and industry factors impacting these reporting units in 2013. Subsequent to our fourth quarter impairment test, we did not identify any indicators of potential impairment that required an update to the annual impairment test. Refer to Note 9 – Goodwill and Intangible Assets, Net in the Consolidated Financial Statements for additional information regarding goodwill by reportable segment.

**Revenue Results Summary**

**Total Revenue**

Revenue for the three years ended December 31, 2012 was as follows:

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</tr>
</thead>
<tbody>
<tr>
<td>Equipment sales</td>
<td>$3,476</td>
<td>$3,856</td>
<td>$3,857</td>
<td>(10)%</td>
<td>–</td>
<td>–</td>
<td>16%</td>
<td>17%</td>
</tr>
<tr>
<td>Annuity revenue</td>
<td>18,914</td>
<td>18,770</td>
<td>17,776</td>
<td>1%</td>
<td>6%</td>
<td>2%</td>
<td>84%</td>
<td>83%</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td>$22,390</td>
<td>$22,626</td>
<td>$21,633</td>
<td>(1)%</td>
<td>5%</td>
<td>2%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Reconciliation to Consolidated Statements of Income:

Sales | $6,578 | $7,126 | $7,234 |
Less: Supplies and other sales | (2,273) | (2,371) | (2,420) |
Less: Paper sales | (829) | (899) | (957) |

**Equipment Sales** | $3,476 | $3,856 | $3,857 | (10)% | – | – | 16% | 17% | 18% |

Outsourcing, service and rentals | $15,215 | $14,868 | $13,739 | 2% | 8% | 4% | 68% | 66% | 64% |
Add: Finance income | 597 | 632 | 660 | (6)% | (4)% | (4)% | 2% | 3% | 3% |
Add: Supplies and other sales | 2,273 | 2,371 | 2,420 | (4)% | (2)% | (3)% | 10% | 10% | 11% |
Add: Paper sales | 829 | 899 | 957 | (8)% | (6)% | (6)% | 4% | 4% | 4% |

**Annuity Revenue** | $18,914 | $18,770 | $17,776 | 1% | 6% | 2% | 84% | 83% | 82% |

(1) 2011 Results are discussed primarily on a pro-forma basis and include ACS’s estimated results from January 1 through February 5 in 2010. See the “Non-GAAP Financial Measures” section for an explanation of this non-GAAP financial measure.

**Revenue 2012**

Total revenues decreased 1% compared to the prior year and included a 1-percentage point negative impact from currency. Total revenues included the following:

- **Annuity revenue** increased 1% and included a 1-percentage point negative impact from currency. Annuity revenue is comprised of the following:
  - **Outsourcing, service and rentals revenue** — includes outsourcing revenue within our Services segment and technical service revenue (including bundled supplies) and rental revenue, both primarily within our Document Technology segment. Revenues of $15,215 million increased 2% and included a 2-percentage point negative impact from currency. The increase was primarily driven by growth in all three lines of business in our Services segment, partially offset by a decline in technical service revenues. Total digital pages declined 2% despite a 3% increase in digital MIF.
  - **Supplies and other sales** — includes unbundled supplies and other sales, primarily within our Document Technology segment. Revenues of $2,273 million decreased 4% and included a 1-percentage point negative impact from currency. The decrease was primarily due to moderately lower demand.
  - **Paper sales** — which are primarily included within our Other segment, of $829 million decreased 8% and included a 2-percentage point negative impact from currency, driven primarily by market pricing and lower activity.
  - **Finance income** — includes $44 million in gains from the sale of finance receivables from our Document Technology segment (see Note 5 – Finance Receivables, Net in the Consolidated Financial Statements for additional information).
Management’s Discussion

- **Equipment sales revenue** is reported primarily within our Document Technology segment and the document outsourcing business within our Services segment. Equipment sales revenue decreased 10% and included a 2-percentage point negative impact from currency, primarily driven by delayed customer decision-making and overall weak economic and market conditions. An increase in total product installs was offset by the impact of lower product mix and price declines. Price declines were in the range of 5% - 10%.

  Equipment sales within our Services segment continued to grow, driven by the migration of customers looking to reduce printing costs by moving to our document outsourcing offering.

- **Color** revenue decreased 6%, including a 2-percentage point negative impact from currency. An increase in color pages of 9% and color MIF of 14% were offset by a decline in color equipment sales revenue, driven primarily by weakness in Europe and the impact of lower product mix. Color pages represented 30% of total pages in 2012.

Revenue 2011

Total revenues increased 5% compared to the prior year. Our consolidated 2011 results include a full year of revenues from ACS, which was acquired on February 5, 2010. On a pro-forma¹ basis, including ACS’s estimated 2010 revenues for the period from January 1 through February 5 in our historical 2010 results, the total revenue for 2011 grew 2%. Total revenue growth included a 2-percentage point positive impact from currency. Total revenues included the following:

- **Annuity revenue increased 6% or 2% on a pro-forma¹ basis, with a 1-percentage point positive impact from currency. Annuity revenue is comprised of the following:**
  - Outsourcing, service and rentals revenue of $14,868 million increased 8%, or 4% on a pro-forma¹ basis, and included a 2-percentage point positive impact from currency. The increase was primarily due to growth in BPO and DO revenue in our Services segment partially offset by a decline in pages. Total digital pages declined 3% despite a 2% increase in digital MIF.
  - Supplies and other sales of $2,371 million decreased 2%, or 3% on a pro-forma¹ basis, with no impact from currency.
  - Paper sales of $899 million decreased 6% and included a 2-percentage point negative impact from currency.
  - Equipment sales revenue was flat and included a 1-percentage point positive impact from currency. Favorable product mix in high-end products was offset by price declines in the range of 5% - 10%.
  - Color² revenue increased 5%, including a 2-percentage point negative impact from currency. This increase was due to an increase in color pages of 9% and an increase in color equipment sales revenue of 4%. Color² pages represented 27% of total pages in 2011 while color device MIF represented 35% of total MIF.

  An analysis of the change in revenue for each business segment is included in the “Operations Review of Segment Revenue and Profit” section.

Costs, Expenses and Other Income

Summary of Key Financial Ratios

<table>
<thead>
<tr>
<th></th>
<th>Year Ended December 31,</th>
<th>Change</th>
<th>Pro-forma (¹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Gross Margin</td>
<td>31.4%</td>
<td>32.8%</td>
<td>34.4%</td>
</tr>
<tr>
<td>RD&amp;E as a % of Revenue</td>
<td>2.9%</td>
<td>3.2%</td>
<td>3.6%</td>
</tr>
<tr>
<td>SAG as a % of Revenue</td>
<td>19.2%</td>
<td>19.9%</td>
<td>21.2%</td>
</tr>
<tr>
<td>Operating Margin (²)</td>
<td>9.3%</td>
<td>9.8%</td>
<td>9.6%</td>
</tr>
<tr>
<td>Pre-tax Income Margin</td>
<td>6.0%</td>
<td>6.9%</td>
<td>3.8%</td>
</tr>
</tbody>
</table>

(¹) See the “Non-GAAP Financial Measures” section for an explanation of Pro-forma and Operating Margin non-GAAP financial measures.
Operating Margin

The operating margin\(^1\) for the year ended December 31, 2012 of 9.3% decreased 0.5-percentage points as compared to 2011. The decline, which was primarily in our Services segment due to a decrease in gross margin, was partially offset by expense reductions.

The operating margin\(^1\) for the year ended December 31, 2011 of 9.8% increased 0.2-percentage points, or 0.3-percentage points on a pro-forma\(^1\) basis, as compared to 2010. The increase was due primarily to disciplined cost and expense management.

Note: The acquisition of ACS increased the proportion of our revenue from services, which has a lower gross margin and SAG as a percent of revenue than we historically experienced when Xerox was primarily a technology company. As a result, in 2011 gross margins and SAG are also discussed below on a pro-forma basis where we adjust our historical 2010 results to include ACS’s 2010 estimated results for the period from January 1 through February 5, 2010. Refer to the “Non-GAAP Financial Measures” section for a further explanation and discussion of this non-GAAP presentation.

Gross Margin

Gross margin for year ended December 31, 2012 of 31.4% decreased 1.4-percentage points as compared to 2011. The decrease was driven by the overall mix of services revenue, the ramping of new services contracts and pressure on government contracts, particularly in the third quarter 2012. These negative impacts were partially offset by productivity improvements and cost savings from restructuring.

Gross margin for year ended December 31, 2011 of 32.8% decreased 1.6-percentage points, or 1.1-percentage points on a pro-forma\(^1\) basis, as compared to 2010. The decrease was driven by the ramping of new services contracts, the impact of lower contract renewals, transaction currency and the mix of higher services revenue.

Services gross margin for the year ended December 31, 2012 decreased 1.7-percentage points as compared to 2011. The decrease is primarily due to the ramping of new services contracts within BPO and ITO and pressure on government contracts, particularly in the third quarter 2012.

Services gross margin for the year ended December 31, 2011 decreased 1.7-percentage points, or 1.2 percentage points, on a pro-forma\(^1\) basis, as compared to 2010. The decrease is primarily due to the ramping of new services contracts within BPO and ITO and the impact of lower contract renewals.

Document Technology gross margin for the year ended December 31, 2012 increased by 0.1-percentage points as compared to 2011. Productivity improvements, restructuring savings and gains recognized on the sales of finance receivables (see Note 5 – Finance Receivables, Net in the Consolidated Financial Statements for additional information) more than offset the impact of price declines, product mix and the unfavorable year-over-year impact of transaction currency.

Document Technology gross margin for the year ended December 31, 2011 decreased by 0.9-percentage points as compared to 2010 due to the impact of price declines and the negative year-over-year impact of transaction currency. The decline was partially offset by cost productivities and restructuring savings which reflect our continued focus on cost management.

Research, Development and Engineering Expenses (“RD&E”)

<table>
<thead>
<tr>
<th>(in millions)</th>
<th>Year Ended December 31,</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>R&amp;D</td>
<td>$545</td>
<td>$613</td>
</tr>
<tr>
<td>Sustaining engineering</td>
<td>110</td>
<td>108</td>
</tr>
<tr>
<td><strong>Total RD&amp;E Expenses</strong></td>
<td><strong>$655</strong></td>
<td><strong>$721</strong></td>
</tr>
<tr>
<td>R&amp;D Investment by Fuji Xerox(^{(1)})</td>
<td>$860</td>
<td>$880</td>
</tr>
</tbody>
</table>

\(^{(1)}\) Fluctuation in Fuji Xerox R&D was primarily due to changes in foreign exchange rates.
Management’s Discussion

RD&E as a percent of revenue for the year ended December 31, 2012 of 2.9% decreased 0.3-percentage points. In addition to lower spending, the decrease was also driven by the positive mix impact of the continued growth in Services revenue, which historically has a lower RD&E percent of revenue.

RD&E of $655 million for the year ended December 31, 2012, was $66 million lower, reflecting the impact of restructuring and productivity improvements. Innovation is one of our core strengths and we continue to invest at levels that enhance this core strength, particularly in color, software and services. During 2012 we managed our investments in R&D to align with growth opportunities in areas like business services, color printing and customized communication. Xerox R&D is also strategically coordinated with Fuji Xerox.

RD&E as a percent of revenue for the year ended December 31, 2011 of 3.2% decreased 0.4-percentage points. In addition to lower spending, the decrease was also driven by the positive mix impact of the continued growth in Services revenue, which historically has a lower RD&E percent of revenue.

RD&E of $721 million for the year ended December 31, 2011, was $60 million lower, reflecting the impact of restructuring and productivity improvements.

Selling, Administrative and General Expenses (“SAG”)

SAG as a percent of revenue of 19.2% decreased 0.7-percentage points for the year ended December 31, 2012. The decrease was driven by spending reductions reflecting benefits from restructuring and productivity improvements in addition to the positive mix impact from the continued growth in Services revenue, which historically has a lower SAG percent of revenue.

SAG expenses of $4,288 million for the year ended December 31, 2012 were $209 million lower than the prior year period including a $60 million favorable impact from currency. The decrease in SAG expenses reflects the following:

- $240 million decrease in selling expenses reflecting the benefits from restructuring and productivity improvements, as well as lower compensation-related expenses and advertising spending partially offset by the impact of acquisitions.
- $68 million increase in general and administrative expenses as restructuring savings and productivity improvements were more than offset by the impact of acquisitions and deferred compensation expense.
- $37 million decrease in bad debt expenses to $120 million, driven primarily by lower write-offs in Europe.

SAG as a percent of revenue of 19.9% decreased 1.3-percentage points, or 1.0-percentage points on a pro-forma basis, for the year ended December 31, 2011.

SAG expenses of $4,497 million for the year ended December 31, 2011 was $97 million lower than the prior year period, or $156 million lower on a pro-forma basis, both including a $68 million unfavorable impact from currency. The pro-forma SAG expense decrease reflects the following:

- $68 million decrease in selling expenses reflecting the benefits from restructuring, productivity improvements and decrease in brand advertising partially offset by the impact of acquisitions.
- $54 million decrease in general and administrative expenses primarily reflecting lower compensation as well as the benefits from restructuring and operational improvements.
- $31 million decrease in bad debt expense, to $157 million as improvements in write-off trends in North America were more than offset by higher write-offs in southern Europe.

Restructuring and Asset Impairment Charges

During the year ended December 31, 2012, we recorded net restructuring and asset impairment charges of $153 million ($97 million after-tax). Approximately 47% of the charges were related to our Services segment and 53% to our Document Technology segment and included the following:

- $160 million of severance costs related to headcount reductions of approximately 6,300 employees primarily in North America. The actions impacted several functional areas, and approximately 63% of the costs were focused on gross margin improvements, 31% in SAG and 6% on the optimization of RD&E investments.
- $5 million for lease termination costs.
- $2 million of asset impairment losses.

The above charges were partially offset by $14 million of net reversals for changes in estimated reserves from prior period initiatives.

We expect 2013 pre-tax savings of approximately $170 million from our 2012 restructuring actions.

During the year ended December 31, 2011, we recorded net restructuring and asset impairment charges of $33 million ($18 million after-tax) which included the following:

- $98 million of severance costs related to headcount reductions of approximately 3,900 employees primarily in North America. The actions impacted several functional areas, and approximately 55% of the costs were focused on gross margin improvements, 36% on SAG and 9% on the optimization of RD&E investments.
- $1 million for lease termination costs.
- $5 million of asset impairment losses from the disposition of two aircraft associated with the restructuring of our corporate aviation operations.
The above charges were partially offset by $71 million of net reversals for changes in estimated reserves from prior period initiatives.

**Restructuring Summary**

The restructuring reserve balance as of December 31, 2012 for all programs was $130 million, of which approximately $122 million is expected to be spent over the next twelve months. Refer to Note 10 – 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. The remainder of the acquisition-related costs represents external incremental costs directly related to the integration of ACS and Xerox.

**Amortization of Intangible Assets**

During the year ended December 31, 2012, we recorded $328 million of expense related to the amortization of intangible assets, which is $70 million lower than the prior year. The prior year expense included $52 million related to the accelerated amortization of the ACS trade name intangible asset which was fully written off in 2011 as a result of the decision to discontinue its use and transition the services business to the “Xerox Business Services” trade name. The impact from the write-off of the ACS trade name was partially offset by the amortization of intangible assets associated with current and prior-year acquisitions.

During the year ended December 31, 2011, we recorded $398 million of expense related to the amortization of intangible assets, which was $86 million higher than the prior year primarily as a result of the accelerated write-off of the ACS trade name.

**Curtailment Gain**

In December 2011, we amended all of our primary non-union U.S. defined benefit pension plans for salaried employees. Our primary qualified plans had previously been amended to freeze the final average pay formulas within the plans as of December 31, 2012, but the cash balance service credit was expected to continue post December 31, 2012. The 2011 amendments now fully freeze benefit and service accruals after December 31, 2012 for these plans, including the related non-qualified plans. As a result of these plan amendments, we recognized a pre-tax curtailment gain of $107 million ($66 million after-tax), which represents the recognition of deferred gains from other prior year amendments (“prior service credits”) as a result of the discontinuation (“freeze”) of any future benefit or service accrual period. The amendments did not materially impact 2012 pension expense.

**Worldwide Employment**

Worldwide employment of 147,600 at December 31, 2012 increased approximately 8,000 from December 31, 2011, primarily due to the impact of acquisitions, partially offset by restructuring related actions. Worldwide employment was approximately 139,650 and 136,500 at December 2011 and 2010, respectively.

**Other Expenses, Net**

<table>
<thead>
<tr>
<th></th>
<th>Year Ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>Non-financing interest expense</td>
<td>$230</td>
</tr>
<tr>
<td>Interest income</td>
<td>(13)</td>
</tr>
<tr>
<td>Loss (gains) on sales of businesses and assets</td>
<td>2</td>
</tr>
<tr>
<td>Currency losses, net</td>
<td>3</td>
</tr>
<tr>
<td>ACS shareholders litigation settlement</td>
<td>–</td>
</tr>
<tr>
<td>Litigation matters</td>
<td>(1)</td>
</tr>
<tr>
<td>Loss on sales of accounts receivables</td>
<td>21</td>
</tr>
<tr>
<td>Loss on early extinguishment of liability</td>
<td>–</td>
</tr>
<tr>
<td>Deferred compensation investment gains</td>
<td>(10)</td>
</tr>
<tr>
<td>All other expenses, net</td>
<td>24</td>
</tr>
<tr>
<td><strong>Total Other Expenses, Net</strong></td>
<td>$256</td>
</tr>
</tbody>
</table>

**Non-Financing Interest Expense:** Non-financing interest expense for the year ended December 31, 2012 of $230 million was $17 million lower than prior year. The decrease in interest expense is primarily due to the benefit of lower borrowing costs achieved as a result of refinancing existing debt.

Non-financing interest expense for the year ended December 31, 2011 of $247 million was $99 million lower than the prior year. The decrease in interest expense reflects a lower average debt balance due to the repayments of Senior Notes, as well as the benefit of lower borrowing costs achieved as a result of refinancing existing debt and utilizing the commercial paper program.

**Loss (Gains) on Sales of Businesses and Assets:** The gains in 2011 and 2010 were primarily related to 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 and the mark-to-market of foreign exchange contracts utilized to hedge those foreign currency-denominated assets and liabilities.

The 2011 net currency losses were primarily due to the significant movement in exchange rates during the third quarter of 2011 among the U.S. Dollar, Euro, Yen and several developing market currencies.
The 2010 net currency losses included a currency loss of $21 million for the re-measurement of our Venezuelan Bolivar denominated monetary net assets following a devaluation of the Bolivar in the first quarter of 2010. 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.

**ACS Shareholders’ Litigation Settlement:** The 2010 expense of $36 million relates to the settlement of claims by ACS shareholders arising from our acquisition of ACS in 2010. The total settlement for all defendants was approximately $69 million, with Xerox paying approximately $36 million net of insurance proceeds.

**Litigation Matters:** Litigation matters for 2012, 2011 and 2010 represent charges related to probable losses for various legal matters, none of which were individually material. Refer to Note 17 – Contingencies and Litigation, in the Consolidated Financial Statements for additional information regarding litigation against the Company.

**Loss on Sales of Accounts Receivables:** Represents the loss incurred on our sales of accounts receivables. Refer to “Sales of Accounts Receivables” below and Note 4 – Accounts Receivables, Net in the Consolidated Financial Statements for additional information regarding our sales of receivables.

**Loss on Early Extinguishment of Liability:** The 2011 loss of $33 million was related to the redemption by Xerox Capital Trust I, our wholly-owned subsidiary trust, of its $650 million 8% Preferred Securities due in 2027. The redemption resulted in a pre-tax loss of $33 million ($20 million after-tax), representing the call premium of approximately $10 million, as well as the write-off of unamortized debt costs and other liability carrying value adjustments of $23 million.

The 2010 loss of $15 million represents the loss associated with the redemption of senior and medium-term notes in the fourth quarter 2010 and reflects a call premium and the write-off of unamortized debt costs.

**Deferred Compensation Investment Gains:** Represents gains on investments supporting certain of our deferred compensation arrangements. These gains or losses are offset by an increase or decrease, respectively, in compensation expense recorded in SAG in our Services segment as a result of the increase or decrease in the liability associated with these arrangements.

**Income Taxes**

The 2012 effective tax rate was 20.5% or 24.0% on an adjusted basis.\(^1\) The adjusted tax rate for the year was lower than the U.S. statutory rate primarily due to the geographical mix of profits as well as a higher foreign tax credit benefit as a result of our decision to repatriate current year income from certain non-U.S. subsidiaries.

The 2010 effective tax rate was 31.4% or 31.2% on an adjusted basis.\(^1\) The adjusted tax rate for the year was lower than the U.S. statutory rate primarily due to the geographical mix of income before taxes and the related tax rates in those jurisdictions as well as the U.S. tax impacts on certain foreign income and tax law changes.

Xerox operations are widely dispersed. The statutory tax rate in most non-U.S. jurisdictions is lower than the combined U.S. and state tax rate. The amount of income subject to these lower foreign rates relative to the amount of U.S. income will impact our effective tax rate. However, no one country outside of the U.S. is a significant factor to our overall effective tax rate. Certain foreign income is subject to U.S. tax net of any available foreign tax credits. Our full year effective tax rate for 2012 includes a benefit of approximately 12 percentage points from these non-U.S. operations. Refer to Note 16 – Income and Other Taxes, in the Consolidated Financial Statements for additional information regarding the geographic mix of income before taxes and the related impacts on our effective tax rate.

Our effective tax rate is based on nonrecurring events as well as recurring factors, including the taxation of foreign income. In addition, our effective tax rate will change based on discrete or other nonrecurring events (e.g. audit settlements, tax law changes, changes in valuation allowances, etc.) that may not be predictable. We anticipate that our effective tax rate for 2013 will be approximately 28%, which excludes the effects of intangibles amortization and other discrete events. We also expect to record an estimated discrete benefit of approximately $19 million in the first quarter 2013 for the retroactive benefits of the American Taxpayer Relief Act of 2012 which was signed into law on January 2, 2013.

**Equity in Net Income of Unconsolidated Affiliates**

<table>
<thead>
<tr>
<th>(in millions)</th>
<th>Year Ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>Total equity in net income of unconsolidated affiliates</td>
<td>$152</td>
</tr>
<tr>
<td>Fuji Xerox after-tax restructuring costs</td>
<td>16</td>
</tr>
</tbody>
</table>

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

The 2011 increase of $71 million 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 the strengthening of the Yen and lower 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 conditions.

Operations Review of Segment Revenue and Profit

Our reportable segments are consistent with how we manage the business and view the markets we serve. Our reportable segments are Services, Document Technology and Other. Revenues by segment for the three years ended December 31, 2012 were as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Revenue (in millions)</th>
<th>Services Revenue (in millions)</th>
<th>Document Technology Revenue (in millions)</th>
<th>Other Revenue (in millions)</th>
<th>Segment Profit (Loss) (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$22,390</td>
<td>$11,528</td>
<td>9,462</td>
<td>1,400</td>
<td>10.2%</td>
</tr>
<tr>
<td>2011</td>
<td>$22,626</td>
<td>$10,837</td>
<td>10,259</td>
<td>1,530</td>
<td>11.1%</td>
</tr>
<tr>
<td>2010</td>
<td>$21,633</td>
<td>$9,637</td>
<td>10,349</td>
<td>1,647</td>
<td>11.7%</td>
</tr>
</tbody>
</table>

Net Income

Net income attributable to Xerox for the year ended December 31, 2012 was $1,195 million, or $0.88 per diluted share. On an adjusted basis, net income attributable to Xerox was $1,398 million, or $1.03 per diluted share, and included adjustments for the amortization of intangible assets.

Net income attributable to Xerox for the year ended December 31, 2011 was $1,295 million, or $0.90 per diluted share. On an adjusted basis, net income attributable to Xerox was $1,563 million, or $1.08 per diluted share, and included adjustments for the amortization of intangible assets and the loss on early extinguishment of liability.

Net income attributable to Xerox for the year ended December 31, 2010 was $606 million, or $0.43 per diluted share. On an adjusted basis, net income attributable to Xerox was $1,296 million, or $0.94 per diluted share, and included adjustments for the amortization of intangible assets, restructuring and asset impairment charges (including those incurred by Fuji Xerox), acquisition-related costs and other discrete costs and expenses.

Refer to the “Non-GAAP Financial Measures” section for the reconciliation of reported net income to adjusted net income.

Other Comprehensive Income

2012 Other comprehensive loss attributable to Xerox of $511 million decreased $217 million from 2011. The decreased loss was primarily due to gains from the translation of our foreign currency-denominated net assets in 2012 as compared to translation losses in 2011. The translation gains are the result of a strengthening of our major foreign currencies against the U.S. Dollar in 2012 as compared to a weakening of those same currencies in 2011. A decrease in losses associated with our defined benefit plans was offset by an increase in unrealized losses from our cash flow hedges primarily due to a weakening of the Japanese Yen particularly in the fourth quarter 2012 (See Note 13 – Financial Instruments in the Consolidated Financial Statements for additional information regarding our cash flow hedges).

2011 Other comprehensive loss attributable to Xerox of $728 million increased $728 million from 2010. The increased loss was primarily due to losses associated with our defined benefit plans due to an increase in our benefit obligations as a result of a decrease in the discount rates used to measure our obligations (See discussion of Pension Plan Assumptions in the Application of Critical Accounting Policies section of the MD&A as well as Note 15 – Employee Benefit Plans in the Consolidated Financial Statements for additional information regarding our cash flow hedges).

2011 Other comprehensive loss attributable to Xerox of $728 million increased $728 million from 2010. The increased loss was primarily due to losses associated with our defined benefit plans due to an increase in our benefit obligations as a result of a decrease in the discount rates used to measure our obligations (See discussion of Pension Plan Assumptions in the Application of Critical Accounting Policies section of the MD&A as well as Note 15 – Employee Benefit Plans in the Consolidated Financial Statements for additional information regarding our cash flow hedges).

Services Segment

Our Services segment is comprised of three service offerings: Business Process Outsourcing (“BPO”), Document Outsourcing (“DO”) and Information Technology Outsourcing (“ITO”). The DO business included within the Services segment essentially represents Xerox’s pre-ACS acquisition outsourcing business, as ACS’s outsourcing business is reported as BPO and ITO revenue.

Refer to Note 8 – Investment in Affiliates, at Equity, in the Consolidated Financial Statements for additional information.
Management’s Discussion

Services segment revenues for the three years ended December 31, 2012 were as follows:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Business processing outsourcing</td>
<td>$6,610</td>
<td>$6,074</td>
<td>$5,145</td>
<td>9%</td>
<td>18%</td>
<td>8%</td>
</tr>
<tr>
<td>Document outsourcing</td>
<td>3,659</td>
<td>3,545</td>
<td>3,264</td>
<td>3%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Information technology outsourcing</td>
<td>1,426</td>
<td>1,326</td>
<td>1,249</td>
<td>8%</td>
<td>6%</td>
<td>(4)%</td>
</tr>
<tr>
<td>Less: Intra-segment elimination</td>
<td>(167)</td>
<td>(108)</td>
<td>(21)</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td><strong>Total Services Revenue</strong></td>
<td>$11,528</td>
<td>$10,837</td>
<td>$9,637</td>
<td>6%</td>
<td>12%</td>
<td>6%</td>
</tr>
</tbody>
</table>

* Percent not meaningful.

(1) See the “Non-GAAP Financial Measures” section for an explanation of this non-GAAP financial measure.

**Note:** In 2011, the Services segment is discussed on a pro-forma basis. ACS was acquired on February 5, 2010, accordingly for comparison purposes, we adjusted our historical 2010 results to include ACS’s 2010 estimated results for the period from January 1 through February 5, 2010. We believe these pro-forma comparisons provide a perspective on the impact of the ACS acquisition on our results and trends. Refer to the “Non-GAAP Financial Measures” section for a further explanation and discussion of this non-GAAP presentation.

**Revenue 2012**

Services revenue of $11,528 million increased 6% with a 1-percentage point negative impact from currency.

- BPO revenue increased 9%, including a 1-percentage point negative impact from currency, and represented 57% of total Services revenue. BPO growth was driven by the government healthcare, healthcare payer, customer care, financial services, retail, travel and insurance businesses and other state government solutions, as well as the benefits from recent acquisitions.

- DO revenue increased 3%, including a 2-percentage point negative impact from currency, and represented 31% of total Services revenue. The increase in DO revenue was primarily driven by our new partner print services offerings as well as new signings.

- ITO revenue increased 8% and represented 12% of total Services revenue. ITO growth was driven by the revenue ramp resulting from strong growth in recent quarters and also includes 3-percentage points of growth related to revenue from intercompany services, which is eliminated in total Services segment revenue.

**Segment Margin 2012**

Services segment margin of 10.2% decreased 0.9-percentage points from the prior year primarily due to a decline in gross margin, which was driven by the ramping of new services contracts, pressure on government contracts, the impact of lower contract renewals and lower volumes in some areas of the business. The gross margin decline was partially offset by the benefits from restructuring and lower SAG, primarily in DO.

**Metrics**

**Pipeline**

Our total services sales pipeline at December 31, 2012, including synergy opportunities, grew 6% over the prior year. This sales pipeline includes the Total Contract Value (“TCV”) of new business opportunities that potentially could be contracted within the next six months and excludes business opportunities with estimated annual recurring revenue in excess of $100 million.

**Signings**

Signings are defined as estimated future revenues from contracts signed during the period, including renewals of existing contracts. TCV represents the estimated future contract revenue for pipeline or signed contracts for signings, as applicable.

Signings were as follows:

<table>
<thead>
<tr>
<th></th>
<th>2012 (in billions)</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>BPO</td>
<td>$6.0</td>
<td>$6.8</td>
<td>$10.0</td>
</tr>
<tr>
<td>DO</td>
<td>3.3</td>
<td>4.4</td>
<td>3.3</td>
</tr>
<tr>
<td>ITO</td>
<td>1.5</td>
<td>3.4</td>
<td>1.3</td>
</tr>
<tr>
<td><strong>Total Signings</strong></td>
<td><strong>$10.8</strong></td>
<td><strong>$14.6</strong></td>
<td><strong>$14.6</strong></td>
</tr>
</tbody>
</table>

Services signings were an estimated $10.8 billion in TCV for 2012 and decreased 25% compared to the prior year. This decline was driven by a decrease in large deals from the prior year as well as delays in customer decision making. While the total number of BPO/ITO contracts signed in 2012 increased from 2011, the decline in large deals drove a reduction in the average contract length of new business signings in 2012. The above DO signings amount represents Enterprise signings only and does not include signings from our partner print services offerings, which is driving the revenue growth in DO.
Services signings were an estimated $14.6 billion in TCV for 2011 and were flat as compared to the prior year and were impacted by the cyclical nature of large deals particularly the California Medicaid signing in 2010. Signings did trend positively in 2011, increasing sequentially for the last three quarters of the year with signings growth particularly in ITO.

Renewal rate (BPO and ITO only)

Renewal rate is defined as the annual recurring revenue (“ARR”) on contracts that are renewed during the period as a percentage of ARR on all contracts on which a renewal decision was made during the period. Although our renewal rate was below our target range in the fourth quarter 2012, our full year 2012 renewal rate was 85%, which was within our target range of 85%-90% and 5-percentage points higher than full year 2011. Our 2011 renewal rate of 80% was 7-percentage points lower than the 2010 renewal rate of 87%.

Revenue 2011

Services revenue of $10,837 million increased 12%, or 6% on a pro-forma basis, with no impact from currency.

- BPO revenue had pro-forma revenue growth of 8% and represented 55% of total Services revenue. The growth in BPO was primarily driven by acquisitions over the past two years consistent with our strategy to expand our service offerings through “tuck-in” acquisitions. BPO growth was also driven to a lesser extent by growth in the healthcare payer, human resources services, business process solutions and transportation solutions businesses.
- DO revenue increased 9%, including a 2-percentage point positive impact from currency, and represented 33% of total Services revenue. The increase in DO revenue reflects an improving growth trend from our partner print services offerings as well as new signings.
- ITO revenue on a pro-forma basis decreased 4% and represented 12% of total Services revenue. The decrease in ITO revenue was driven by lower third-party equipment sales as well as the impact of lower contract renewals partially offset by growth in new commercial business.

Segment Margin 2011

Services segment margin of 11.1% decreased 0.6-percentage points, or 0.3-percentage points on a pro-forma basis, from the prior year as the gross margin decline, which was driven by the ramping of new services contracts and the impact of lower contract renewals more than offset the lower costs and expenses from restructuring and synergy savings.

Document Technology Segment

Our Document Technology segment includes the sale of products and supplies, as well as the associated technical service and financing of those products. The Document Technology segment represents our pre-ACS acquisition equipment-related business exclusive of our document outsourcing business, which was integrated into the Services segment together with the acquired ACS outsourcing businesses – business process outsourcing and information technology outsourcing.

Revenue

<table>
<thead>
<tr>
<th></th>
<th>Year Ended December 31,</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment sales</td>
<td>$ 2,879</td>
<td>$ 3,277</td>
</tr>
<tr>
<td>Annuity revenue</td>
<td>6,583</td>
<td>6,982</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>$ 9,462</td>
<td>$ 10,259</td>
</tr>
</tbody>
</table>

Revenue 2012

Document Technology revenue of $9,462 million decreased 8%, including a 2-percentage point negative impact from currency. Total revenues include the following:

- 12% decrease in equipment sales revenue with a 1-percentage point negative impact from currency. This decline, primarily in mid-range and high-end equipment, was driven by delayed customer decision-making reflecting the continued weak macro-environment. In addition, the impact of lower product mix and price declines in the range of 5%-10% more than offset growth in installs. Document Technology revenue excludes increasing revenues in our DO offerings. As noted previously, in 2013 we will be investing in our portfolio with significant product announcements in the mid-range and entry production color spaces.
- 6% decrease in annuity revenue, including a 2-percentage point negative impact from currency, driven by lower supplies and a decline in total digital pages of 2% as well as the continued migration of customers to our partner print services offerings, which is included in our Services segment.
- Document Technology revenue mix is 22% entry, 57% mid-range and 21% high-end.

Segment Margin 2012

Document Technology segment margin of 11.3% increased 0.2-percentage points from prior year. Productivity improvements, restructuring savings and gains recognized on the sale of finance receivables (see Note 5 – Finance Receivables, Net in the Consolidated Financial Statements for additional information) more than offset the impact of price declines and overall lower revenues.
Installs 2012

Entry
- 39% increase in color multifunction devices driven by demand for the WorkCentre® 6015, WorkCentre 6605 and Xerox® ColorQube 8700/8900.
- 23% increase in entry black-and-white multifunction devices driven by demand for the WorkCentre® 3045.
- 7% decrease in color printers driven by a decrease in sales to OEM partners.

Mid-Range
- 2% decrease in installs of mid-range color devices driven as a difficult compare in the U.S. from the fourth quarter 2012 was partially offset by demand for products such as the WorkCentre® 7535/7125/7530 and the WorkCentre® 7556, which enabled continued market share gains in the fastest growing and most profitable segment of the office color market.
- 10% decrease in installs of mid-range black-and-white devices.

High-End
- 34% increase in installs of high-end color systems driven by strong demand for the Xerox Color 770. This product has enabled large market share gains in the Entry Production Color market segment.
- 26% decrease in installs of high-end black-and-white systems, reflecting continued declines in the overall market.

Install activity percentages include installations for Document Outsourcing and the Xerox-branded product shipments to GIS.

Descriptions of “Entry”, “Mid-range” and “High-end” are defined in Note 2 – Segment Reporting, in the Consolidated Financial Statements.

Revenue 2011

Document Technology revenue of $10,259 million decreased 1%, including 2-percentage points positive impact from currency. Total revenues include the following:
- 4% decrease in equipment sales revenue, with a 1-percentage point positive impact from currency, primarily driven by a decline in Europe reflecting the economic conditions in the Euro Zone, particularly in the fourth quarter 2011. In addition, install declines of entry and mono products were only partially offset by install growth in mid-range and high-end color products. Consistent with prior years, price declines were in the range of 5%-10%. Document Technology revenue excludes increasing revenues in our DO offerings.
- 1% increase in annuity revenue, including a 2-percentage point positive impact from currency. An increase in supplies revenue was offset by a decline in pages.
- Document Technology revenue mix is 22% entry, 57% mid-range and 21% high-end.

Segment Margin 2011

Document Technology segment margin of 11.1% increased 0.6-percentage points from prior year. Lower cost and expense from restructuring savings in addition to an increase in equity in net income from unconsolidated affiliates more than offset the gross margin decline.

Installs 2011

Entry
- 4% decrease in entry black-and-white and color multifunction devices and color printers reflecting:
  - A decline in sales to OEM partners.
  - A decline in developing markets due in part to a very strong 2010 in which installs increased significantly.
- These declines were partially offset by growth in newly launched products such as the WorkCentre® 3045 and WorkCentre® 6015.

Mid-Range
- 26% increase in installs of mid-range color devices driven primarily by demand for new products, such as the WorkCentre® 7530/7535, WorkCentre® 7545/7556 and WorkCentre® 7120 and the Xerox Color 550/560. This growth has enabled market share gains in the fastest growing and most profitable segment of the office color market.
- 2% increase in installs of mid-range black-and-white devices driven by strong demand for the recently launched WorkCentre® 5325/5330/5335 products partially offset by declines in Europe.

High-End
- 7% increase in installs of high-end color systems driven primarily by installs of our market-leading Xerox Color 800 and 1000 and iGen as well as strong demand for the recently launched Xerox Color 770 and the DocuColor™ 8080. These products have improved our offerings in the entry production color product category.
- 8% decrease in installs of high-end black-and-white systems driven by declines across most product areas.

Other Segment

Revenue 2012

Other segment revenue of $1,400 million decreased 8%, including a 1-percentage point negative impact from currency, due to a decline in paper sales, which is driven by lower market pricing and activity, as well as a decline in revenues from wide format systems and lower patent sales and licensing revenue. Paper comprised approximately 59% of the 2012 Other segment revenue.
Segment Loss 2012
Other segment loss of $241 million, improved $14 million from the prior year, primarily driven by a decrease in Other Expenses, Net partially offset by lower gross profit as a result of the decline in revenues.

Revenue 2011
Other segment revenue of $1,530 million decreased 7%, including 2-percentage points positive impact from currency, due to a decline in paper sales, wide format systems and other supplies partially offset by an increase in revenue from patent sales and licensing as noted below. Paper comprised approximately 59% of the 2011 Other segment revenue.

In 2011, we entered into an agreement with another company that included, among other items, the sale of certain patents and the cross-licensing of certain patents of each party, pursuant to which we received an up-front payment with the remaining amount payable in two equal annual installments. Consistent with our accounting policy for these transactions, revenue associated with this agreement will be recorded as earned and only to the extent of cash received. During 2011, the Other segment included revenue and pre-tax income/segment profit of approximately $32 million and $26 million ($16 million after-tax), respectively, which is net of certain expenses paid in connection with this agreement.

Segment Loss 2011
Other segment loss of $255 million, improved $87 million from the prior year, primarily driven by lower non-financing interest expense and SAG expense.

Capital Resources and Liquidity
Our ability to maintain positive liquidity going forward depends on our ability to continue to generate cash from operations and access the financial capital markets, both of which are subject to general economic, financial, competitive, legislative, regulatory and other market factors that are beyond our control.

- As of December 31, 2012 and 2011, total cash and cash equivalents were $1,246 million and $902 million, respectively, we had no borrowings under our Commercial Paper Programs as of December 31, 2012 and $100 million as of December 31, 2011. There were no outstanding borrowings or letters of credit under our $2 billion Credit Facility for either year end. The increase in our cash balance in 2012 was largely from the sales and run-off of finance receivables partially offset by an increase in share repurchases. We expect to use approximately $400 million of our total cash to pay down maturing Senior Notes in May 2013.
- Our Commercial Paper program was established in 2010 as a means to reduce our cost of capital and to provide us with an additional liquidity vehicle in the market. Aggregate Commercial Paper and Credit Facility borrowings may not exceed the borrowing capacity under our Credit Facility at any time.
- 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 $2,580 million, $1,961 million and $2,726 million for the three years ended December 31, 2012, respectively.
- We expect cash flows from operations between $2.1 and $2.4 billion for 2013. We expect lower contributions from finance receivables of approximately $500 million, due to fewer collections as a result of the 2012 finance receivables sales and a lower natural run-off of the portfolio, given our expectations of better equipment activity. This impact is expected to be partially offset by lower pension funding requirements. We expect the rest of working capital to be essentially flat year-over-year.

Cash Flow Analysis
The following summarizes our cash flows for the three years ended December 31, 2012, as reported in our Consolidated Statements of Cash Flows in the accompanying Consolidated Financial Statements:

<table>
<thead>
<tr>
<th></th>
<th>Year Ended December 31,</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net cash provided by operating activities</td>
<td>$ 2,580</td>
<td>$ 1,961</td>
</tr>
<tr>
<td>Net cash used in investing activities</td>
<td>(761)</td>
<td>(675)</td>
</tr>
<tr>
<td>Net cash used in financing activities</td>
<td>(1,472)</td>
<td>(1,586)</td>
</tr>
<tr>
<td>Effect of exchange rate changes on cash and cash equivalents</td>
<td>(3)</td>
<td>(9)</td>
</tr>
<tr>
<td>Increase (decrease) in cash and cash equivalents</td>
<td>344</td>
<td>(309)</td>
</tr>
<tr>
<td>Cash and cash equivalents at beginning of year</td>
<td>902</td>
<td>1,211</td>
</tr>
<tr>
<td>Cash and Cash Equivalents at End of Year</td>
<td>$ 1,246</td>
<td>$ 902</td>
</tr>
</tbody>
</table>
Management’s Discussion

Cash Flows from Operating Activities

Net cash provided by operating activities was $2,580 million for the year ended December 31, 2012. The $619 million increase in cash from 2011 was primarily due to the following:

• $879 million increase from finance receivables primarily due to sales of receivables as well as higher net run-off of finance receivables as a result of lower equipment sales (see Note 5 – Finance Receivables, Net in the Consolidated Financial Statements for additional information).
• $124 million increase due to lower inventory growth.
• $74 million increase due to lower restructuring payments.
• $62 million increase due to lower contributions to our defined benefit pension plans primarily in the U.S. as a result of the recently enacted pension funding legislation.
• $41 million increase as a result of less up-front costs and other customer-related spending associated primarily with new services contracts.
• $390 million decrease due to a lower benefit from accounts receivable sales as well as growth in services revenue.
• $45 million decrease from higher net income tax payments primarily due to refunds in the prior year.

In March 2012, we elected to make a contribution of 15.4 million shares of our common stock, with an aggregate value of approximately $130 million, to our U.S. defined benefit pension plan for salaried employees in order to meet our planned level of funding.

Net cash provided by operating activities was $1,961 million for the year ended December 31, 2011. The $619 million increase in cash from 2011 was primarily due to the following:

• $670 million decrease reflecting the absence of payment of our liability to Xerox Capital Trust I in connection with their redemption of preferred securities.
• $24 million increase due to lower cash proceeds from asset sales.

Net cash used in investing activities was $675 million for the year ended December 31, 2011. The $1,503 million decrease in the use of cash from 2011 was primarily due to the following:

• $64 million increase in acquisitions: 2012 acquisitions include Wireless Data for $95 million, RK Dixon for $58 million, as well as seven smaller acquisitions totaling $123 million. 2011 acquisitions include Unamic/HCN B.V. for $55 million, ESM for $43 million, Concept Group for $41 million, MBM for $42 million, Breakaway for $18 million and ten smaller acquisitions for an aggregate of $46 million, as well as a net cash receipt of $35 million for Symcor.
• $19 million increase due to lower cash proceeds from asset sales.
• $1,522 million decrease in acquisitions: 2011 acquisitions include Unamic/HCN B.V. for $55 million, ESM for $43 million, Concept Group for $41 million, MBM for $42 million, Breakaway for $18 million and ten smaller acquisitions for an aggregate of $46 million, as well as a net cash receipt of $35 million for Symcor. 2010 acquisitions include ACS for $1,495 million, ExcellerateHRO, LLP for $125 million, TMS Health, LLC for $48 million, Irish Business Systems Limited for $29 million, Georgia Duplicating Products for $21 million and Spur Information Solutions for $12 million.
• $24 million increase due to lower cash proceeds from asset sales.

Cash Flows from Financing Activities

Net cash used in financing activities was $1,472 million for the year ended December 31, 2012. The $114 million decrease in the use of cash from 2011 was primarily due to the following:

• $16 million decrease due to a lower benefit from accounts receivable sales partially offset by improved collections.
• $290 million increase in pre-tax income before depreciation and amortization, litigation, restructuring, curtailment and the Venezuelan currency devaluation.
• $113 million increase due to the absence of cash outflows from acquisition-related expenditures.

In September 2011, we elected to make a contribution of 16.6 million shares of our common stock, with an aggregate value of approximately $130 million, to our U.S. defined benefit pension plan for salaried employees in order to meet our planned level of funding.

Cash Flows from Investing Activities

Net cash used in investing activities was $761 million for the year ended December 31, 2012. The $68 million increase in the use of cash from 2011 was primarily due to the following:

• $64 million increase in acquisitions: 2012 acquisitions include Wireless Data for $95 million, RK Dixon for $58 million, as well as seven smaller acquisitions totaling $123 million. 2011 acquisitions include Unamic/HCN B.V. for $55 million, ESM for $43 million, Concept Group for $41 million, MBM for $42 million, Breakaway for $18 million and ten smaller acquisitions for an aggregate of $46 million, as well as a net cash receipt of $35 million for Symcor.
• $19 million increase due to lower cash proceeds from asset sales.

Net cash used in investing activities was $675 million for the year ended December 31, 2011. The $1,503 million decrease in the use of cash from 2010 was primarily due to the following:

• $1,522 million decrease in acquisitions: 2011 acquisitions include Unamic/HCN B.V. for $55 million, ESM for $43 million, Concept Group for $41 million, MBM for $42 million, Breakaway for $18 million and ten smaller acquisitions for an aggregate of $46 million, as well as a net cash receipt of $35 million for Symcor. 2010 acquisitions include ACS for $1,495 million, ExcellerateHRO, LLP for $125 million, TMS Health, LLC for $48 million, Irish Business Systems Limited for $29 million, Georgia Duplicating Products for $21 million and Spur Information Solutions for $12 million.
• $24 million increase due to lower cash proceeds from asset sales.
• $351 million increase from higher share repurchases in 2012.
• $157 million increase from net debt activity. 2012 reflects net proceeds of $1.1 billion from Senior Notes issued in March offset by net payments on 2012 Senior Notes of $1.1 billion that matured in May and a decrease of $100 million in Commercial Paper. 2011 includes proceeds of $1.0 billion from the issuance of Senior Notes offset by the repayment of $750 million for Senior Notes due in 2011 and a decrease of $200 million in Commercial Paper.
• $47 million increase due to higher distributions to noncontrolling interests.

Net cash used in financing activities was $1,586 million for the year ended December 31, 2011. The $1,530 million decrease in the use of cash from 2010 was primarily due to the following:
• $3,105 million decrease from net debt activity. 2011 includes proceeds of $1.0 billion from the issuance of Senior Notes offset by the repayment of $750 million for Senior Notes due in 2011 and a decrease of $200 million in Commercial Paper. 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 $109 million for 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 an increase of $300 million in Commercial Paper.
• $701 million increase resulting from the resumption of our share repurchase program.
• $670 million increase reflecting the payment of our liability to Xerox Capital Trust I in connection with their redemption of preferred securities.
• $139 million increase due to lower proceeds from the issuances of common stock under our stock option plans.
• $26 million increase reflecting a full year of dividend payments on shares issued in connection with the acquisition of ACS in 2010.
• $12 million increase due to higher share repurchases related to employee withholding taxes on stock-based compensation vesting.

Customer Financing Activities

We provide lease equipment financing to our customers, primarily in our Document 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 primarily fund our customer financing activity through cash generated from operations, cash on hand, commercial paper borrowings, sales and securitizations of finance receivables and proceeds from capital markets offerings.

We have arrangements in certain international countries and domestically with our small and mid-sized customers, 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 Total finance assets, net associated with our lease and finance operations:

<table>
<thead>
<tr>
<th></th>
<th>December 31,</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2011</td>
</tr>
<tr>
<td>Total Finance receivables, net</td>
<td>$ 5,313</td>
<td>$ 6,362</td>
</tr>
<tr>
<td>Equipment on operating leases, net</td>
<td>535</td>
<td>533</td>
</tr>
<tr>
<td><strong>Total Finance Assets, Net</strong></td>
<td><strong>$ 5,848</strong></td>
<td><strong>$ 6,895</strong></td>
</tr>
</tbody>
</table>

(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 our Consolidated Balance Sheets.

The decrease of $1,047 million in Total finance assets, net reflects the sale of finance receivables (discussed further below) and the decrease in equipment sales over the past several years, as well as equipment sales growth in regions or operations where we don’t offer direct leasing. These impacts were partially offset by an increase of $83 million due to currency.

We maintain a certain level of debt, referred to as financing debt, to support our investment in these lease contracts or Total finance assets, net. We maintain this financing debt at an assumed 7:1 leverage ratio of debt to equity as compared to our Total finance assets, net for this financing aspect of our business. Based on this leverage, the following represents the breakdown of our total debt at December 31, 2012 and 2011 between financing debt and core debt:

<table>
<thead>
<tr>
<th></th>
<th>December 31,</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2011</td>
</tr>
<tr>
<td>Financing debt</td>
<td>$ 5,117</td>
<td>$ 6,033</td>
</tr>
<tr>
<td>Core debt</td>
<td>3,372</td>
<td>2,600</td>
</tr>
<tr>
<td><strong>Total Debt</strong></td>
<td><strong>$ 8,489</strong></td>
<td><strong>$ 8,633</strong></td>
</tr>
</tbody>
</table>

(1) Financing debt includes $4,649 million and $5,567 million as of December 31, 2012 and December 31, 2011, 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.
In 2013, we expect to continue the leveraging of our finance assets at an assumed 7:1 ratio of debt to equity. We also may sell or securitize certain finance receivables as another means to support our customer financing activities — see discussion further below of finance receivable sale activity in 2012. The following summarizes our total debt at December 31, 2012 and 2011:

<table>
<thead>
<tr>
<th></th>
<th>December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>Principal debt balance</td>
<td>$8,410</td>
</tr>
<tr>
<td>Net unamortized discount</td>
<td>(63)</td>
</tr>
<tr>
<td>Fair value adjustments</td>
<td>142</td>
</tr>
<tr>
<td>Total Debt</td>
<td>$8,489</td>
</tr>
</tbody>
</table>

(1) Includes Commercial Paper of $0 and $100 million as of December 31, 2012 and 2011, respectively.

Sales of Accounts Receivable

Accounts receivable sales arrangements are utilized in the normal course of business as part of our cash and liquidity management. We have facilities in the U.S., Canada and several countries in Europe that enable us to sell certain accounts receivables without recourse to third-parties. The accounts receivables sold are generally short-term trade receivables with payment due dates of less than 60 days.

Accounts receivables sales were as follows:

<table>
<thead>
<tr>
<th></th>
<th>Year ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>Accounts receivable sales</td>
<td>$3,699</td>
</tr>
<tr>
<td>Deferred proceeds</td>
<td>639</td>
</tr>
<tr>
<td>Loss on sale of accounts receivable</td>
<td>21</td>
</tr>
<tr>
<td>Estimated (decrease) increase to operating cash flows (1)</td>
<td>(78)</td>
</tr>
</tbody>
</table>

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

Net Impact on Operating Cash Flows from Operating Activities

<table>
<thead>
<tr>
<th></th>
<th>Year ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>Cash received from finance receivables sales</td>
<td>$625</td>
</tr>
<tr>
<td>Collections on sold finance receivables (1)</td>
<td>(45)</td>
</tr>
<tr>
<td>Net cash impact of finance receivable sales</td>
<td>$80</td>
</tr>
<tr>
<td>Net cash impact of accounts receivable sales</td>
<td>(78)</td>
</tr>
</tbody>
</table>

(1) Represents cash that would have been collected if we had not sold finance receivables.

Capital Market Activity

Debt Exchange

In February 2012, we completed an exchange of our 5.71% Zero Coupon Notes due 2023 with an accreted book value at the date of the exchange of $303 million, for $362 million of our 4.50% Senior Notes due 2021. Accordingly, this increased the principal amount for our 4.50% Senior Notes due 2021 from $700 million to $1,062 million. The exchange was conducted to retire high-interest, long-dated debt in a favorable interest rate environment. The debt exchange was accounted for as a non-revolving debt modification and, therefore, it did not result in any gain or loss. The difference between the book value of our Zero Coupon Notes and the principal value of the Senior Notes issued in exchange will be accreted over the remaining term of the Senior Notes. Upfront fees paid to third parties in connection with the exchange were not material and were expensed as incurred.

Senior Notes

In March 2012, we issued $600 million of Floating Rate Senior Notes due 2013 (the “2013 Floating Rate Notes”) and $500 million of 2.95% Senior Notes due 2017 (the “2017 Senior Notes”). The 2013 Floating Rate Notes were issued at par and the 2017 Senior Notes were issued at 99.875% of par, resulting in aggregate net proceeds for both notes of approximately $1,093 million. The 2013 Floating Rate Notes accrue interest at a rate per annum, reset quarterly, equal to the three-month LIBOR plus 1.400% and are payable quarterly. The 2017 Senior Notes accrue interest at a rate of 2.95% per annum and are payable semi-annually. As a result of the discount, they have a weighted average effective interest rate of 2.977%. In connection with the issuance of
these Senior Notes, debt issuance costs of $6 million were deferred. This debt issuance partially funded the May 2012 maturity of our $1,100 million of 5.59% Senior Notes.

Refer to Note 12 – Debt in the Consolidated Financial Statements for additional information regarding our debt.

**Financial Instruments**

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

**Share Repurchase Programs – Treasury Stock**

During 2012, we repurchased 146.3 million shares for an aggregate cost of $1.1 billion, including fees. Through February 20, 2013, we repurchased an additional 1.4 million shares at an aggregate cost of $10.1 million, including fees, for a cumulative program total of 429.7 million shares at a cost of $4.7 billion, including fees. We expect total share repurchases of at least $400 million in 2013.

In October 2012, the Board of Directors authorized an additional $1.0 billion in share repurchase, bringing the total remaining authorization for share repurchases to $1.3 billion as of February 20, 2013.

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 $226 million, $241 million and $243 million on common stock in 2012, 2011 and 2010, respectively. The decrease in 2012 as compared to prior years is primarily due to a lower level of outstanding shares in 2012 as a result of the repurchase of shares under our share repurchase programs.

The Board of Directors declared aggregate dividends of $24 million, $24 million and $21 million on the Series A Convertible Preferred Stock in 2012, 2011 and 2010, respectively. The preferred shares were issued in connection with the acquisition of ACS.

In addition, the company increased its dividend from 4.25 cents per share to 5.75 cents per share per quarter, beginning with the dividend payable on April 30, 2013. Accordingly, we expect approximately $300 million in dividend payments for the full year 2013.

**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 principal debt maturities are in line with historical and projected cash flows and are spread over the next ten years as follows (in millions):

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>$1,039</td>
</tr>
<tr>
<td>2014</td>
<td>1,093</td>
</tr>
<tr>
<td>2015</td>
<td>1,259</td>
</tr>
<tr>
<td>2016</td>
<td>954</td>
</tr>
<tr>
<td>2017</td>
<td>1,002</td>
</tr>
<tr>
<td>2018</td>
<td>1,001</td>
</tr>
<tr>
<td>2019</td>
<td>650</td>
</tr>
<tr>
<td>2020</td>
<td>–</td>
</tr>
<tr>
<td>2021</td>
<td>1,062</td>
</tr>
<tr>
<td>2022 and thereafter</td>
<td>350</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$8,410</strong></td>
</tr>
</tbody>
</table>

**Foreign Cash**

At December 31, 2012, we had $1,246 million of cash and cash equivalents on a consolidated basis. Of that amount, approximately $400 million was held outside the U.S. by our foreign subsidiaries to fund future working capital, investment and financing needs of our foreign subsidiaries. Accordingly, we have asserted that such funds are indefinitely reinvested outside the U.S.

We believe we have sufficient levels of cash and cash flows to support our domestic requirements. However, if the cash held by our foreign subsidiaries was needed to fund our U.S. requirements, there would not be a significant tax liability associated with the repatriation, as any U.S. liability would be reduced by the foreign tax credits associated with the repatriated earnings.

However, our determination above is based on the assumption that only the cash held outside the U.S. would be repatriated as a result of an unanticipated or unique domestic need. It does not assume repatriation of the entire amount of indefinitely reinvested earnings of our foreign subsidiaries. As disclosed in Note 16 – Income and Other Taxes in our Consolidated Financial Statements, we have not estimated the potential tax consequences associated with the repatriation of the entire amount of our foreign earnings indefinitely reinvested outside the U.S. We do not believe it is practical to calculate the potential tax impact, as there is a significant amount of uncertainty with respect to determining the amount of foreign tax credits as well as any additional local withholding tax and other indirect tax consequences that may arise from the distribution of these earnings. In addition, because such earnings have been indefinitely reinvested in our foreign operations, repatriation would require liquidation of those investments or a recapitalization of our foreign subsidiaries, the impacts and effects of which are not readily determinable.
Management’s Discussion

Loan Covenants and Compliance

At December 31, 2012, we were in full compliance with the covenants and other provisions of our Credit Facility and Senior Notes. We have the right 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 12 – Debt in the Consolidated Financial Statements for additional information regarding debt arrangements.

Contractual Cash Obligations and Other Commercial Commitments and Contingencies

At December 31, 2012, we had the following contractual cash obligations and other commercial commitments and contingencies:

<table>
<thead>
<tr>
<th>(in millions)</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>Thereafter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total debt, including capital lease obligations (1)</td>
<td>$ 1,039</td>
<td>$ 1,093</td>
<td>$ 1,259</td>
<td>$ 954</td>
<td>$ 1,002</td>
<td>$ 3,063</td>
</tr>
<tr>
<td>Interest on debt (1)</td>
<td>421</td>
<td>363</td>
<td>293</td>
<td>234</td>
<td>177</td>
<td>777</td>
</tr>
<tr>
<td>Minimum operating lease commitments (2)</td>
<td>636</td>
<td>425</td>
<td>265</td>
<td>157</td>
<td>74</td>
<td>83</td>
</tr>
<tr>
<td>Defined benefit pension plans</td>
<td>195</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Retiree health payments</td>
<td>80</td>
<td>80</td>
<td>79</td>
<td>77</td>
<td>75</td>
<td>339</td>
</tr>
<tr>
<td>Estimated Purchase Commitments:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Flextronics (3)</td>
<td>498</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Fuji Xerox (4)</td>
<td>2,069</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Other (5)</td>
<td>169</td>
<td>131</td>
<td>43</td>
<td>16</td>
<td>1</td>
<td>–</td>
</tr>
<tr>
<td>Total</td>
<td>$ 5,107</td>
<td>$ 2,092</td>
<td>$ 1,939</td>
<td>$ 1,438</td>
<td>$ 1,329</td>
<td>$ 4,262</td>
</tr>
</tbody>
</table>

(1) Refer to Note 12 – Debt in the Consolidated Financial Statements for additional information regarding debt.
(2) Refer to Note 7 – Land, Buildings, Equipment and Software, Net in the Consolidated Financial Statements for additional information related to minimum operating lease commitments.
(3) Flextronics: We outsource certain manufacturing activities to Flextronics. The amount included in the table reflects our estimate of purchases over the next year and is not a contractual commitment. In the past two years, actual purchases from Flextronics averaged approximately $600 million per year.
(4) Fuji Xerox: The amount included in the table reflects our estimate of purchases over the next year and is not a contractual commitment.
(5) 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.
We sponsor defined benefit pension plans and retiree health plans that require periodic cash contributions. Our 2012 cash contributions for these plans were $364 million for our defined benefit pension plans and $84 million for our retiree health plans. We also elected to make a contribution of 15.4 million shares of our common stock, with an aggregate value of approximately $130 million, to our U.S. defined benefit pension plan for salaried employees in order to meet our planned level of funding for 2012. Accordingly, total contributions to our defined benefit pension plans were $494 million in 2012.

In 2013, based on current actuarial calculations, we expect to make contributions of approximately $195 million to our worldwide defined benefit pension plans and approximately $80 million to our retiree health benefit plans. The decrease in required contributions to our worldwide defined benefit pension plans is largely in the U.S. and reflects the expected benefits from the pension funding legislation enacted in the U.S. during 2012. 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. Although we currently expect contributions to our worldwide defined benefit pension plans to increase moderately in 2014, primarily in the U.S., contributions are still expected to be lower over the next several years as compared to 2011 and 2012, primarily as a result of the amendment of several of our defined benefit pension plans to freeze current benefits and eliminate benefit accruals for future service.

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, $2.2 billion and $2.1 billion in 2012, 2011 and 2010, 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 8 – 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.
Management’s Discussion

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, 2012, we had $201 million of unrecognized tax benefits. This represents the tax benefits associated with various tax positions taken, or expected to be taken, on domestic and foreign 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
Occasionally we may utilize off-balance sheet arrangements in our operations (as defined by the SEC Financial Reporting Release 67 (FRR-67), “Disclosure in Management’s Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations.”). We enter into the following arrangements that have off-balance sheet elements:

• Operating leases in the normal course of business. The nature of these lease arrangements is discussed in Note 7 – Land, Buildings, Equipment and Software, Net in the Consolidated Financial Statements.

• We have facilities, primarily in the U.S., Canada and several countries in Europe, that enable us to sell to third-parties certain accounts receivable without recourse. In most instances a portion of the sales proceeds are held back by the purchaser and payment is deferred until collection of the related sold receivables. Refer to Note 4 – Accounts Receivables, Net in the Consolidated Financial Statements for further information regarding these facilities.

• During 2012 we entered into arrangements to sell our entire interest in certain groups of finance receivables where we received cash and beneficial interests from the third-party purchaser. Refer to Note 5 – Finance Receivables, Net in the Consolidated Financial Statements for further information regarding these sales.

At December 31, 2012, we do not believe we have any off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

In addition, see the table above for the Company’s contractual cash obligations and other commercial commitments and Note 17 – Contingencies and Litigation in the Consolidated Financial Statements for additional information regarding contingencies, 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, 2012, 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, 2012. A 10% appreciation or depreciation of the U.S. Dollar against all currencies from the quoted foreign currency exchange rates at December 31, 2012 would have an impact on our cumulative translation adjustment portion of equity of approximately $711 million. The net amount invested in foreign subsidiaries and affiliates, primarily Xerox Limited, Fuji Xerox, Xerox Canada Inc. and Xerox Brasil, and translated into U.S. Dollars using the year-end exchange rates, was approximately $7.1 billion at December 31, 2012.

Interest Rate Risk Management
The consolidated weighted-average interest rates related to our total debt for 2012, 2011 and 2010 approximated 4.7%, 5.2%, and 5.8%, 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, 2012, $903 million of our total debt of $8,489 million carried variable interest rates, including the effect of pay variable interest rate swaps, if any, we may 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, 2012, a 10% change in market interest rates would change the fair values of such financial instruments by approximately $113 million.

Non-GAAP Financial Measures

We have reported our financial results in accordance with generally accepted accounting principles (“GAAP”). In addition, 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, and the most directly comparable measures calculated and presented in accordance with GAAP, are set forth on the following tables.

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. For our 2012 reporting year, adjustments were limited to the amortization of intangible assets:

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

The above have been adjusted for the following items:

- **Amortization of intangible assets (all periods):** 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 inapplicability 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.

- **Restructuring and asset impairment charges (including those incurred by Fuji Xerox) (2010 only):** 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 (2010 only):** 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.

- **Other discrete, unusual or infrequent costs and expenses:** In addition, we have also excluded the following additional items given the discrete, unusual or infrequent nature of the item on our results of operations for the period: (1) Loss on early extinguishment of liability (2011 and 2010), (2) Medicare subsidy tax law change (income tax effect only) (2010), (3) ACS shareholder’s litigation settlement (2010) and (4) Venezuela devaluation (2010). 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.

We also calculate and utilize an Operating income and margin earnings measure by adjusting our pre-tax income and margin amounts to exclude certain items. In addition to the amortization of intangible assets and restructuring expenses (see above), operating income and margin also exclude Other expenses, net. 2011 operating income and margin also exclude a Curtailment gain recorded in the fourth quarter 2011 while 2010 operating income and margin exclude ACS acquisition related costs (see above). Other expenses, net is primarily comprised of non-financing interest expense and also includes certain other non-operating costs and expenses. The Curtailment gain resulted from the amendment of our primary non-union U.S. defined benefit pension plans for salaried employees to fully freeze future benefit and service accruals after December 31, 2012. We exclude these amounts in order to evaluate our current and past operating performance and to better understand the expected future trends in our business.
Pro-forma Basis

To better understand the trends in our business, we discuss our 2011 operating results by comparing them against adjusted prior period results which include ACS historical results for the comparable period. We acquired ACS on February 5, 2010 and ACS’s results subsequent to that date are included in our reported results. Accordingly, for the comparison of our reported 2011 results to 2010, we included ACS’s 2010 estimated results for the period January 1 through February 5, 2010 in our reported 2010 results (pro-forma 2010). We refer to these comparisons against adjusted results as “pro-forma” basis comparisons. ACS’s historical results for this period 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 provide an enhanced assessment than the actual comparisons, given the size and nature of the ACS acquisition. In addition, the acquisition of ACS increased the proportion of our revenue from services, which has a lower gross margin and SAG as a percent of revenue than we historically experienced when Xerox was primarily a Technology company. We believe the pro-forma basis comparisons provide investors with a 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.

Net Income and EPS reconciliation:

<table>
<thead>
<tr>
<th>Year Ended December 31,</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Net Income</td>
<td>EPS</td>
<td>Net Income</td>
</tr>
<tr>
<td>As Reported</td>
<td>$1,195</td>
<td>$0.88</td>
<td>$1,295</td>
</tr>
<tr>
<td>Adjustments:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amortization of intangible assets</td>
<td>203</td>
<td>0.15</td>
<td>248</td>
</tr>
<tr>
<td>Loss on early extinguishment of liability</td>
<td>–</td>
<td>–</td>
<td>20</td>
</tr>
<tr>
<td>Xerox and Fuji Xerox restructuring charges</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>ACS acquisition-related costs</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>ACS shareholders’ litigation settlement</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Venezuelan devaluation costs</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Medicare subsidy tax law change</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Adjusted</td>
<td>$1,398</td>
<td>$1.03</td>
<td>$1,563</td>
</tr>
<tr>
<td>Weighted average shares for adjusted EPS (1)</td>
<td>1,356</td>
<td></td>
<td>1,444</td>
</tr>
<tr>
<td>Fully diluted shares at December 31, 2012 (2)</td>
<td>1,271</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(1) Average shares for the calculation of adjusted EPS and include 27 million of shares associated with the Series A convertible preferred stock and therefore the related annual dividend was excluded.

(2) Represents common shares outstanding at December 31, 2012 as well as shares associated with our Series A convertible preferred stock plus dilutive potential common shares as used for the calculation of diluted earnings per share in the fourth quarter 2012.
Effective Tax reconciliation:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>As Reported</td>
<td>$ 1,348</td>
<td>$ 1,565</td>
</tr>
<tr>
<td>Adjustments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amortization of intangible assets</td>
<td>328</td>
<td>398</td>
</tr>
<tr>
<td>Loss on early extinguishment of liability</td>
<td>–</td>
<td>33</td>
</tr>
<tr>
<td>Xerox restructuring charge</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>ACS acquisition-related costs</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>ACS shareholders’ litigation settlement</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Venezuelan devaluation costs</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Medicare subsidy tax law change</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Adjusted</td>
<td>$ 1,676</td>
<td>$ 1,996</td>
</tr>
</tbody>
</table>

Operating Income/Margin reconciliation:

<table>
<thead>
<tr>
<th></th>
<th>As Reported</th>
<th>Pro-forma (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2011</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>$ 22,390</td>
<td>$ 22,626</td>
</tr>
<tr>
<td>Pre-tax Income</td>
<td>1,348</td>
<td>1,565</td>
</tr>
<tr>
<td>Adjustments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amortization of intangible assets</td>
<td>328</td>
<td>398</td>
</tr>
<tr>
<td>Xerox restructuring charge</td>
<td>153</td>
<td>33</td>
</tr>
<tr>
<td>Curtailment gain</td>
<td>–</td>
<td>(107)</td>
</tr>
<tr>
<td>ACS acquisition-related costs</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Other expenses, net</td>
<td>256</td>
<td>322</td>
</tr>
<tr>
<td>Adjusted Operating Income</td>
<td>$ 2,085</td>
<td>$ 2,211</td>
</tr>
<tr>
<td>Pre-tax Income Margin</td>
<td>6.0%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Adjusted Operating Margin</td>
<td>9.3%</td>
<td>9.8%</td>
</tr>
</tbody>
</table>

(1) Pro-forma 2010 includes ACS’s 2010 estimated results from January 1 through February 5 in our reported 2010 results.
Management’s Discussion

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 2012 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.