XEROX®

Treasury Best Practice
Treasury Management on a Global Basis

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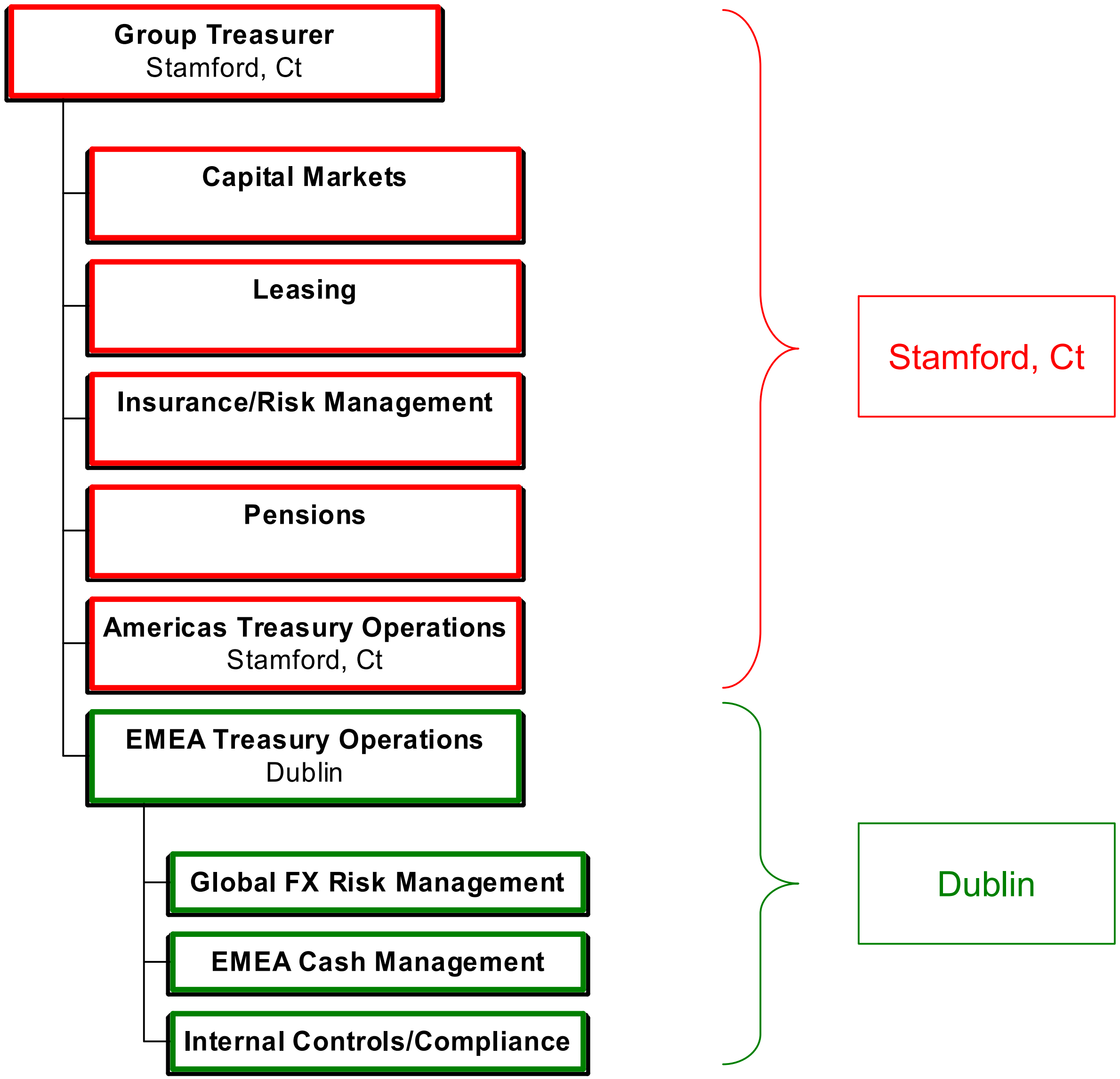
Agenda

- Xerox Corporation - background
- Xerox Group Treasury – Org chart & activities
- Managing Global FX Risk
- Accounting implications
- Hedge Accounting
- Cash management
- Capital Structure
- Loan Covenant Compliance
- Credit Ratings
- Q&A

Xerox Corporation

- Xerox Corporation is a technology and services enterprise which develops, manufactures, markets, services and finances a range of document equipment, supplies, software, solutions and services.
- Xerox employs over 55,000 people, operates in over 160 countries worldwide and distributes products & services through divisions, wholly owned subsidiaries, JV's and third-party distributors.
- Market Capitalisation – $13.25bn
- 2005 Revenue – $15.7bn
- Total Debt - $7.2bn; $3.5bn Secured & $3.7bn Unsecured (Dec2005)
- Credit Rating – Ba1 (Moodys), BB+ (S&P)

Xerox Group Treasury – Org Chart



Xerox Treasury – Dublin Office

- Established in 1998, 12 Staff
- Responsibility for:
  - Global FX Risk management
  - Security and investment of cash balances throughout EMEA
  - Management of liquidity and provision of funding to EMEA Group companies.
  - Running the intercompany netting cycle for over 100 EMEA entities
  - Administration of Corporate Debt programmes
  - Bank relationship management (EMEA)
  - EMEA Capital Structure (inc Dividend Policy)
  - EMEA Covenant Compliance

Managing FX Risk - Why Hedge?

- **Economic benefit**
  - Provides economic **certainty**: Locks in the price of future foreign currency purchases and value of future foreign currency revenues
  - Over the full cycle, reduces impact of currency fluctuations on earnings
- **Policy**
  - “All firmly committed and current transaction exposures should be fully (100%) hedged. Treasury will seek to hedge at least 50% of forecasted anticipated exposures*; Exceptions to these are at the discretion of the Group Treasurer”

    *(*currently a quarterly process)*

Quantifying the Risks

- **Balance Sheet Assets and Liabilities denominated in currencies other than functional currency**
  - External debt
  - Inter Company loans and deposits
- **Trading Activities**
  - Anticipated foreign currency inventory purchases
  - Anticipated foreign currency revenues

Easily hedged

- **One-off events**
  - Capital Structure (Injections, Dividends)
  - M&A activity
  - 2004 devaluation of Venezuelan Bolivar

Event driven

- **Translation Risk**
  - Future value of net foreign investments
- **Economic / Competitive Risk**
  - Loss of market share due to currency move

Generally unhedged

Designing a strategy

Based on:

- Nature and predictability of the Company's business
- Risk tolerance
- Cost
- Timing
- Expected volatility

With defined objectives:

- Reduction of performance volatility
- Predictability of forecast cashflows

And defined benchmarks:

- Plan rates
- Pricing rates

Note: A hedging strategy only postpones the effect of long term currency trends – once the hedges mature the company will have to face the new currency environment.

Lowering the “cost” of hedging

- Centralisation of Risk & Netting
  - All entities operate in local or functional currency
  - Net FX exposures managed at the centre
- Portfolio approach using Value @ Risk
  - Takes advantage of diversification benefits
  - Knowing the maximum simulated loss (not to be confused with the maximum possible loss) allows a company to identify a mix of hedges which provide the lowest risk at an acceptable level of cost

Hedging the Balance Sheet

- Dublin Treasury hedges all Balance Sheet Monetary Assets and Liabilities denominated in currencies other than functional currency for all Xerox Corporation affiliates (unless prohibited by local regulations)
  - External debt
  - Inter Company loans and deposits
  - Non-functional currency payables and receivables

Example:

- ***Non EUR-functional entities lend surplus cash to TreasuryCo***
- ***Loans appear on TreasuryCo's EUR balance sheet as foreign currency denominated liabilities***
- ***Hedged via FX swaps, selling currency at spot rate, buying back at forward rate***
- ***Cost of hedging = Difference between Spot and Forward rate***
- ***Reflects interest rate differential between EUR (2.5%) and other currency (e.g. GBP 4.50%)***

Hedging Trade Activity

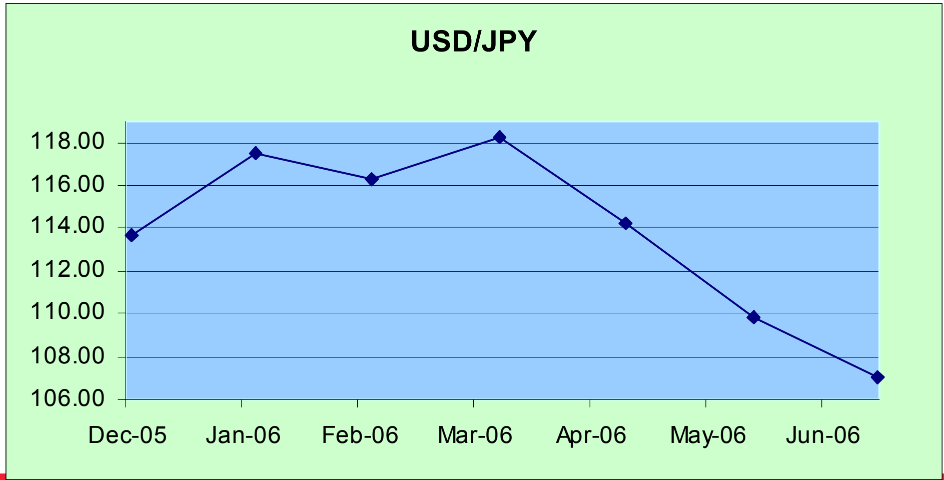
- Each entity is responsible for forecasting its currency requirements for the upcoming quarter
- Treasury calculates the net position per currency - Hedged via FX Forwards
- An inter-company Billing Rate is set based on these trades
- Some longer dated commitments hedged via FX Options for a tenor of up to one year.
- Each entity is invoiced / credited in its own functional currency via a web-based platform which is linked to the TMS
- All inter-company balances are netted and settled at the Billing Rate via Treasury once a month – either in cash or by loan.
- Any variance in actual volumes vs. forecast can drive material P&L volatility:
  - If an entity requires more or less currency than forecast, Treasury closes out the difference at spot market rates
  - Currently any gain or loss resulting from inefficient forecasting resides on Treasury's books on the close-out.

Accounting Implications - Treasury

Unrealized Gains and Losses Occur When Derivatives are Held to Maturity

Example: Longer term USD/JPY hedge.

- Q1 JPY weakens by 4% against the USD
  - ➢ Large USD/JPY hedges traded earlier in quarter at 113.50 are out of the money = ***unrealised losses***
  - ➢ At Mar 31, derivative is marked to market and Treasury records an unrealised loss in the P&L. There is no offset since no payable has been recorded in the field.
- In Q2 the trend reverses - JPY strengthens by 7% against the USD
  - ➢ Now USD/JPY hedges are gaining = ***unrealised gains***
  - ➢ At Jun 30, derivative is marked to market and Treasury records an unrealised gain. There is still no offset since the payable has still not been recorded.



Accounting Implications - Field

- Forecast inventory purchases are hedged by Treasury on a quarterly basis
- Local units record inventory to COGS using Average Monthly Rate, but use Billing rate to record associated payable.
- Difference between these values is posted to Aggregate Exchange
- The benefit / cost of cheaper / dearer inventory is being captured in Gross Margin

Hedge Accounting

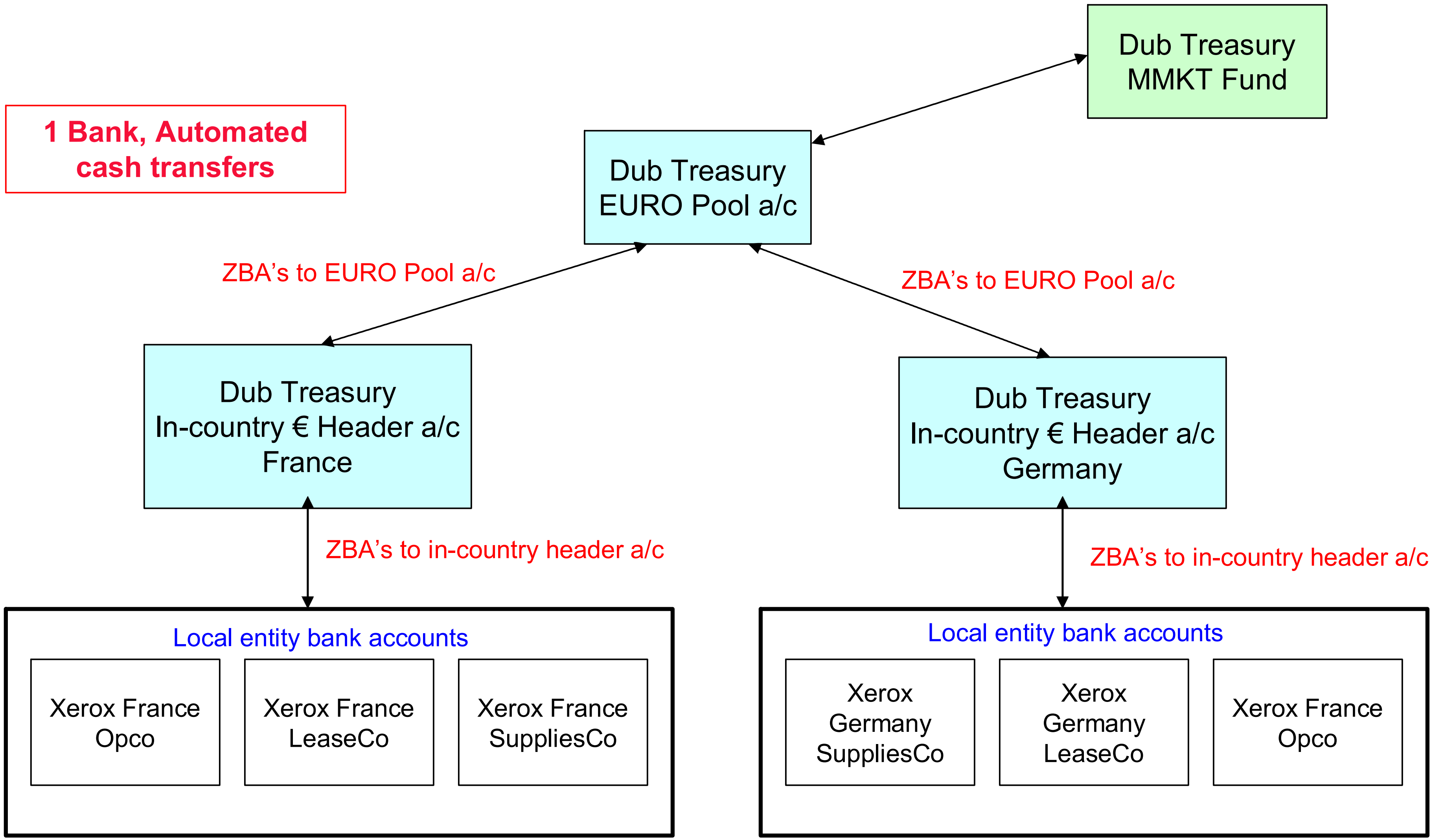
- FAS 133 governs how derivatives are valued and recorded
  - All derivatives must be recorded at fair market value
  - Changes in fair values <u>must</u> be taken to P&L <u>except</u> where they qualify for hedge accounting treatment
  - Changes in values of qualifying derivatives are taken to the Balance Sheet, offsetting changes in value of underlying asset or liability

- Very difficult to achieve Hedge Accounting for derivatives hedging anticipated transactions. At a minimum, it requires accurate forecasting and tracking:
  - To enable proof that transactions are "probable"
  - To identify when transactions occur
  - To identify timing of earnings impact from these transactions
  - To identify derivatives that are "linked" to <u>specific anticipated transactions</u> (not portfolios of transactions) and critical terms that precisely match with those transactions.

Banking/Cash Management

- Treasury has the responsibility to manage all banking relationships worldwide
- Major credit providers & cash management banks are managed centrally.
- Some local banking arrangements are managed in-country
- Currently undergoing major EMEA initiative to establish cash pools in major currencies giving central access to all bank accounts
    - promotes efficient cash management
    - drives cost benefits
    - improves control
- In the process of establishing a new automated zero-balancing bank account ("ZBA") structure in place in each country.

Bank account/Cash pool structure



Capital Structure

- Annual review of balance sheets carried out in conjunction with Tax and Accounting
  - Debt / Equity Ratios
  - Working Capital requirements
  - Local Regulatory Capital requirements
  - Dividend policy

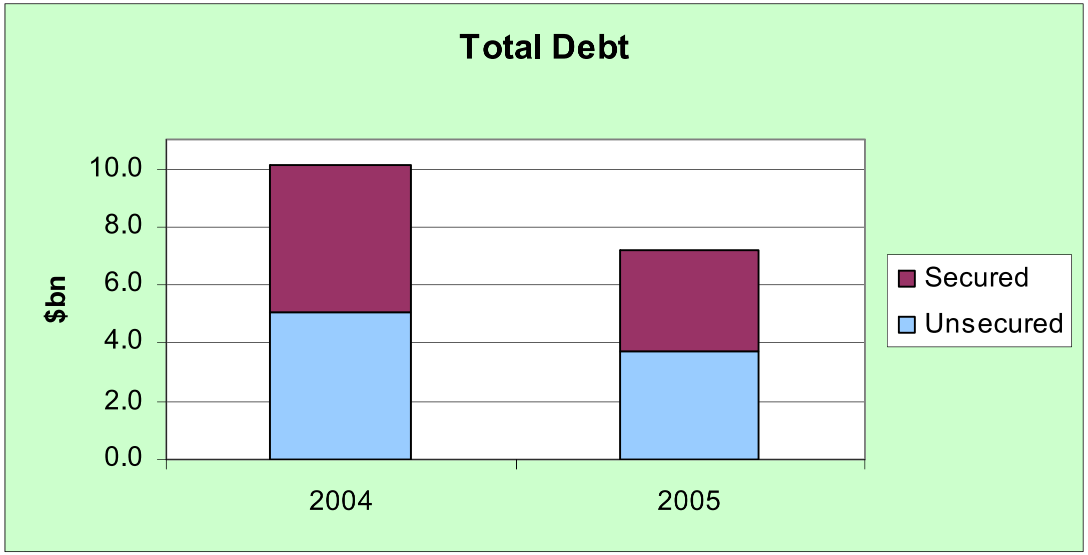
Loan Covenant Compliance

- Corporate Borrowings generally contain restrictive covenants
  - Acquisition & disposal of assets and/or businesses
  - Granting of liens over assets
  - Establishment of new subsidiaries / joint ventures
  - Incurrence of debt
  - Provision of guarantees
  - Payment of dividends
- The higher the credit rating the less restrictive the covenants
- All Corporate & Affiliate transactions are reviewed by Legal, Treasury, Tax & Accounting to ensure compliance.

Credit Ratings

"On March 1, 2006, Standard & Poor's Ratings Services raised its corporate credit rating on Xerox Corp. and related entities to 'BB+' from 'BB-'…. The upgrade reflects substantial recent debt reductions, good cash flow and growth in equipment sales. The outlook is stable.

…Xerox's ability to attain an investment-grade corporate credit rating would depend upon the company's ability to achieve sustainable revenue growth with stable operating margins, and maintain adjusted total debt to EBITDA of 2.5x or less"



Ratings History (S&P)	
Jul-1990	A
Jul-2000	A-
Sep-2000	BBB
Oct-2000	BBB-
Oct-2001	BB
Jun-2002	BB-
Mar-2006	BB+

Rating	Credit Spread
AA	+13bps
A	+33bps
BBB	+61bps
BB	+180bps

Questions?