XEROX CORP
Form 10-Q/A
November 12, 2002
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A
(Amendment No. 1)

(Mark One)

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

For the quarterly period ended: September 30, 2002

OR

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

For the transition period from __________ to __________

Commission File Number 1-4471

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

New York	**16-0468020**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
P.O. Box 1600 **Stamford, Connecticut**	**06904-1600**
(Address of principal executive offices)	**(Zip Code)**

(203) 968-3000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at October 31, 2002
Common Stock	735,298,618 shares

This Amendment No. 1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002 is being filed only to include electronic signatures on the Certifications Pursuant to Rule 13A-14 Under the Securities Exchange Act of 1934, as amended and the Certification of CEO and CFO Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to §906 of the Sarbanes-Oxley Act of 2002. All of the financial data and other information remain unchanged.

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Forward Looking Statements

From time to time we and our representatives may provide information, whether orally or in writing, including certain statements in this Quarterly Report on Form 10-Q, which are forward-looking. These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information currently available.

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

We are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors which could cause actual results to differ materially from those contained in the forward-looking statements. Such factors include, but are not limited to, the following:

Competition We operate in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. There are a number of companies worldwide with significant financial resources which compete with us to provide document processing products and services in each of the markets we serve, some of which operate on a global basis. Our success in future performance is largely dependent upon our ability to compete successfully in the markets we currently serve and to expand into additional market segments.

Transition to Digital Presently, black and white light-lens copiers represent between 15-20% of our revenues. This segment of the market is mature with anticipated declining industry revenues as the market transitions to digital technology. Some of our new digital products replace or compete with our current light-lens equipment. Changes in the mix of products from light-lens to digital, and the pace of that change, as well as competitive developments, could cause actual results to vary from those expected.

Expansion of Color Color printing and copying represents an important and growing segment of the market. Printing from computers has both facilitated and increased the demand for color. A significant part of our strategy and ultimate success in this changing market is our ability to develop and market technology that produces color prints and copies quickly, easily and at reduced cost. Our continuing success in this strategy depends on our ability to make the investments and commit the necessary resources in this highly competitive market, as well as the pace of color adoption by our prospective customers.

Pricing Our success is dependent upon our ability to obtain adequate pricing for our products and services which provides a reasonable return to our shareholders. Depending on competitive market factors, future prices we obtain for our products and services may vary from historical levels. In addition, pricing actions to offset the effect of currency devaluations may not prove sufficient to offset further devaluations or may not hold in the face of customer resistance and/or competition.

Customer Financing Activities Prior to 2002, we financed approximately 80 percent of our equipment sales. To fund these arrangements, we accessed the credit markets and used cash generated from operations. In 2001, we announced several Framework Agreements with General Electric (GE), under which GE would become our primary equipment-financing provider in the U.S., Canada, Germany and France. In connection therewith, in October 2002, we completed an eight-year agreement in the U.S. (the New U.S. Vendor Financing Agreement), effective immediately, under which GE Vendor Financial Services became the primary equipment financing provider in the U.S., through monthly securitizations of our new lease originations. In addition to the $2.5 billion funded by GE prior to this transaction, which is secured by portions of our current lease receivables in the U.S., the New U.S. Vendor Financing Agreement calls for GE to provide funding in the U.S., through 2010, of up to $5 billion, outstanding during any time, subject to normal customer acceptance criteria. The New U.S. Vendor Financing Agreement also includes opportunities to increase financing levels over time, based on our revenue growth. We are currently negotiating all of the other GE transactions contemplated under the respective Framework Agreements.

The long-term viability and profitability of our customer financing activities is dependent, in part, on our ability to borrow and the cost of borrowing in the credit markets. This ability and cost, in turn, is dependent on our credit ratings. We are currently funding our customer financing activity from the aforementioned New U.S. Vendor Financing Agreement, cash generated from operations, as well as, from cash on hand, unregistered capital markets offerings and securitizations. There is no assurance that we will be able to continue to fund our customer financing activity at present levels. We continue to negotiate and implement third-party vendor financing programs and securitizations of portions of our existing finance receivable portfolios and we continue to actively pursue alternative forms of financing including securitizations and secured borrowings. These initiatives are expected to improve our liquidity going forward. Our ability to continue to offer customer financing and be successful in the placement of equipment with customers is largely dependent upon successful implementation of our third party financing initiatives.

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Productivity Our ability to sustain and improve profit margins is largely dependent on our ability to continue to improve the cost efficiency of our operations. Productivity improvements through process re-engineering, design efficiency and supplier and manufacturing cost improvements are required to offset labor cost inflation, potential materials cost increases and competitive price pressures.

International Operations We derive approximately 40 percent of our revenue from operations outside the United States. In addition, we manufacture or acquire many of our products and/or their components outside the United States. Our future revenues, costs and results from operations could be affected by a number of factors, including changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country s political conditions, trade protection measures, licensing requirements and local tax issues. Our ability to enter into new foreign exchange contracts to manage foreign exchange risk is currently limited given our below investment grade credit ratings. Despite our current credit ratings, we have been able to restore a significant level of currency derivative capacity. Although we are still unable to hedge all of our current currency exposures, we are currently utilizing our current capacity to hedge currency exposures primarily related to foreign currency denominated debt. We anticipate continued volatility in our results of operations due to market changes in interest rates and foreign currency rates which we are currently unable to hedge.

New Products/Research and Development The process of developing new high technology products and solutions is inherently complex and uncertain. It requires accurate anticipation of customers changing needs and emerging technological trends. We must then make long-term investments and commit significant resources before knowing whether these investments will eventually result in products that achieve customer acceptance and generate the revenues required to provide anticipated returns from these investments.

Revenue Trends Our ability to return to and maintain a consistent trend of revenue growth over the intermediate to longer term is largely dependent upon expansion of our worldwide equipment placements, as well as sales of services and supplies occurring after the initial equipment placement (post sale revenue) in the key growth markets of color and multifunction devices. We expect that revenue growth can be further enhanced through our consulting services in the areas of document, content and knowledge management. The ability to achieve growth in our equipment placements is subject to the successful implementation of our initiatives to provide advanced systems, industry-oriented global solutions and services for major customers, improved direct sales productivity and expansion of our indirect distribution channels in the face of global competition and pricing pressures. Our ability to increase post sale revenue is largely dependent on our ability to increase equipment placements. Equipment placements typically occur through leases with original terms of three to five years. Our leases generate contractual and contingent post sale revenue during the terms. Once equipment placements start to increase, there will be a lag before post sale revenues also start to increase. The ability to grow our customers usage of our products may continue to be adversely impacted by the movement towards distributed printing and electronic substitutes and the impact of lower equipment placements in prior periods. If we are unable to return to and maintain a consistent trend of revenue growth, there could be a material adverse effect on our operating results.

Liquidity The adequacy of our continuing liquidity depends on our ability to successfully generate positive cash flow from an appropriate combination of operating improvements, financing from third parties, access to capital markets and additional asset sales, including sales or securitizations of our receivables portfolios. We believe our liquidity (including operating and other cash flows we will generate) will be sufficient to meet operating cash flow requirements as they occur and to satisfy all scheduled debt maturities for at least the next twelve months; however, our ability to maintain positive liquidity going forward is highly dependent on achieving our expected operating results, including capturing the benefits from restructuring activities, and continuing to complete announced vendor financing and other initiatives that are discussed in this Quarterly Report on Form 10-Q. There is no assurance that these initiatives will be successful. Failure to successfully complete these initiatives could have a material adverse effect on our liquidity and our operations, and could require us to consider further measures, including deferring planned capital expenditures, modifying current restructuring plans, reducing discretionary spending, selling additional assets and if necessary, restructuring existing debt.

As announced on June 21, 2002, we successfully completed the renegotiation of our $7 billion Revolving Credit Agreement dated as of October 22, 1997 (the Old Revolver). Of the original $7 billion in loans outstanding under the Old Revolver, $3.5 billion has now been repaid and the remaining $3.5 billion is outstanding under the new Amended and Restated Credit Agreement (the New Credit Facility). The New Credit Facility requires principal payments as well as prepayments in the case of certain events. A full discussion of these terms and the final maturity dates of the various loans is included in the Capital Resources and Liquidity section in this Quarterly Report on Form 10-Q. The New Credit Facility contains

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affirmative and negative covenants including limitations on issuance of debt and preferred stock; certain fundamental changes, as defined; investments and acquisitions; mergers; certain transactions with affiliates; creation of liens; asset transfers; hedging transactions; payment of dividends; inter-company loans and certain restricted payments; and a requirement to transfer excess foreign cash, as defined, and excess cash of Xerox Credit Corporation to us in certain circumstances. It also contains additional financial covenants, including minimum EBITDA, as defined, maximum leverage (total adjusted debt divided by EBITDA), annual maximum capital expenditures limits and minimum consolidated net worth, as defined. We are, and expect to remain, in full compliance with the covenants and other provisions of the New Credit Facility. Any failure to be in compliance with any material provision or covenant of the New Credit Facility could have a material adverse effect on our liquidity and operations.

Litigation We are a defendant in numerous litigation and regulatory matters involving securities law, patent law, environmental law, employment law and the Employee Retirement Income Security Act (ERISA). Should these matters result in a change in our determination as to an unfavorable outcome, result in a final adverse judgment or be settled for significant amounts, they could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such judgment or settlement occurs.

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Additional Information

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

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PART I FINANCIAL INFORMATION

Item 1

Xerox Corporation
Condensed Consolidated Statements of Income (Unaudited)

(In millions, except per-share data)	Three Months Ended September 30, 2002	Three Months Ended September 30, 2001 Restated Note 2	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2001 Restated Note 2
Revenues				
Sales	$ 1,593	$ 1,708	$ 4,838	$ 5,431
Service, outsourcing and rentals	1,953	2,071	6,004	6,344
Finance income	247	273	761	851
Total Revenues	3,793	4,052	11,603	12,626
Costs and Expenses				
Cost of sales	1,013	1,239	3,036	3,917
Cost of service, outsourcing and rentals	1,079	1,183	3,411	3,658
Equipment financing interest	107	107	300	362
Research and development expenses	229	257	699	765
Selling, administrative and general expenses	1,023	1,175	3,302	3,544
Restructuring and asset impairment charges	63	63	262	487
Gain on sale of half of interest in Fuji Xerox				(769)
Other expenses, net	93	125	290	327
Total Costs and Expenses	3,607	4,149	11,300	12,291
Income (Loss) before Income Taxes (Benefits), Equity Income, Minorities Interests and Cumulative Effect of Change in Accounting Principle	186	(97)	303	335
Income taxes (benefits)	81	(42)	128	279
Income (Loss) before Equity Income, Minorities Interests and Cumulative Effect of Change in Accounting Principle	105	(55)	175	56
Equity in net income of unconsolidated affiliates	17		43	34
Minorities interests in earnings of subsidiaries	(17)	(9)	(66)	(26)
	105	(64)	152	64

Income (Loss) before Cumulative Effect of Change in Accounting Principle								
Cumulative effect of change in accounting principle								(2)
Net Income (Loss)	$	105	$	(64)	$	152	$	62
Less: Preferred stock dividends		(63)				(63)		(12)
Net Income (Loss) available to common shareholders	$	42	$	(64)	$	89	$	50
Basic Earnings (Loss) per Share	$	0.06	$	(0.09)	$	0.12	$	0.07
Diluted Earnings (Loss) per Share	$	0.05	$	(0.09)	$	0.11	$	0.07

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

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Xerox Corporation
Condensed Consolidated Balance Sheets (Unaudited)

(In millions, except share data in thousands)	September 30, 2002	December 31, 2001
Assets		
Cash and cash equivalents	$ 2,281	$ 3,990
Accounts receivable, net	1,822	1,896
Billed portion of finance receivables, net	544	584
Finance receivables, net	3,160	3,338
Inventories	1,207	1,364
Deferred taxes and other current assets	1,436	1,428
Total Current Assets	10,450	12,600
Finance receivables due after one year, net	5,176	5,756
Equipment on operating leases, net	506	804
Land, buildings and equipment, net	1,773	1,999
Goodwill, net	1,587	1,445
Other long-term assets	4,974	5,085
Total Assets	$ 24,466	$ 27,689
Liabilities and Equity		
Short-term debt and current portion of long-term debt	$ 3,514	$ 6,637
Accounts payable	716	704
Other current liabilities	2,535	2,919
Total Current Liabilities	6,765	10,260
Long-term debt	10,470	10,128
Other long-term liabilities	3,031	3,251
Total Liabilities	20,266	23,639
Deferred ESOP benefits	(135)	(135)
Minorities interests in equity of subsidiaries	68	73
Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company	1,698	1,687
Preferred stock	559	605
Common shareholders equity	2,010	1,820
Total Liabilities and Equity	$ 24,466	$ 27,689
Shares of common stock issued and outstanding	734,070	722,314

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

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Xerox Corporation
Condensed Consolidated Statements of Cash Flows (Unaudited)

(In millions)	Three Months Ended September 30, 2002	Three Months Ended September 30, 2001 Restated Note 2	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2001 Restated Note 2
Cash Flows from Operating Activities				
Net Income (Loss)	$ 105	$ (64)	$ 152	$ 62
Adjustments required to reconcile net income to cash flows from operating activities:				
Depreciation and amortization	213	317	772	997
Provisions for receivables and inventory	118	186	375	574
Restructuring and asset impairment charges	63	63	262	487
Cash payments for restructurings	(93)	(101)	(276)	(365)
Gain on sales of businesses and assets, net	(14)		(20)	(759)
(Increase) decrease in inventories	(17)	(9)	64	118
Increase in on-lease equipment	(7)	(50)	(98)	(231)
Decrease in finance receivables	188	194	656	222
Decrease (increase) in billed portion of finance and accounts receivable	91	(74)	(11)	