XEROX CORP
Form 10-Q
August 02, 2010
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended: June 30, 2010**

**OR**

**¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from to**

**Commission File Number 001-04471**

# XEROX CORPORATION

**(Exact Name of Registrant as specified in its charter)**

| | |
|---|---|
| **New York** | **16-0468020** |
| **(State or other jurisdiction of** | **(IRS Employer** |
| **incorporation or organization)** | **Identification No.)** |
| **P.O. Box 4505, 45 Glover Avenue** | |
| **Norwalk, Connecticut** | **06856-4505** |
| **(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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

| **Class** | **Outstanding at June 30, 2010** |
|---|---|
| Common Stock, $1 par value | 1,383,046,977 shares |

Table of Contents

## FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q and any exhibits to this Report may contain 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 r 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. These factors include but are not limited to: the unprecedented volatility in the global economy; the risk that unexpected costs will be incurred; the outcome of litigation and regulatory proceedings to which we may be a party; actions of competitors; changes and developments affecting our industry; quarterly or cyclical variations in financial results; development of new products and services; interest rates and cost of borrowing; our ability to protect our intellectual property rights; our ability to maintain and improve cost efficiency of operations, including savings from restructuring actions; changes in foreign currency exchange rates; changes in economic conditions, political conditions, trade protection measures, licensing requirements and tax matters in the foreign countries in which we do business; reliance on third parties for manufacturing of products and provision of services; the risk that we may not realize all of the anticipated benefits from the acquisition of Affiliated Computer Services, Inc.; our ability to recover capital investments; the risk that subcontractors, software vendors and utility and network providers will not perform in a timely, quality manner; the risk that multi-year contracts with governmental entities could be terminated prior to the end of the contract term; the risk that individually identifiable information of customers, clients and employees could be inadvertently disclosed or disclosed as a result of a breach of our security; and other risks that are set forth in the Risk Factors section, the Legal Proceedings section, the Management s Discussion and Analysis of Financial Condition and Results of Operations section and other sections of this Quarterly Report on Form 10-Q, our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 and our 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission ( SEC ). The Company assumes no obligation to update any forward-looking statements as a result of new information or future events or developments, except as required by law.

**Table of Contents**

**XEROX CORPORATION**

**FORM 10-Q**

**June 30, 2010**

**TABLE OF CONTENTS**



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

Table of Contents

## PART I FINANCIAL INFORMATION

## ITEM 1 FINANCIAL STATEMENTS

## XEROX CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

| (in millions, except per-share data) | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Sales | $ 1,791 | $ 1,602 | $ 3,469 | $ 3,096 |
| Service, outsourcing and rentals | 3,553 | 1,951 | 6,423 | 3,831 |
| Finance income | 164 | 178 | 337 | 358 |
| **Total Revenues** | 5,508 | 3,731 | 10,229 | 7,285 |
| **Costs and Expenses** | | | | |
| Cost of sales | 1,172 | 1,065 | 2,254 | 2,069 |
| Cost of service, outsourcing and rentals | 2,359 | 1,100 | 4,230 | 2,200 |
| Equipment financing interest | 61 | 68 | 125 | 137 |
| Research, development and engineering expenses | 194 | 202 | 399 | 406 |
| Selling, administrative and general expenses | 1,163 | 1,013 | 2,262 | 2,017 |
| Restructuring and asset impairment charges | 11 | (1) | 206 | (3) |
| Acquisition-related costs | 15 | | 63 | |
| Amortization of intangible assets | 85 | 15 | 142 | 29 |
| Other expenses, net | 128 | 72 | 238 | 155 |
| **Total Costs and Expenses** | 5,188 | 3,534 | 9,919 | 7,010 |
| **Income before Income Taxes and Equity Income** | 320 | 197 | 310 | 275 |
| Income tax expense | 112 | 59 | 134 | 78 |
| Equity in net income (loss) of unconsolidated affiliates | 28 | 9 | 26 | (1) |
| **Net Income** | 236 | 147 | 202 | 196 |
| Less: Net income attributable to noncontrolling interests | 9 | 7 | 17 | 14 |
| **Net Income Attributable to Xerox** | $ 227 | $ 140 | $ 185 | $ 182 |
| **Basic Earnings per Share** | $ 0.16 | $ 0.16 | $ 0.14 | $ 0.21 |
| **Diluted Earnings per Share** | $ 0.16 | $ 0.16 | $ 0.14 | $ 0.21 |

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

**Table of Contents**

**XEROX CORPORATION**

**CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

| (in millions, except share data in thousands) | June 30, 2010 | December 31, 2009 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | $ 1,082 | $ 3,799 |
| Accounts receivable, net | 2,974 | 1,702 |
| Billed portion of finance receivables, net | 210 | 226 |
| Finance receivables, net | 2,183 | 2,396 |
| Inventories | 1,026 | 900 |
| Other current assets | 1,023 | 708 |
| Total current assets | 8,498 | 9,731 |
| Finance receivables due after one year, net | 3,999 | 4,405 |
| Equipment on operating leases, net | 504 | 551 |
| Land, buildings and equipment, net | 1,622 | 1,309 |
| Investments in affiliates, at equity | 1,150 | 1,056 |
| Intangible assets, net | 3,495 | 598 |
| Goodwill | 8,446 | 3,422 |
| Deferred tax assets, long-term | 635 | 1,640 |
| Other long-term assets | 1,665 | 1,320 |
| **Total Assets** | $ 30,014 | $ 24,032 |
| **Liabilities and Equity** | | |
| Short-term debt and current portion of long-term debt | $ 358 | $ 988 |
| Accounts payable | 1,670 | 1,451 |
| Accrued compensation and benefits costs | 830 | 695 |
| Other current liabilities | 1,834 | 1,327 |
| Total current liabilities | 4,692 | 4,461 |
| Long-term debt | 9,259 | 8,276 |
| Liability to subsidiary trust issuing preferred securities | 649 | 649 |
| Pension and other benefit liabilities | 2,023 | 1,884 |
| Post-retirement medical benefits | 970 | 999 |
| Other long-term liabilities | 737 | 572 |
| **Total Liabilities** | 18,330 | 16,841 |
| Series A Convertible Preferred Stock | 349 | |
| Common stock | 1,384 | 871 |
| Additional paid-in capital | 6,475 | 2,493 |
| Retained earnings | 5,729 | 5,674 |
| Accumulated other comprehensive loss | (2,403) | (1,988) |
| Xerox shareholders equity | 11,185 | 7,050 |
| Noncontrolling interests | 150 | 141 |
| **Total Equity** | 11,335 | 7,191 |

| | | | | |
|---|---|---|---|---|
| **Total Liabilities and Equity** | $ | 30,014 | $ | 24,032 |
| Shares of common stock issued and outstanding | | 1,383,047 | | 869,381 |

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

**Table of Contents**

**XEROX CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

| (in millions) | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 |
|---|---|---|---|---|
| **Cash Flows from Operating Activities:** | | | | |
| Net income | $ 236 | $ 147 | $ 202 | $ 196 |
| Adjustments required to reconcile net income to cash flows from operating activities: | | | | |
| Depreciation and amortization | 279 | 168 | 520 | 337 |
| Provision for receivables | 43 | 78 | 93 | 146 |
| Provision for inventory | 8 | 13 | 17 | 29 |
| Net loss (gain) on sales of businesses and assets | 1 | (7) | (1) | (9) |
| Undistributed equity in net (income) loss of unconsolidated affiliates | (12) | (4) | (9) | 6 |
| Stock-based compensation | 30 | 14 | 57 | 31 |
| Provision for litigation, net | 36 | | 36 | |
| Payments for litigation, net | (36) | | (36) | (28) |
| Restructuring and asset impairment charges | 11 | (1) | 206 | (3) |
| Payments for restructurings | (55) | (78) | (94) | (165) |
| Contributions to pension benefit plans | (30) | (31) | (63) | (59) |
| Decrease (increase) in accounts receivable and billed portion of finance receivables | 62 | 138 | (135) | 305 |
| Collections of deferred proceeds from sales of receivables | 42 | | 42 | |
| (Increase) decrease in inventories | (61) | 187 | (198) | 82 |
| Increase in equipment on operating leases | (64) | (64) | (122) | (127) |
| Decrease in finance receivables | 70 | 118 | 201 | 231 |
| (Increase) decrease in other current and long-term assets | (8) | 27 | 13 | 44 |
| Increase (decrease) in accounts payable and accrued compensation | 18 | (105) | 187 | (273) |
| Decrease in other current and long-term liabilities | (12) | (35) | (66) | (138) |
| Net change in income tax assets and liabilities | 110 | 32 | 107 | 34 |
| Net change in derivative assets and liabilities | (22) | (28) | (4) | (68) |
| Other operating, net | 32 | 40 | 100 | 60 |
| Net cash provided by operating activities | 678 | 609 | 1,053 | 631 |
| **Cash Flows from Investing Activities:** | | | | |
| Cost of additions to land, buildings and equipment | (83) | (11) | (134) | (48) |
| Proceeds from sales of land, buildings and equipment | 6 | 6 | 25 | 9 |
| Cost of additions to internal use software | (44) | (28) | (69) | (56) |
| Acquisitions, net of cash acquired | (4) | | (1,528) | (145) |
| Net change in escrow and other restricted investments | (9) | (3) | 6 | (3) |
| Other investing | 4 | | 4 | |
| Net cash used in investing activities | (130) | (36) | (1,696) | (243) |
| **Cash Flows from Financing Activities:** | | | | |
| Net proceeds (payments) on secured financings | 1 | (15) | (3) | (40) |
| Net (payments) proceeds on other debt | (396) | 151 | (2,035) | (266) |
| Common stock dividends | (60) | (38) | (97) | (75) |
| Preferred stock dividends | (3) | | (3) | |
| Proceeds from issuances of common stock | 2 | | 117 | |
| Repurchases related to stock-based compensation | (2) | (11) | (2) | (11) |
| Excess tax benefits from stock-based compensation | 6 | | 10 | |
| Other financing | (5) | (5) | (9) | (8) |

| | | | | |
|---|---|---|---|---|
| Net cash (used in) provided by financing activities | (457) | 82 | (2,022) | (400) |
| Effect of exchange rate changes on cash and cash equivalents | (19) | 17 | (52) | 4 |
| Increase (decrease) in cash and cash equivalents | 72 | 672 | (2,717) | (8) |
| Cash and cash equivalents at beginning of period | 1,010 | 549 | 3,799 | 1,229 |
| **Cash and Cash Equivalents at End of Period** | $ 1,082 | $ 1,221 | $ 1,082 | $ 1,221 |

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

Table of Contents

XEROX CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in millions, except per-share data and where otherwise noted)

## Note 1 Basis of Presentation

References herein to we, us, our, the Company and Xerox refer to Xerox Corporation and its consolidated subsidiaries unless the co specifically requires otherwise.

We have prepared the accompanying unaudited Condensed Consolidated Financial Statements in accordance with the accounting policies described in our 2009 Annual Report to Shareholders, which is incorporated by reference in our 2009 Annual Report on Form 10-K ( 2009 Annual Report ), and the interim reporting requirements of Form 10-Q. Accordingly, certain information and note disclosures normally included in our annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. You should read these Condensed Consolidated Financial Statements in conjunction with the Consolidated Financial Statements included in our 2009 Annual Report.

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

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

## Note 2 Significant Accounting Policies

### Revenue Recognition

As a result of our recent acquisition of Affiliated Computer Services, Inc. ( ACS ), a significant portion of our revenues are derived from service arrangements. The following summary is an update of our accounting policy, as included in our 2009 Annual Report, associated with revenue recognition for service arrangements (refer to Note 5 Acquisitions for information regarding the ACS acquisition):

**Services:** Technical service revenues are derived primarily from maintenance contracts on our equipment sold to customers and are recognized over the term of the contracts. A substantial portion of our products are sold with full service maintenance agreements for which the customer typically pays a base service fee plus a variable amount based on usage. As a consequence, other than the product warranty obligations associated with certain of our low end products we do not have any significant product warranty obligations, including any obligations under customer satisfaction programs.

Revenues associated with outsourcing, professional and value-added services are generally recognized as services are rendered, on the basis of the number of accounts or transactions processed. Information technology processing revenues are recognized as services are provided to the customer, generally at the contractual selling prices of resources consumed or capacity utilized by our customers. In those service arrangements where final acceptance of a system or solution by the customer is required, revenue is deferred until all acceptance criteria have been met. Revenues on cost reimbursable contracts are recognized by applying an estimated factor to costs as incurred, determined by the contract provisions and prior experience. Revenues on unit-price contracts are recognized at the contractual selling prices as work is completed and accepted by the customer. Revenues on time and material contracts are recognized at the contractual rates as the labor hours and direct expenses are incurred.

Costs associated with service arrangements are generally recognized as incurred. Initial direct costs of an arrangement are capitalized and amortized over the contractual service period. Long-lived assets used in the fulfillment of the arrangements are capitalized and depreciated over the shorter of their useful life or the term of the contract. Losses on service arrangements are recognized in the period that the contractual loss becomes probable and estimable.

Table of Contents

Revenues on certain fixed price contracts where we provide information technology system development and implementation services are recognized over the contract term based on the percentage of development and implementation services that are provided during the period compared with the total estimated development and implementation services to be provided over the entire contract using guidance from ASC Topic 605-35 Revenue Recognition Construction-Type and Certain Production-Type Contracts . These services require that we perform significant, extensive and complex design, development, modification or implementation activities of our customers systems. Performance will often extend over long periods, and our right to receive future payment depends on our future performance in accordance with the agreement.

The percentage-of-completion methodology involves recognizing probable and reasonably estimable revenue using the percentage of services completed, on a current cumulative cost to estimated total cost basis, using a reasonably consistent profit margin over the period. Due to the long-term nature of these projects, developing the estimates of costs often requires significant judgment. Factors that must be considered in estimating the progress of work completed and ultimate cost of the projects include, but are not limited to, the availability of labor and labor productivity, the nature and complexity of the work to be performed and the impact of delayed performance. If changes occur in delivery, productivity or other factors used in developing the estimates of costs or revenues, we revise our cost and revenue estimates, which may result in increases or decreases in revenues and costs, and such revisions are reflected in income in the period in which the facts that give rise to that revision become known.

Revenues earned in excess of related billings are accrued, whereas billings in excess of revenues earned are deferred until the related services are provided. We recognize revenues for non-refundable, upfront implementation fees on a straight-line basis over the period between the initiations of the ongoing services through the end of the contract term.

## Note 3 Recent Accounting Pronouncements

### Revenue Recognition

In late 2009, the FASB issued the following new accounting guidance which is first applicable for our 2010 reporting:

- ASU No. 2009-14, Software (ASC Topic 985) Certain Revenue Arrangements That Include Software Elements, a consensus of the FASB Emerging Issues Task Force. This guidance modifies the scope of ASC subtopic 985-605 Software-Revenue Recognition to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionality.

- ASU No. 2009-13, Revenue Recognition (ASC Topic 605) Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force. This guidance modifies previous requirements by allowing the use of the best estimate of selling price in the absence of vendor-specific objective evidence ( VSOE ) or verifiable objective evidence ( VOE ) (now referred to as TPE or third-party evidence) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when more objective evidence of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted.

We adopted these updates effective for our fiscal year beginning January 1, 2010, and are applying them prospectively from that date for new or materially modified arrangements. As described below, the adoption of these updates did not have, nor are they expected to have, a material effect on our financial condition or results of operations.

With respect to the new software guidance, the modification in the scope of the industry-specific software revenue recognition guidance did not result in a change in the recognition of revenue for our equipment and services. Software included within our equipment and services has generally been considered incidental and therefore has been, and will continue to be, accounted for as part of the sale of equipment or services. Most of our equipment have both software and non-software components that function together to deliver the equipment s essential functionality. The software scope modification is also not expected to change the recognition of revenue for software accessories sold in connection with our equipment or free-standing software sales as these transactions will continue to be accounted for under the industry-specific software revenue recognition guidance as separate software elements.

Table of Contents

With respect to the new guidance for arrangements with multiple deliverables, we enter into the following revenue arrangements that may consist of multiple deliverables:

- Bundled arrangements, which typically include both lease deliverables and non-lease deliverables. Lease deliverables include the equipment, financing, maintenance and executory costs. Non-lease deliverables generally consist of supplies and non-maintenance services.

- Sales of equipment with a related full-service maintenance agreement.

- Contracts for multiple types of outsourcing services, as well as professional and value-added services. For instance, we may contract for an implementation or development project and also provide services to operate the system over a period of time; or we may contract to scan, manage and store customer documents.

If a deliverable in a multiple-element arrangement is subject to specific guidance, such as leased equipment in our bundled lease arrangements (which is subject to specific leasing guidance) or accessory software (which is subject to software revenue recognition guidance) that deliverable is separated from the arrangement based on its relative selling price (the relative selling price method see below) and accounted for in accordance with such specific guidance. The remaining deliverables in a multiple-element arrangement are accounted for based on the following guidance.

A multiple-element arrangement is separated into more than one unit of accounting if both of the following criteria are met:

- The delivered item(s) has value to the customer on a stand-alone basis; and

- If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in our control. If these criteria are not met, the arrangement is accounted for as one unit of accounting and the recognition of revenue is generally upon delivery/completion or ratably as a single unit of accounting over the contractual service period.

Consideration in a multiple-element arrangement is allocated at the inception of the arrangement to all deliverables on the basis of the relative selling price. When applying the relative selling price method, the selling price for each deliverable is determined using VSOE of the selling price, or TPE of the selling price. If neither VSOE nor TPE of the selling price exists for a deliverable, we will use our best estimate of the selling price for that deliverable.

The new guidance with respect to multiple-element arrangements is not expected to change the allocation of arrangement consideration to the units of accounting or the pattern and timing of revenue recognition for those units. Normally our equipment and services will qualify as separate units of accounting, which are the majority of our multiple-element arrangements. In addition, under previous guidance, consideration for multiple-element arrangements was allocated based on VSOE or TPE, since products and services are generally sold separately or the selling price is determinable based on competitor prices for similar deliverables. As a result, for substantially all of our multiple-element arrangements we expect to continue using VSOE or TPE to allocate the arrangement consideration to each respective deliverable.

Although infrequent, under previous guidance with respect to multiple-element arrangements, if we were unable to establish the selling price using VSOE or TPE, arrangement consideration was allocated using the residual method or recognized ratably over the contractual service period. However, since the new guidance allows for the use of our best estimate of the selling price in our allocation of arrangement consideration if VSOE or TPE is not determinable, we expect to use our best estimate of selling price in those infrequent situations. The objective of using estimated selling price based methodology is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. Accordingly, we determine our best estimate of selling price considering multiple factors including, but not limited to, geographies, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. Estimated selling price based methodology generally will apply to an insignificant proportion of our arrangements with multiple deliverables.

**Fair Value Accounting**

In 2010, the FASB issued ASU No. 2010-06 which amends Fair Value Measurements and Disclosures Overall (ASC Topic 820-10). This update requires a gross presentation of activities within the Level 3 rollforward and adds a new requirement to disclose transfers in and out of Level 1 and 2 measurements. The update further clarifies the existing disclosure requirements in ASC 820-10 regarding: i) the level of disaggregation of fair value measurements; and ii) the disclosures regarding inputs and valuation techniques. This update was effective for our fiscal year beginning January 1, 2010 except for the gross presentation of the Level 3 rollforward information, which is effective for our fiscal year beginning January 1, 2011. The principal impact from this update will be expanded disclosures regarding our fair value measurements.

### Other Accounting Changes

In 2009, the FASB issued the following codification updates:

ASU 2009-17 which amends Consolidations (ASC Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This update requires an analysis to determine whether a variable interest gives the entity a controlling financial interest in a variable interest entity. It also requires an ongoing reassessment and eliminates the quantitative approach previously required for determining whether an entity is the primary beneficiary.

ASU 2009-16 which amends Transfers and Servicing (ASC Topic 860): Accounting for Transfers of Financial Assets. This update removed the concept of a qualifying special-purpose entity and removed the exception from applying consolidation guidance to these entities. This update also clarified the requirements for isolation and limitations on portions of financial assets that are eligible for sales accounting.

We adopted these updates effective for our fiscal year beginning January 1, 2010. The adoption of these updates did not have a material effect on our financial condition or results of operations.

In July 2010, the FASB issued ASU 2010-20 which amended Receivables (ASC Topic 310) and requires significantly increased disclosures regarding the credit quality of an entity s financing receivables and its allowance for credit losses. In addition, this update requires an entity to disclose credit quality indicators, past due information, and modifications of its financing receivables. The disclosures are first effective for our 2010 Annual Report. The principal impact from this update will be to require us to report increased disclosures concerning the details of finance receivables and the related provisions and reserves for credit losses.

In May 2010, the FASB issued ASU 2010-19 which amended Foreign Currency (ASC Topic 830). The purpose of this update was to codify the SEC staff s view on certain foreign currency issues related to investments in Venezuela. We have operations in Venezuela where the U.S. Dollar is the functional currency. In January 2010, Venezuela announced a devaluation of the Bolivar to an official rate of 4.30 Bolivars to the U.S. Dollar for the majority of our products. As a result of this devaluation, we recorded a currency loss of $21 in the first quarter of 2010 for the re-measurement of our net Bolivar denominated monetary assets. During the first half of 2010, the ability to obtain U.S. Dollars remained severely restricted. As a result, we are currently re-measuring our net Bolivar denominated monetary transactions based on rates available in alternative markets. The average rate in the second quarter of 2010 was approximately 7 Bolivars to the U.S. Dollar. The impact of this change in the exchange rate was not material to our results for the quarter or year-to-date periods since we derive less than 0.5% of our total revenues from Venezuela.

Since the filing of our 2009 Annual Report, the FASB issued ASU No. 2010-09 through No. 2010-20. Other than those ASU s discussed above, these ASUs generally entail technical corrections to existing guidance or affect guidance related to specialized industries or entities and therefore have minimal, if any, impact on the Company.

### Note 4 Segment Reporting

Our reportable segments are aligned with how we manage the business and view the markets we serve. In 2010, as a result of our acquisition of ACS, we realigned our internal financial reporting structure. (Refer to Note 5 Acquisitions for information regarding the ACS acquisition.) We now report our financial performance based on the following two primary reportable segments Technology and Services. The Technology segment represents the combination of our former Production and Office segments excluding the document outsourcing business, which was previously included in these reportable segments. The Services segment represents the combination of our document outsourcing business, which includes Xerox s historical business process services, and ACS s business process outsourcing and information technology ( IT ) outsourcing businesses. We believe this realignment will help us to better manage our business and view the markets we serve, which are primarily centered around equipment systems and outsourcing services. Our Technology segment operations involve the

sale and support of a broad range of document systems from entry level to the high-end. Our Services segment operations involve delivery of a broad range of outsourcing services including document, business processing and IT outsourcing services. Our 2009 segment disclosures have been restated to reflect our new 2010 internal reporting structure.

The Technology segment is centered around strategic product groups, which share common technology, manufacturing and product platforms. This segment includes the sale of document systems and supplies, provision of technical service and financing of products. Our products range from:

Entry, which includes A4 devices and desktop printers.

Mid-Range, which includes A3 devices that generally serve workgroup environments in mid to large enterprises. This includes products that fall into the following market categories: Color 41+ ppm priced at less than $100K and Light Production 91+ppm priced at less than $100K.

High-End, which includes production printing and publishing systems that generally serve the graphic communications marketplace and large enterprises.

The Services segment comprises three outsourcing service offerings, Document Outsourcing (which includes Managed Print Services and our historical Xerox Business Process Outsourcing services), Business Process Outsourcing and Information Technology Outsourcing. Document outsourcing services include service arrangements that allow customers to streamline, simplify and digitize their document-intensive business processes through automation and deployment of software application and tools and the management of their printing needs. Business process outsourcing services include service arrangements where we manage a customer s business activity or process. Information technology outsourcing services include service arrangements where we manage a customer s IT-related activities, such as application management and application development, data center operations or testing and quality assurance.

The segment classified as Other includes several units, none of which meet the thresholds for separate segment reporting. This group primarily includes Xerox Supplies Business Group (predominantly paper sales), Wide Format Systems, licensing revenues, GIS network integration solutions and electronic presentation systems and non-allocated Corporate items including non-financing interest, as well as other items included in Other expenses, net.

Operating segment revenues and profitability for the three and six months ended June 30, 2010 and 2009 were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | Revenue | Profit (Loss) | Revenue | Profit (Loss) |
| **2010** | | | | |
| Technology | $ 2,555 | $ 273 | $ 5,038 | $ 506 |
| Services | 2,529 | 319 | 4,372 | 522 |
| Other | 424 | (93) | 819 | (197) |
| **Total** | $ 5,508 | $ 499 | $ 10,229 | $ 831 |
| **2009** | | | | |
| Technology | $ 2,476 | $ 248 | $ 4,811 | $ 414 |
| Services | 850 | 61 | 1,683 | 92 |
| Other | 405 | (80) | 791 | (175) |
| **Total** | $ 3,731 | $ 229 | $ 7,285 | $ 331 |

Table of Contents

| Reconciliation to Pre-tax Income | Three Months Ended June 30, 2010 | 2009 | Six Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|
| Segment Profit | $ 499 | $ 229 | $ 831 | $ 331 |
| Reconciling items: | | | | |
| Restructuring and asset impairment charges | (11) | 1 | (206) | 3 |
| Restructuring charges of Fuji Xerox | (5) | (9) | (27) | (31) |
| Acquisition-related costs | (15) | | (63) | |
| Amortization of intangible assets | (85) | (15) | (142) | (29) |
| Venezuelan devaluation | | | (21) | |
| ACS shareholders litigation settlement | (36) | | (36) | |
| Equity in net (income) loss of unconsolidated affiliates | (28) | (9) | (26) | 1 |
| Other | 1 | | | |
| **Pre-tax Income** | $ 320 | $ 197 | $ 310 | $ 275 |

## Note 5 Acquisitions

### Affiliated Computer Services, Inc.

On February 5, 2010 (the acquisition date ) we acquired all of the outstanding equity of ACS in a cash-and-stock transaction valued at approximately $6.5 billion. ACS provides business process outsourcing ( BPO ) and information technology ( IT ) services and solutions to commercial and government clients worldwide. ACS delivers a full range of BPO and IT services, as well as end-to-end solutions to the public and private sectors and supports a variety of industries including education, energy, financial, government, healthcare, retail and transportation. ACS s revenues for the calendar year ended December 31, 2009 were $6.6 billion, and they employed 78,000 people and operated in over 100 countries on the acquisition date.

**Equity transaction:** Each outstanding share of ACS Class A and Class B common stock was converted into a combination of 4.935 shares of Xerox common stock and $18.60 in cash for a combined value of $60.40 per share, or approximately $6.0 billion based on the closing price of Xerox common stock of $8.47 on the acquisition date. Approximately 489,800 thousand shares of Xerox common stock were issued. We also issued convertible preferred stock with a liquidation value of $300 and a fair value of $349 as of the acquisition date to ACS s Class B shareholder.

All ACS stock options outstanding at closing were assumed by Xerox and converted into Xerox stock options. ACS stock options issued prior to August 2009, whether or not then vested and exercisable, became fully vested and exercisable in accordance with preexisting change-in-control provisions. ACS stock options issued in August 2009 will continue to vest and become exercisable for Xerox common stock in accordance with their original vesting schedule. For the August 2009 options, the portion of the estimated fair value associated with service prior to the close was recorded as part of the acquisition fair value with the remainder to be recorded as future compensation cost over the remaining vesting period. Each assumed ACS option became exercisable for 7.085289 Xerox common shares for a total of approximately 96,700 thousand shares at a weighted average exercise price of $6.79 per option. The estimated fair value associated with the Xerox options issued in exchange for the ACS options was approximately $222 based on a Black-Scholes valuation model utilizing the assumptions stated below. Approximately $168 of the estimated fair value was recorded as part of the acquisition fair value, and $54 is expected to be expensed over the remaining vesting period which is estimated to be approximately 3.9 years.

| Assumptions | Pre-August 2009 Options | August 2009 Options |
|---|---|---|
| Strike price | $ 6.89 | $ 6.33 |
| Expected volatility | 37.90% | 38.05% |
| Risk-free interest rate | 0.23% | 1.96% |
| Expected term | 0.75 years | 4.2 years |

Table of Contents

**Fair value of consideration transferred:** The table below details the consideration transferred to acquire ACS (certain amounts reflect rounding adjustments):

| (shares in millions) | Conversion Calculation | Estimated Fair Value | Form of Consideration |
|---|---|---|---|
| ACS Class A shares outstanding as of the acquisition date | 92.7 | | |
| ACS Class B shares outstanding as of the acquisition date | 6.6 | | |
| **Total ACS Shares Outstanding** | 99.3 | | |
| Xerox stock price as of the acquisition date | $ 8.47 | | |
| Multiplied by the exchange ratio | 4.935 | | |
| **Equity Consideration per Common Share Outstanding** | $ 41.80 | $ 4,149 | Xerox common stock |
| **Cash Consideration per Common Share Outstanding** | $ 18.60 | $ 1,846 | Cash |
| ACS stock options exchanged for a Xerox equivalent stock option | 13.6 | | |
| Multiplied by the option exchange ratio | 7.085289 | | |
| **Total Xerox Equivalent Stock Options** | 96.7 | $ 168 | Xerox stock options |
| **Xerox Preferred Stock Issued to ACS Class B Shareholder** | | $ 349 | Xerox preferred stock |
| **Total Fair Value of Consideration Transferred** | | $ 6,512 | |

**Recording of assets acquired and liabilities assumed:** The transaction was accounted for using the acquisition method of accounting which requires, among other things, that most assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. Certain estimated values are not yet finalized (see below) and are subject to change. We will finalize the amounts recognized as we obtain the information necessary to complete the analyses. Companies have one year after an acquisition to finalize the purchase accounting.

The following table summarizes the provisional recording of assets acquired and liabilities assumed as of the acquisition date:

| | February 5, 2010 |
|---|---|
| **Assets** | |
| Cash and cash equivalents | $ 351 |
| Accounts receivable | 1,368 |
| Other current assets | 393 |
| Land, buildings and equipment | 416 |
| Intangible assets | 3,035 |
| Goodwill | 5,111 |
| Other long-term assets | 231 |
| **Liabilities** | |
| Other current liabilities | 656 |
| Deferred revenue | 161 |
| Deferred tax liability | 980 |
| Debt | 2,310 |
| Pension liabilities | 39 |
| Other long-term liabilities | 247 |

| | | |
|---|---|---|
| **Net Assets Acquired** | $ | 6,512 |

Table of Contents

**Intangible assets:** The following table is a summary of the fair value estimates of the identifiable intangible assets and their weighted-average useful lives:

| | Estimated Fair Value | Estimated Useful Life |
|---|---|---|
| Customer relationships/contracts | $ 2,920 | 11.6 years |
| ACS tradename | 100 | 4 years |
| Buck tradename | 10 | (1) |
| Title plant | 5 | (2) |
| **Total Identifiable Intangible Assets** | $ 3,035 | |

(1) Determined to be an indefinite-lived asset.
(2) Title plant is not subject to depreciation or charged to earnings based on ASC Topic 950 Financial Services Title Plant, unless circumstances indicate that the carrying amount of the title plant has been impaired.

**Deferred revenue:** As part of our purchase price allocation, we revalued ACS s existing deferred revenue to fair value based on the remaining post-acquisition service obligation. The total revaluation adjustment was $133 ($53 current; $80 non-current) and represented the value for services already rendered for which no future obligation to provide services remains. Post acquisition, revenue will accordingly be reduced for the value of this adjustment. Accordingly, the remaining balance of deferred revenue included in the above of $161 ($145 current; $16 non-current) primarily represents our estimate of the fair value for the remaining service obligation.

**Deferred taxes:** We provided deferred taxes and recorded other tax adjustments as part of the accounting for the acquisition primarily related to the estimated fair value adjustments for acquired intangible assets, as well as the elimination of a previously recorded deferred tax liability associated with ACS s historical goodwill that was tax deductible. In addition, we also provided deferred taxes of $76 for the outside basis difference associated with certain foreign subsidiaries of ACS for which no taxes have been previously provided. We expect to reverse the outside basis difference primarily through repatriating earnings from those subsidiaries in lieu of permanently reinvesting them as well as through the reorganization of those subsidiaries.

**Debt:** We repaid $1.7 billion of ACS s debt and assumed an additional $0.6 billion. The following is a summary of the third-party debt assumed and not repaid in connection with the close of the acquisition:

| | |
|---|---|
| 4.70% Senior Notes due June 2010 | $ 250 |
| 5.20% Senior Notes due June 2015 | 250 |
| Capital lease obligations and other debt | 64 |
| Principal debt balance | 564 |
| Fair value adjustments | 13 |
| **Total ACS Debt Assumed** | $ 577 |

**Pension obligations:** We assumed several defined benefit pension plans covering the employees of ACS s human resources consulting and outsourcing business in the U.S., U.K., Germany and Canada. The plans in the U.S. and Canada are both funded and unfunded; the plan in the U.K. is funded; and the plan in Germany is unfunded.

The following is a summary of the funded position of the assumed ACS plans as of the acquisition date, as well as associated weighted-average assumptions used to determine benefit obligations:

| | Estimated Fair Value |
|---|---|
| Projected benefit obligation | $ 142 |
| Fair value of plan assets | 111 |
| **Net Funded Status** | $ (31) |

**Table of Contents**

Amounts recognized in the Condensed Consolidated Balance Sheets:

| | |
|---|---|
| Other long-term assets | $ 8 |
| Pension liabilities | (39) |
| **Net Amount Recognized** | $ (31) |

Weighted average assumption used to determine benefit obligations at the acquisition date and net periodic benefit cost from the acquisition date through December 31, 2010:

| | |
|---|---|
| Discount rate | 5.7% |
| Expected rate of return on plan assets | 6.9% |
| Rate of compensation increase | 3.9% |

**Change-in-control liabilities:** We assumed liabilities due under contractual change-in-control provisions in employment agreements of certain ACS employees and its Chairman of approximately $95 ($15 current; $80 non-current). The liabilities include accruals for related excise and other taxes we are obligated to pay on these obligations.

**Contingent consideration:** Although there is no contingent consideration associated with our acquisition of ACS, ACS is obligated to make contingent payments in connection with prior acquisitions upon satisfaction of certain contractual criteria. Contingent consideration obligations must be recorded at their respective fair value. The maximum aggregate amount of ACS s outstanding contingent obligations to former shareholders of acquired entities is approximately $46, of which $11 was recorded representing the estimated fair value of this obligation as of the acquisition date. We made contingent payments of $3 in the second quarter of 2010 which are reflected within investing cash flows in the Condensed Consolidated Statements of Cash Flows.

**Goodwill:** Goodwill in the amount of $5.1 billion was recognized for this acquisition and is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. Specifically, the goodwill recorded as part of the acquisition of ACS includes:

the expected synergies and other benefits that we believe will result from combining the operations of ACS with the operations of Xerox;

any intangible assets that do not qualify for separate recognition such as the assembled workforce; and

the value of the going-concern element of ACS s existing businesses (the higher rate of return on the assembled collection of net assets versus acquiring all of the net assets separately).

Goodwill of $2.28 billion is deductible for tax purposes as a result of previous taxable acquisitions made by ACS. While the allocation of goodwill among reporting units is not complete, we expect the majority of the goodwill will be related to our Services segment.

The recorded amounts for assets and liabilities are provisional and subject to change. However, we do not expect that any future adjustments will be material. The following are the major items which are still subject to change:

amounts for income tax assets, receivables and liabilities pending the filing of ACS s pre-acquisition tax returns and the receipt of information from the taxing authorities which may change certain estimates and assumptions used; and

allocation of goodwill among reporting units.

Table of Contents

**Pro-forma impact of the acquisition:** The unaudited pro-forma results presented below include the effects of the ACS acquisition as if it had been consummated as of January 1, 2010 and 2009. The pro-forma results include the amortization associated with an estimate for the acquired intangible assets and interest expense associated with debt used to fund the acquisition, as well as fair value adjustments for unearned revenue, software and land, buildings and equipment. To better reflect the combined operating results, material non-recurring charges directly attributable to the transaction have been excluded. In addition, the pro-forma results do not include any anticipated synergies or other expected benefits of the acquisition. Accordingly, the unaudited pro forma financial information below is not necessarily indicative of either future results of operations or results that might have been achieved had the acquisition been consummated as of January 1, 2010 or January 1, 2009.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Revenue | $ 5,508 | $ 5,417 | $ 10,839 | $ 10,572 |
| Net income Xerox | 227 | 212 | 181 | 319 |
| Basic earnings per-share | 0.16 | 0.15 | 0.12 | 0.23 |
| Diluted earnings per-share | 0.16 | 0.15 | 0.12 | 0.22 |

The pro-forma information presented above is different than the pro-forma information provided in ITEM 2 Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q for the period ended June 30, 2010.

### ExcellerateHRO, LLP ( EHRO )

In July 2010, ACS completed its acquisition of EHRO, a global benefits administration and relocation services provider, for $125 net of cash acquired. This acquisition establishes ACS as one of the worlds largest pension plan administrators and as a leading provider of outsourced health and welfare and relocation services.

### Irish Business Systems Limited

On January 20, 2010, we acquired Irish Business Systems Limited ( IBS ) for approximately $29 net of cash acquired. This acquisition expands our reach into the small and mid-size business market in Ireland. IBS has eight offices located throughout Ireland and is a managed print services provider and the largest independent supplier of digital imaging and printing solutions in Ireland. The operating results of IBS are not material to our financial statements and are primarily included within our Technology segment from the date of acquisition. The purchase price was primarily allocated to intangible assets and goodwill based on management s estimates.

## Note 6 Sales of Accounts Receivables

We have facilities in the U.S., Canada and several countries in Europe that enable us to sell to third-parties, on an on-going basis, certain accounts receivable without recourse. The accounts receivables sold are generally short-term trade receivables with payment due dates of less than 60 days. The agreements involve the sale of entire groups of accounts receivable for cash. In certain instances a portion of the sales proceeds are held back and deferred until collection of the related receivables by the purchaser. The portion of the sales proceeds held back and deferred is initially recorded at estimated fair value and is subsequently accounted for as a short-term receivable. Such holdbacks are not considered legal securities nor are they certificated. We report collections on such receivables as operating cash flows in the Condensed Consolidated Statements of Cash Flows since such receivables are the result of an operating activity and the associated interest rate risk is de minimis due to its short-term nature. These receivables are included in the caption Other current assets in the accompanying Condensed Consolidated Balance Sheets and were $74 at June 30, 2010. Under most of the agreements, we also continue to service the sold accounts receivable. When applicable, a servicing liability is recorded for the estimated fair value of the servicing. The amounts associated with the servicing liability were not material at June 30, 2010. Accounts receivables sales were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Accounts receivable sales | $ 535 | $ 373 | $ 1,012 | $ 611 |
| Deferred proceeds | 73 | | 115 | |
| Fees associated with sales | 3 | 3 | 7 | 6 |

| | | | | |
|---|---|---|---|---|
| Estimated increase (decrease) on operating cash flows[1] | 86 | 111 | (68) | 135 |

(1) Represents the difference between current and prior period receivable sales adjusted for the effects of the deferred proceeds and currency.

**Table of Contents**

## Note 7 Inventories

The following is a summary of Inventories by major category:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Finished goods | $ 870 | $ 772 |
| Work-in-process | 57 | 43 |
| Raw materials | 99 | 85 |
| **Total Inventories** | $ 1,026 | $ 900 |

## Note 8 Investment in Affiliates, at Equity

Our equity in net income (loss) of our unconsolidated affiliates was as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Fuji Xerox | $ 23 | $ 5 | $ 18 | $ (7) |
| Other investments | 5 | 4 | 8 | 6 |
| **Total Equity in Net Income (Loss) of Unconsolidated Affiliates** | $ 28 | $ 9 | $ 26 | $ (1) |

### Fuji Xerox

Equity in net income (loss) of Fuji Xerox is affected by certain adjustments to reflect the deferral of profit associated with intercompany sales. These adjustments may result in recorded equity income that is different from that implied by our 25% ownership interest. Equity income (loss) for the six months ended June 30, 2010 and 2009 includes after-tax restructuring charges of $27 and $31, respectively, primarily reflecting Fuji Xerox s continued cost-reduction initiatives.

Condensed financial data of Fuji Xerox was as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| **Summary of Operations:** | | | | |
| Revenues | $ 2,609 | $ 2,252 | $ 5,466 | $ 4,922 |
| Costs and expenses | 2,416 | 2,205 | 5,239 | 4,968 |
| Income (loss) before income taxes | 193 | 47 | 227 | (46) |
| Income tax expense (benefit) | 78 | 26 | 107 | (26) |
| **Net Income (Loss)** | 115 | 21 | 120 | (20) |
| Less: Net income noncontrolling interests | 2 | | 2 | |
| **Net Income (Loss) - Fuji Xerox** | $ 113 | $ 21 | $ 118 | $ (20) |

| | | | | |
|---|---|---|---|---|
| Weighted Average Rate (1) | 92.08 | 97.45 | 91.34 | 95.46 |

(1) Represents Yen/U.S. Dollar exchange rate used to translate.

**Note 9 Restructuring Programs**

In 2010, we recorded $206 of net restructuring and asset impairment charges, which included $199 of severance costs related to headcount reductions of approximately 2,600 employees, lease termination and asset impairment charges of $19 and $12 of net reversals primarily due to changes in estimated reserves from prior year initiatives. Year-to-date actions applied almost equally to North America and Europe, with approximately 10% related to our developing market countries. Of these actions, approximately 45% were focused on gross margin improvements, 30% on selling, administrative and general expense reductions and 25% on the optimization of RD&E investments. We expect to incur additional restructuring costs of approximately $74 over the remainder of the year for actions and initiatives which have not yet been finalized.

Table of Contents

Information related to restructuring program activity during the six months ended June 30, 2010 is outlined below:

| | Severance and Related Costs | Lease Cancellation and Other Costs | Asset Impairments[1] | Total |
|---|---|---|---|---|
| Balance December 31, 2009 | $ 54 | $ 20 | $ | $ 74 |
| Restructuring provision | 199 | 15 | 4 | 218 |
| Reversals of prior accruals | (8) | (4) | | (12) |
| Net current period charges[2] | 191 | 11 | 4 | 206 |
| Charges against reserve and currency | (76) | (3) | (4) | (83) |
| **Balance June 30, 2010** | $ 169 | $ 28 | $ | $ 197 |

(1) Charges associated with asset impairments represent the write-down of the related assets to their new cost basis and are recorded concurrently with the recognition of the provision.
(2) Represents net amount recognized within the Condensed Consolidated Statements of Income for the period shown.

Reconciliation to the Condensed Consolidated Statements of Cash Flows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Charges against reserve | $ (60) | $ (69) | $ (83) | $ (166) |
| Asset impairment | | | 4 | |
| Effects of foreign currency and other non-cash items | 5 | (9) | (15) | 1 |
| **Cash Payments for Restructurings** | $ (55) | $ (78) | $ (94) | $ (165) |

The following table summarizes the total amount of costs incurred in connection with these restructuring programs by segment:

| | Three Months Ended June 30,[1] | | Six Months Ended June 30,[1] | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Technology | $ 7 | $ (2) | $ 136 | $ (4) |
| Services | 2 | | 45 | |
| Other | 2 | 1 | 25 | 1 |
| **Total Net Restructuring Charges** | $ 11 | $ (1) | $ 206 | $ (3) |

(1) Adjusted to conform to our 2010 segment change. Refer to Note 4, Segment Reporting, for additional information related to segments.

## Note 10 Interest Expense and Income

Interest expense and interest income were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Interest expense[(1)] | $ 153 | $ 131 | $ 306 | $ 261 |
| Interest income[(2)] | 168 | 184 | 346 | 369 |

(1) Includes Equipment financing interest, as well as non-financing interest expense that is included in Other expenses, net in the Condensed Consolidated Statements of Income.

(2) Includes Finance income, as well as other interest income that is included in Other expenses, net in the Condensed Consolidated Statements of Income.

Table of Contents

## Note 11 Financial Instruments

### Interest Rate Risk Management

We use interest rate swap agreements to manage our interest rate exposure and to achieve a desired proportion of variable and fixed rate debt. These derivatives may be designated as **fair value hedges** or **cash flow hedges** depending on the nature of the risk being hedged.

### Fair Value Hedges

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings. As of June 30, 2010 and December 31, 2009, pay variable/receive fixed interest rate swaps with notional amounts of $2,650 and $2,350 and net asset fair values of $57 and $1, respectively, were designated and accounted for as fair value hedges. The swaps were structured to hedge the fair value of related debt by converting them from fixed rate instruments to variable rate instruments. No ineffective portion was recorded to earnings during 2010 or 2009.

The following is a summary of our fair value hedges at June 30, 2010:

| Debt Instrument | Year First Designated | Notional Amount | Net Fair Value | Weighted Average Interest Rate Paid | Interest Rate Received | Basis | Maturity |
|---|---|---|---|---|---|---|---|
| Senior Notes due 2012 | 2009 | $ 1,100 | $ 10 | 4.19% | 5.50% | Libor | 2012 |
| Senior Notes due 2013 | 2009 | 400 | 11 | 3.81% | 5.65% | Libor | 2013 |
| Senior Notes due 2014 | 2009 | 750 | 24 | 5.87% | 8.25% | Libor | 2014 |
| Senior Notes due 2015 | 2010 | 300 | 11 | 1.67% | 4.25% | Libor | 2015 |
| Senior Notes due 2016 | 2009 | 100 | 1 | 4.00% | 6.40% | Libor | 2016 |
| **Total** | | $ 2,650 | $ 57 | | | | |

### *Terminated Swaps*

During the six months ended June 30, 2010, interest rate swaps that had been designated as fair value hedges of certain debt instruments were terminated. These terminated interest rate swaps had an aggregate notional value of $800. The fair value adjustment of $(21) to the debt instruments is being amortized to interest income over the remaining term of the related notes.

### Foreign Exchange Risk Management

We are a global company that is exposed to foreign currency exchange rate fluctuations in the normal course of our business. As a part of our foreign exchange risk management strategy, we use derivative instruments, primarily forward contracts, to hedge certain foreign currency exposures, thereby reducing volatility of earnings or protecting fair values of assets and liabilities.

### Foreign Currency-denominated Assets and Liabilities

We generally utilize forward foreign exchange contracts to hedge these exposures. Changes in the value of these currency derivatives are recorded in earnings together with the offsetting foreign exchange gains and losses on the underlying assets and liabilities.

### Forecasted Purchases and Sales in Foreign Currency

We generally utilize forward foreign exchange contracts and purchased option contracts to hedge these anticipated transactions. These contracts generally mature in 12 months or less. A portion of these contracts are designated as cash-flow hedges.

**Table of Contents**

## Summary of Foreign Exchange Hedging Positions

At June 30, 2010, we had outstanding forward exchange and purchased option contracts with gross notional values of $1.937 billion, which is reflective of the amounts that are normally outstanding at any point during the year.

The following is a summary of the primary hedging positions and corresponding fair values as of June 30, 2010:

| Currency Hedged (Buy/Sell) | Gross Notional Value | Fair Value Asset (Liability) (1) |
|---|---|---|
| Euro/U.S. Dollar | $ 356 | $ (14) |
| U.K. Pound Sterling/Euro | 316 | 19 |
| Japanese Yen/U.S. Dollar | 216 | 9 |
| Japanese Yen/Euro | 177 | 10 |
| Swiss Franc/Euro | 140 | 11 |
| Euro/U.K. Pound Sterling | 138 | (2) |
| U.S. Dollar/Euro | 130 | 3 |
| Swedish Krona/Euro | 82 | 1 |
| U.K. Pound Sterling/Swiss Franc | 70 | (1) |
| Danish Krone/Euro | 52 | |
| All Other | 260 | 4 |
| **Total Foreign Exchange Hedging** | $ 1,937 | $ 40 |

(1) Represents the net receivable (payable) amount included in the Condensed Consolidated Balance Sheet at June 30, 2010.

## Foreign Currency Cash Flow Hedges

We designate a portion of our foreign currency derivative contracts as cash flow hedges of our foreign currency-denominated inventory purchases, sales and expenses. The changes in fair value for these contracts were reported in Accumulated Other Comprehensive Loss and reclassified to Cost of sales and Revenues in the period or periods during which the related inventory was sold to a third party. No amount of ineffectiveness was recorded in the Condensed Consolidated Statements of Income for these designated cash flow hedges and all components of each derivative s gain or loss was included in the assessment of hedge effectiveness. The net asset fair value of these contracts was $15 and $1 as of June 30, 2010 and December 31, 2009, respectively.

**Table of Contents**

## Summary of Derivative Instruments Fair Value

The following table provides a summary of the fair value amounts of our derivative instruments:

| Designation of Derivatives | Balance Sheet Location | June 30, 2010 | December 31, 2009 |
|---|---|---|---|
| **Derivatives Designated as Hedging Instruments** | | | |
| Foreign exchange contracts forwards | Other current assets | $ 15 | $ 4 |
| Interest rate swaps | Other long-term assets | 57 | 10 |
| | Total Assets | $ 72 | $ 14 |
| Foreign exchange contracts forwards | Other current liabilities | $ | $ 3 |
| Interest rate swaps | Other long-term liabilities | | 9 |
| | Total Liabilities | $ | $ 12 |
| **Derivatives NOT Designated as Hedging Instruments** | | | |
| Foreign exchange contracts forwards | Other current assets | $ 43 | $ 12 |
| Foreign exchange contracts forwards | Other current liabilities | $ 18 | $ 12 |
| **Summary of Derivatives** | Total Derivative Assets | $ 115 | $ 26 |
| | Total Derivative Liabilities | 18 | 24 |
| | Total Net Derivative Asset | $ 97 | $ 2 |

Table of Contents

### Summary of Derivative Instruments Gains (Losses)

The following tables provide a summary of gains (losses) on derivative instruments:

| Derivatives in Fair Value Relationships | Location of Gain (Loss) Recognized In Income | Derivative Gain (Loss) Recognized in Income Three Months Ended June 30, 2010 | 2009 | Hedged Item Gain (Loss) Recognized in Income Three Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|---|
| Interest rate contracts | Interest expense | $ 55 | $ (8) | $ (55) | $ 8 |

| Derivatives in Fair Value Relationships | Location of Gain (Loss) Recognized In Income | Derivative Gain (Loss) Recognized in Income Six Months Ended June 30, 2010 | 2009 | Hedged Item Gain (Loss) Recognized in Income Six Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|---|
| Interest rate contracts | Interest expense | $ 77 | $ (22) | $ (77) | $ 22 |

**Table of Contents**

| Derivatives in Cash Flow Hedging Relationships | | Derivative Gain (Loss) Recognized in OCI (Effective Portion) Three Months Ended June 30, 2010 | 2009 | Location of Derivative Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Gain (Loss) Reclassified from AOCI to Income (Effective Portion) Three Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|---|---|
| Interest rate contracts | | $ | $ (3) | Interest expense | $ | $ |
| Foreign exchange contracts | forwards | 16 | (5) | Cost of sales | 7 | (2) |
| **Total Cash Flow Hedges** | | $ 16 | $ (8) | | $ 7 | $ (2) |

| Derivatives in Cash Flow Hedging Relationships | | Derivative Gain (Loss) Recognized in OCI (Effective Portion) Six Months Ended June 30, 2010 | 2009 | Location of Derivative Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Gain (Loss) Reclassified from AOCI to Income (Effective Portion) Six Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|---|---|
| Interest rate contracts | | $ | $ (2) | Interest expense | $ | $ |
| Foreign exchange contracts | forwards | 25 | (10) | Cost of sales | 11 | 3 |
| **Total Cash Flow Hedges** | | $ 25 | $ (12) | | $ 11 | $ 3 |

No amount of ineffectiveness was recorded in the Condensed Consolidated Statements of Income for these designated cash flow hedges and all components of each derivative s gain or loss was included in the assessment of hedge effectiveness.

**Summary of Non-Designated Derivative Instruments Gains (Losses)**

Non-designated derivative instruments are primarily instruments used to hedge foreign currency-denominated assets and liabilities. They are not designated as hedges since there is a natural offset for the re-measurement of the underlying foreign currency-denominated asset or liability.

The following table provides a summary of gains (losses) on **non-designated** derivative instruments:

| Derivatives NOT Designated as Hedging Instruments | | Location of Derivative Gain (Loss) | Three Months Ended June 30, 2010 | 2009 | Six Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|---|---|
| Foreign exchange contracts | forwards | Other expense - Currency gains (losses), net | $ 67 | $ 37 | $ 89 | $ 45 |

During the three months ended June 30, 2010 and 2009, we recorded Currency gains (losses), net of $2 and $(1), respectively. During the six months ended June 30, 2010 and 2009, we recorded Currency gains (losses), net of $(20) and $(21), respectively. Currency gains (losses), net includes the mark-to-market adjustments of the derivatives not designated as hedging instruments and the related cost of those derivatives, as well as the re-measurement of foreign currency-denominated assets and liabilities.

**Table of Contents**

## Note 12 Fair Value of Financial Assets and Liabilities

The following table represents assets and liabilities measured at fair value on a recurring basis and the basis for that measurement:

| | Total Fair Value Measurement June 30, 2010 | Quoted Prices in Active Markets for Identical Asset (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| **Assets:** | | | | |
| Foreign exchange contracts-forwards | $ 58 | $ | $ 58 | $ |
| Interest rate swaps | 57 | | 57 | |
| Deferred compensation investments in cash surrender life insurance | 64 | | 64 | |
| Deferred compensation investments in mutual funds | 27 | | 27 | |
| **Total** | $ 206 | $ | $ 206 | $ |
| **Liabilities:** | | | | |
| Foreign exchange contracts-forwards | $ 18 | $ | $ 18 | $ |
| Deferred compensation plan liabilities | 88 | | 88 | |
| **Total** | $ 106 | $ | $ 106 | $ |

| | Total Fair Value Measurement December 31, 2009 | Quoted Prices in Active Markets for Identical Asset (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| **Assets:** | | | | |
| Foreign exchange contracts-forwards | $ 16 | $ | $ 16 | $ |
| Interest rate swaps | 10 | | 10 | |
| **Total** | $ 26 | $ | $ 26 | $ |
| **Liabilities:** | | | | |
| Foreign exchange contracts-forwards | $ 15 | $ | $ 15 | $ |
| Interest rate swaps | 9 | | 9 | |
| **Total** | $ 24 | $ | $ 24 | $ |

We utilize the income approach to measure the fair value for our derivative assets and liabilities. The income approach uses pricing models that rely on market observable inputs such as yield curves, currency exchange rates and forward prices, and therefore are classified as Level 2.

Fair value for our deferred compensation plan investments in Company-owned life insurance is reflected at cash surrender value. Fair value for our deferred compensation plan investments in mutual funds is based on quoted market prices for actively traded investments similar to those held by the plan. Fair value for deferred compensation plan liabilities is based on the fair value of investments corresponding to employees investment selections, based on quoted prices for similar assets in actively traded markets.

**Table of Contents**

### Summary of Other Financial Assets and Liabilities Not Measured at Fair Value on a Recurring Basis

The estimated fair values of our other financial assets and liabilities not measured at fair value on a recurring basis were as follows:

| | June 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash and cash equivalents | $ 1,082 | $ 1,082 | $ 3,799 | $ 3,799 |
| Accounts receivable, net | 2,974 | 2,974 | 1,702 | 1,702 |
| Short-term debt | 358 | 361 | 988 | 1,004 |
| Long-term debt | 9,259 | 9,791 | 8,276 | 8,569 |
| Liability to subsidiary trust issuing preferred securities | 649 | 663 | 649 | 814 |

The fair value amounts for Cash and cash equivalents and Accounts receivable, net, approximate carrying amounts due to the short maturities of these instruments. The fair value of Short- and Long-term debt, as well as our Liability to subsidiary trust issuing preferred securities, was estimated based on quoted market prices for publicly traded securities or on the current rates offered to us for debt of similar maturities. The difference between the fair value and the carrying value represents the theoretical net premium or discount we would pay or receive to retire all debt at such date.

### Note 13 Employee Benefit Plans

The components of Net periodic benefit cost and other amounts recognized in Other comprehensive income were as follows:

| | Pension Benefits | | | | Retiree Health | | | |
|---|---|---|---|---|---|---|---|---|
| | Three Months Ended June 30 | | Six Months Ended June 30 | | Three Months Ended June 30 | | Six Months Ended June 30 | |
| | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 |
| **Components of Net Periodic Benefit Costs:** | | | | | | | | |
| Service cost | $ 42 | $ 41 | $ 88 | $ 85 | $ 2 | $ 2 | $ 4 | $ 4 |
| Interest cost | 118 | 122 | 238 | 243 | 14 | 16 | 28 | 31 |
| Expected return on plan assets | (116) | (126) | (236) | (250) | | | | |
| Recognized net actuarial loss | 19 | 7 | 35 | 12 | | | | |
| Amortization of prior service credit | (5) | (6) | (10) | (11) | (7) | (11) | (13) | (21) |
| Recognized settlement loss | 15 | 13 | 46 | 28 | | | | |
| **Net periodic benefit cost** | 73 | 51 | 161 | 107 | 9 | 7 | 19 | 14 |
| **Other changes in plan assets and benefit obligations recognized in Other comprehensive income:** | | | | | | | | |
| Amortization of net prior service credit | 5 | 6 | 10 | 11 | 7 | 11 | 13 | 21 |
| Amortization of net actuarial losses | (34) | (20) | (81) | (40) | | | | |
| **Total recognized in Other comprehensive income[(1)]** | (29) | (14) | (71) | (29) | 7 | 11 | 13 | 21 |
| **Total recognized in Net periodic benefit cost and Other comprehensive income** | $ 44 | $ 37 | $ 90 | $ 78 | $ 16 | $ 18 | $ 32 | $ 35 |

(1) Amount represents the pre-tax effect included within Other comprehensive income. The amount, net of tax, is included within Note 14, Shareholders Equity.

During the six months ended June 30, 2010, we made contributions of $63 and $46 to our pension plans and our other post-retirement benefit plans, respectively. We presently anticipate contributing an additional $194 to our pension plans and $52 to our other post-retirement benefit plans in 2010 for a total of $257 for pension plans and $98 for other post-retirement benefit plans.

Table of Contents

## Note 14 Shareholders Equity

| (in millions) | Common Stock | Additional Paid-in Capital | Retained Earnings | AOCL [1] | Xerox Shareholders Equity | Non-controlling Interests | Total Equity |
|---|---|---|---|---|---|---|---|
| **Balance at December 31, 2009** | $ 871 | $ 2,493 | $ 5,674 | $ (1,988) | $ 7,050 | $ 141 | $ 7,191 |
| Net income | | | 185 | | 185 | 17 | 202 |
| Translation adjustments | | | | (544) | (544) | (1) | (545) |
| Changes in defined benefit plans[2] | | | | 119 | 119 | | 119 |
| Other unrealized gains, net | | | | 10 | 10 | | 10 |
| **Comprehensive (Loss) Income** | | | | | $ (230) | $ 16 | $ (214) |
| ACS Acquisition[3] | 490 | 3,825 | | | 4,315 | | 4,315 |
| Cash dividends declared-common stock[4] | | | (121) | | (121) | | (121) |
| Cash dividends declared-preferred stock[5] | | | (9) | | (9) | | (9) |
| Stock option and incentive plans | 23 | 150 | | | 173 | | 173 |
| Tax benefit on stock option and incentive plans, net | | 7 | | | 7 | | 7 |
| Distributions to noncontrolling interests | | | | | | (7) | (7) |
| **Balance at June 30, 2010** | $ 1,384 | $ 6,475 | $ 5,729 | $ (2,403) | $ 11,185 | $ 150 | $ 11,335 |

| | Common Stock | Additional Paid-in Capital | Retained Earnings | AOCL [1] | Xerox Shareholders Equity | Non-controlling Interests | Total Equity |
|---|---|---|---|---|---|---|---|
| **Balance at December 31, 2008** | $ 866 | $ 2,447 | $ 5,341 | $ (2,416) | $ 6,238 | $ 120 | $ 6,358 |
| Net income | | | 182 | | 182 | 14 | 196 |
| Translation adjustments | | | | 452 | 452 | | 452 |
| Changes in defined benefit plans[2] | | | | (156) | (156) | | (156) |
| Other unrealized losses, net | | | | (9) | (9) | | (9) |
| **Comprehensive Income** | | | | | $ 469 | $ 14 | $ 483 |
| Cash dividends declared-common stock[4] | | | (75) | | (75) | | (75) |
| Stock option and incentive plans | 4 | 14 | | | 18 | | 18 |
| Tax loss on stock option and incentive plans, net | | (21) | | | (21) | | (21) |
| Distributions to noncontrolling interests | | | | | | (6) | (6) |
| **Balance at June 30, 2009** | $ 870 | $ 2,440 | $ 5,448 | $ (2,129) | $ 6,629 | $ 128 | $ 6,757 |

(1) Refer to the Accumulated Other Comprehensive Loss (AOCL) section for additional information.
(2) Refer to Note 13, Employee Benefit Plans for additional information.
(3) See Note 5 Acquisitions for further information.
(4) Cash dividends declared on common stock of $0.0425 per share in each quarter of 2010 and 2009.
(5) Cash dividends declared on preferred stock of $12.22 per share in the first quarter of 2010 and $20 per share in the second quarter of 2010.

Table of Contents

### Comprehensive Income

Comprehensive income for the three and six months ended June 30, 2010 and 2009 is as follows:

| | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 |
|---|---|---|---|---|
| Net income attributable to Xerox | $ 227 | $ 140 | $ 185 | $ 182 |
| Translation adjustments | (236) | 726 | (544) | 452 |
| Changes in defined benefit plans(1) | 20 | (121) | 119 | (156) |
| Other unrealized gains (losses), net | 6 | (4) | 10 | (9) |
| **Comprehensive Income (Loss) Xerox** | 17 | 741 | (230) | 469 |
| Net income attributable to noncontrolling interests | 9 | 7 | 17 | 14 |
| Translation adjustments noncontrolling interests | | | (1) | |
| **Comprehensive Income Noncontrolling Interests** | 9 | 7 | 16 | 14 |
| **Total Comprehensive Income (Loss)** | $ 26 | $ 748 | $ (214) | $ 483 |

(1) Includes currency gains of $11 and $53 for the three and six months ended June 30, 2010, respectively, and our share of Fuji Xerox changes in defined benefit plans of $(3) and $33 for the three and six months ended June 30, 2010, respectively. 2009 includes currency losses of $(117) and $(100) for the three and six months ended June 30, 2009, respectively, as well as our share of Fuji Xerox changes in defined benefit plans of $25 and $(31) for the three and six months ended June 30, 2009, respectively.

### Preferred Stock

In connection with the acquisition of ACS in February 2010 (see Note 5 Acquisitions for additional information), we issued 300,000 shares of Series A convertible perpetual preferred stock with an aggregate liquidation preference of $300 and a fair value of $349 as of the acquisition date to the holder of ACS Class B common stock. The convertible preferred stock pays quarterly cash dividends at a rate of 8 percent per year and has a liquidation preference of $1,000 per share. Each share of convertible preferred stock is convertible at any time, at the option of the holder, into 89.8876 shares of common stock for a total of 26,966 thousand shares (reflecting an initial conversion price of approximately $11.125 per share of common stock and is a 25% premium over $8.90, the average closing price of Xerox common stock over the 7-trading day period ended on September 14, 2009 and the number used for calculating the conversion price in the ACS merger agreement), subject to customary anti-dilution adjustments. On or after the fifth anniversary of the issue date, we have the right to cause, under certain circumstances, any or all of the convertible preferred stock to be converted into shares of common stock at the then applicable conversion rate. The convertible preferred stock is also convertible, at the option of the holder, upon a change in control, at the applicable conversion rate plus an additional number of shares determined by reference to the price paid for our common stock upon such change in control. In addition, upon the occurrence of certain fundamental change events, including a change in control or the delisting of Xerox s common stock, the holder of convertible preferred stock has the right to require us to redeem any or all of the convertible preferred stock in cash at a redemption price per share equal to the liquidation preference and any accrued and unpaid dividends to, but not including the redemption date. The convertible preferred stock is classified as temporary equity (i.e., apart from permanent equity) as a result of the contingent redemption feature.

### Accumulated Other Comprehensive Loss ( AOCL )

AOCL is composed of the following as of June 30, 2010 and December 31, 2009, respectively:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|

| | | | | |
|---|---|---|---|---|
| Cumulative translation adjustments | $ | (1,344) | $ | (800) |
| Benefit plans net actuarial losses and prior service credits [(1)] | | (1,071) | | (1,190) |
| Other unrealized gains, net | | 12 | | 2 |
| **Total Accumulated Other Comprehensive Loss** | $ | (2,403) | $ | (1,988) |

(1) Includes our share of Fuji Xerox.

Table of Contents

### Note 15 Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share of common stock (shares in thousands):

| | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 |
|---|---|---|---|---|
| **Basic Earnings per Share:** | | | | |
| Net income attributable to Xerox | $ 227 | $ 140 | $ 185 | $ 182 |
| Accrued dividends on preferred stock | (6) | | (9) | |
| Adjusted Net Income Available to Common Shareholders | $ 221 | $ 140 | $ 176 | $ 182 |
| Weighted-average common shares outstanding | 1,383,283 | 870,161 | 1,265,080 | 868,782 |
| **Basic Earnings per Share** | $ 0.16 | $ 0.16 | $ 0.14 | $ 0.21 |
| **Diluted Earnings per Share:** | | | | |
| Net income attributable to Xerox | $ 227 | $ 140 | $ 185 | $ 182 |
| Accrued dividends on preferred stock | (6) | | (9) | |
| Adjusted Net Income Available to Common Shareholders | $ 221 | $ 140 | $ 176 | $ 182 |
| Weighted-average common shares outstanding | 1,383,283 | 870,161 | 1,265,080 | 868,782 |
| Common shares issuable with respect to: | | | | |
| Stock options | 14,393 | 325 | 12,439 | 322 |
| Restricted stock and performance shares | 18,984 | 6,448 | 16,756 | 8,144 |
| Convertible securities | 1,992 | 1,992 | | |
| Adjusted Weighted Average Common Shares Outstanding | 1,418,652 | 878,926 | 1,294,275 | 877,248 |
| **Diluted Earnings per Share** | $ 0.16 | $ 0.16 | $ 0.14 | $ 0.21 |
| The following securities were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive (shares in thousands): | | | | |
| Stock options | 109,790 | 44,398 | 111,744 | 44,401 |
| Restricted stock and performance shares | 12,852 | 8,482 | 15,080 | 6,786 |
| Convertible preferred stock | 26,966 | | 26,966 | |
| Convertible securities | | | 1,992 | 1,992 |
| | 149,608 | 52,880 | 155,782 | 53,179 |
| **Dividends per common share** | $ 0.0425 | $ 0.0425 | $ 0.0850 | $ 0.0850 |

### Note 16 Contingencies

#### 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

Table of Contents

on rentals and gross revenue taxes. We are disputing these tax matters and intend to vigorously defend our position. Based on the opinion of legal counsel and current reserves for those matters deemed probable of loss, we do not believe that the ultimate resolution of these matters will materially impact our results of operations, financial position or cash flows. The labor matters principally relate to claims made by former employees and contract labor for the equivalent payment of all social security and other related labor benefits, as well as consequential tax claims, as if they were regular employees. The total amounts related to the unreserved portion of the tax and labor contingencies, inclusive of any related interest, amounted to approximately $1,164 and $1,225 as of June 30, 2010 and December 31, 2009, respectively, with the decrease primarily related to the favorable resolution of certain cases and currency, partially offset by interest and indexation. In connection with the above proceedings, customary local regulations may require us to make escrow cash deposits or post other security of up to half of the total amount in dispute. As of June 30, 2010 we had $245 of escrow cash deposits for matters we are disputing, and there are liens on certain Brazilian assets with a net book value of $18 and additional letters of credit of approximately $134. Generally, any escrowed amounts would be refundable and any liens would be removed to the extent the matters are resolved in our favor. We routinely assess all these matters as to probability of ultimately incurring a liability against our Brazilian operations and record our best estimate of the ultimate loss in situations where we assess the likelihood of an ultimate loss as probable.

### Legal Matters

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

### Litigation Against the Company

***In re Xerox Corporation Securities Litigation:*** A consolidated securities law action (consisting of 17 cases) is pending in the United States District Court for the District of Connecticut. Defendants are the Company, Barry Romeril, Paul Allaire and G. Richard Thoman. The consolidated action is a class action on behalf of all persons and entities who purchased Xerox Corporation common stock during the period October 22, 1998 through October 7, 1999 inclusive ( Class Period ) and who suffered a loss as a result of misrepresentations or omissions by Defendants as alleged by Plaintiffs (the Class ). The Class alleges that in violation of Section 10(b) and/or 20(a) of the Securities Exchange Act of 1934, as amended ( 1934 Act ), and SEC Rule 10b-5 thereunder, each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of the Company s common stock during the Class Period by disseminating materially false and misleading statements and/or concealing material facts relating to the defendants alleged failure to disclose the material negative impact that the April 1998 restructuring had on the Company s operations and revenues. The complaint further alleges that the alleged scheme: (i) deceived the investing public regarding the economic capabilities, sales proficiencies, growth, operations and the intrinsic value of the Company s common stock; (ii) allowed several corporate insiders, such as the named individual defendants, to sell shares of privately held common stock of the Company while in possession of materially adverse, non-public information; and (iii) caused the individual plaintiffs and the other members of the purported class to purchase common stock of the Company at inflated prices. The complaint seeks unspecified compensatory damages in favor of the plaintiffs and the other members of the purported class against all defendants, jointly and severally, for all damages sustained as a result of defendants alleged wrongdoing, including interest thereon, together with reasonable costs and expenses incurred in the action, including counsel fees and expert fees. In 2001, the Court denied the defendants motion for dismissal of the complaint. The plaintiffs motion for class certification was denied by the Court in 2006, without prejudice to refiling. In February 2007, the Court granted the motion of the International Brotherhood of Electrical Workers Welfare Fund of Local

Table of Contents

Union No. 164, Robert W. Roten, Robert Agius ( Agius ) and Georgia Stanley to appoint them as additional lead plaintiffs. In July 2007, the Court denied plaintiffs renewed motion for class certification, without prejudice to renewal after the Court holds a pre-filing conference to identify factual disputes the Court will be required to resolve in ruling on the motion. After that conference and Agius s withdrawal as lead plaintiff and proposed class representative, in February 2008 plaintiffs filed a second renewed motion for class certification. In April 2008, defendants filed their response and motion to disqualify Milberg LLP as a lead counsel. On September 30, 2008, the Court entered an order certifying the class and denying the appointment of Milberg LLP as class counsel. Subsequently, on April 9, 2009, the Court denied defendants motion to disqualify Milberg LLP. The parties have filed motions to exclude certain expert testimony. On November 6, 2008, the defendants filed a motion for summary judgment. Briefing with respect to each of these motions is complete. On April 22, 2009, the Court denied plaintiffs motions to exclude the testimony of two of defendants experts. The Court has not yet rendered decisions regarding the other pending motions. The individual defendants and we deny any wrongdoing and are vigorously defending the action. In the course of litigation, we periodically engage in discussions with plaintiffs counsel for possible resolution of this matter. Should developments cause a change in our determination as to an unfavorable outcome, or result in a final adverse judgment or a settlement for a significant amount, there could be a material adverse effect on our results of operations, cash flows and financial position in the period in which such change in determination, judgment or settlement occurs.

***Merger Agreement Between Xerox and Affiliated Computer Services, Inc.:*** In late September and early October 2009, nine purported class action complaints were filed by ACS shareholders challenging ACS s proposed merger with Xerox. Two actions were filed in the Delaware Court of Chancery which subsequently were consolidated into one action. Seven actions were filed in state courts in Texas, which subsequently were consolidated into one action in the Dallas County Court at Law No. 3. The operative complaints in the Delaware and Texas actions name as defendants ACS and/or the members of ACS s board of directors (the Individual Defendants ) and Xerox Corporation and/or Boulder Acquisition Corp., a wholly owned subsidiary of Xerox ( Boulder ) (ACS, the Individual Defendants, Xerox Corporation and Boulder, collectively, the Xerox Defendants ). On October 22, 2009, a class of ACS shareholders was certified in the Delaware action. Pursuant to a stipulation entered into by all parties in the Delaware and Texas actions on November 20, 2009, the Texas plaintiffs agreed to stay prosecution of the Texas action until agreed otherwise by the defendants and ordered by the Texas court, and all plaintiffs agreed that any further prosecution of the Delaware and Texas actions, or any claims that could have been brought in those actions, would proceed in the Delaware action.

On December 11, 2009, plaintiffs in the Delaware action filed an amended complaint alleging, among other things, that (i) the Individual Defendants breached their fiduciary duties to ACS and its shareholders by authorizing the sale of ACS to Xerox for what plaintiffs deem inadequate consideration and pursuant to inadequate process, and the Xerox Defendants aided and abetted these alleged breaches; (ii) the Individual Defendants breached their fiduciary duties to ACS and its shareholders by agreeing to the provisions of the merger agreement relating to the consideration to be paid to the holders of Class B shares which the Delaware plaintiffs allege violates the ACS certificate of incorporation and is, therefore, void, and the Xerox Defendants aided and abetted these alleged breaches; and (iii) the Individual Defendants breached their fiduciary duties by failing to disclose material facts in the October 23, 2009 Form S-4 filed with the SEC in connection with the merger. The amended complaint seeks, among other things, to enjoin the defendants from consummating the merger on the agreed-upon terms, and unspecified compensatory damages, together with the costs and disbursements of the action.

On December 16, 2009, the Delaware court ordered a stipulation between Xerox, ACS and certain Individual Defendants and the plaintiffs in the Delaware action providing, among other things, that in exchange for modifying certain provisions of the merger agreement and other consideration, the plaintiffs would not seek to enjoin any shareholder vote on the closing of the merger, nor take any action for the purpose of preventing or delaying the closing of the merger. On January 20, 2010, the Delaware court ordered a stipulation by all parties in the Delaware action providing, among other things, for a trial to take place May 10-14, 2010 on the claims for damages asserted in the action. On January 29, 2010, defendants moved to dismiss the amended complaint, and on February 8, 2010, plaintiffs moved for partial summary judgment. That motion was fully briefed and argued before the Delaware court on April 5, 2010, and the Delaware court reserved judgment on the motion. All defendants answered the amended complaint, mooting their previously filed motions to dismiss. On April 28, 2010, plaintiffs filed a motion seeking leave to amend and to supplement the amended complaint.

On May 19, 2010, Xerox, ACS, Boulder, and the other defendants and plaintiffs in the Delaware and Texas Actions entered into a Stipulation and Agreement of Compromise and Settlement ( Settlement ) resolving all claims by ACS shareholders arising out of Xerox s acquisition of ACS, including all claims in the Delaware and Texas Actions. The defendants in the Delaware and

Table of Contents

Texas Actions did not admit to any wrongdoing as part of the Settlement, which provides for an aggregate payment of $69 on behalf of all defendants, including a payment of approximately $36 by Xerox, net of expected insurance proceeds. The Settlement is subject to approval by the Delaware court and other conditions. The Delaware court scheduled a Settlement approval hearing for August 24, 2010. In light of the Settlement, the Texas court signed an order continuing to stay the Texas action until such time as the case is placed on the Texas court s dismissal docket.

### Other Contingencies

Certain contracts, primarily those involving public sector customers, require us to provide a surety bond or a letter of credit as a guarantee of performance. As of June 30, 2010, $679 of our outstanding surety bonds and $60 of our outstanding letters of credit secure our performance of contractual obligations with our customers. In addition, approximately $18 of our letters of credit secure our casualty insurance and vendor programs and other corporate obligations. In general, we would only be liable for the amount of these guarantees in the event of default in our performance of our obligations under each contract; the probability of which we believe is remote. We believe that our capacity in the surety markets as well as under various credit arrangements (including our Credit Facility) is sufficient to allow us to respond to future requests for proposals that require such credit support.

We have service arrangements where we service third party student loans in the Federal Family Education Loan program ( FFEL ) on behalf of various financial institutions. We service these loans for investors under outsourcing arrangements and do not acquire any servicing rights that are transferable by us to a third party. At June 30, 2010, we serviced a FFEL portfolio of approximately 4.1 million loans with an outstanding principal balance of approximately $55.9 billion. Some servicing agreements contain provisions that, under certain circumstances, require us to purchase the loans from the investor if the loan guaranty has been permanently terminated as a result of a loan default caused by our servicing error. If defaults caused by us are cured during an initial period, any obligation we may have to purchase these loans expires. Loans that we purchase may be subsequently cured, the guaranty reinstated and the loans repackaged for sale to third parties. We evaluate our exposure under our purchase obligations on defaulted loans and establish a reserve for potential losses, or default liability reserve, through a charge to the provision for loss on defaulted loans purchased. The reserve is evaluated periodically and adjusted based upon management s analysis of the historical performance of the defaulted loans. As of June 30, 2010, other current liabilities include reserves which we believe to be adequate.

In connection with the acquisition of ACS, the Company agreed to provide certain tax and prior employment agreement-related indemnities to former officers and directors of ACS. Management does not anticipate any potential claims under these indemnities would have a material adverse effect on the Company s financial statements taken as a whole and accordingly no value has been assigned for financial reporting purposes.

## ITEM 2 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 condensed 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 Xe Corporation refer to the stand-alone parent company and do not include its subsidiaries.

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 includes translating the most recent financial results of operations using foreign currency of the earliest period presented. Currencies for our developing market countries (Latin America, Brazil, the Middle East, India, Eurasia and Central-Eastern Europe) are reflected at actual exchange rates for all periods presented, since these countries generally have volatile currency and inflationary environments, and our operations in these countries have historically implemented pricing actions to

Table of Contents

recover the impact of inflation and devaluation. In addition, ACS s revenues are reflected at actual exchange rates for all periods presented as more than 90% of ACS s revenue is derived domestically and any currency impact is immaterial. We do not hedge the translation effect of revenues or expenses denominated in currencies where the local currency is the functional currency.

## Overview

Results for the three and six months ended June 30, 2010 included revenue growth, operational cost and expense improvements and strong cash performance. We completed the acquisition of Affiliated Computer Services, Inc. ( ACS ) on February 5, 2010, and their results subsequent to that date through June 30, 2010 are included in our results. Total revenue of $5.5 billion and $10.2 billion for the three and six months ended June 30, 2010, respectively, reflects a substantial increase of 48% and 40%, respectively, from the prior year, including a 1% unfavorable and 1% favorable impact from currency, respectively. In order to provide a clearer comparison of our results to the prior year, we are also providing a discussion and analysis on a pro-forma basis, where we include ACS s 2009 estimated results from February 6 through June 30 in our historical 2009 results. (The pro-forma information included within this MD&A is different than the pro-forma information provided in Note 5 Acquisitions, in the Condensed Consolidated Financial Statements. The pro-forma information included in Note 5 presents the combined results for 2010 and 2009 as if the acquisition was completed January 1st of each respective year. See the Non-GAAP Financial Measures section for a further explanation and discussion of this non-GAAP measure). On a pro-forma[3] basis, total revenue for the three and six months ended June 30, 2010 increased 2% and 3%, respectively, with currency having a 1% unfavorable impact on the three month period and no impact on the six month period.

Net income attributable to Xerox for the three and six months ended June 30, 2010 was $227 million and $185 million, respectively, and included $115 million and $380 million, respectively, of after-tax costs and expenses related to restructuring, intangibles amortization, acquisition-related costs and other discrete and usual items. Net income attributable to Xerox for the three and six months ended June 30, 2009 was $140 million and $182 million, respectively, and included $18 million and $49 million, respectively, of similar after-tax costs and expenses.

Cash flow from operations was $1.1 billion for the six months ended June 30, 2010. Cash used in investing activities of $1.7 billion primarily reflects the net cash consideration of $1.5 billion for the ACS acquisition. Cash used in financing activities was $2.0 billion primarily reflecting the repayment of ACS s debt of $1.7 billion as well as net payments on other debt. Total debt at June 30, 2010 decreased approximately $350 million from March 31, 2010.

**Table of Contents**

## Summary Results

### Revenues

| (in millions) | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | % Change | Pro-forma[3] % Change | % of Total Revenue 2010 | % of Total Revenue 2009 |
|---|---|---|---|---|---|---|
| **Revenue:** | | | | | | |
| Equipment sales | $ 930 | $ 828 | 12% | 12% | 17% | 22% |
| Supplies, paper and other | 861 | 774 | 11% | 7% | 16% | 21% |
| Sales | 1,791 | 1,602 | 12% | 9% | 33% | 43% |
| Service, outsourcing and rentals | 3,553 | 1,951 | 82% | (1)% | 64% | 52% |
| Finance income | 164 | 178 | (8)% | (8)% | 3% | 5% |
| **Total Revenues** | $ 5,508 | $ 3,731 | 48% | 2% | 100% | 100% |
| **Segments:** | | | | | | |
| Technology | $ 2,555 | $ 2,476 | 3% | 3% | 46% | 66% |
| Services | 2,529 | 850 | 198% | 1% | 46% | 23% |
| Other | 424 | 405 | 5% | 5% | 8% | 11% |
| **Total Revenues** | $ 5,508 | $ 3,731 | 48% | 2% | 100% | 100% |
| Memo: | | | | | | |
| Annuity Revenue [1] | $ 4,578 | $ 2,903 | 58% | % | 83% | 78% |
| Color [2] | $ 1,567 | $ 1,456 | 8% | 8% | | |

| (in millions) | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 | % Change | Pro-forma[3] % Change | % of Total Revenue 2010 | % of Total Revenue 2009 |
|---|---|---|---|---|---|---|
| **Revenue:** | | | | | | |
| Equipment sales | $ 1,752 | $ 1,598 | 10% | 10% | 17% | 22% |
| Supplies, paper and other | 1,717 | 1,498 | 15% | 10% | 17% | 20% |
| Sales | 3,469 | 3,096 | 12% | 10% | 34% | 42% |
| Service, outsourcing and rentals | 6,423 | 3,831 | 68% | 1% | 63% | 53% |
| Finance income | 337 | 358 | (6)% | (6)% | 3% | 5% |
| **Total Revenues** | $ 10,229 | $ 7,285 | 40% | 3% | 100% | 100% |
| **Segments:** | | | | | | |
| Technology | $ 5,038 | $ 4,811 | 5% | 5% | 49% | 66% |
| Services | 4,372 | 1,683 | 160% | 2% | 43% | 23% |
| Other | 819 | 791 | 4% | 4% | 8% | 11% |
| **Total Revenues** | $ 10,229 | $ 7,285 | 40% | 3% | 100% | 100% |
| Memo | | | | | | |
| Annuity Revenue [1] | $ 8,477 | $ 5,687 | 49% | 2% | 83% | 78% |

| | | | | |
|---|---|---|---|---|
| Color (2) | $ 3,082 | $ 2,821 | 9% | 9% |

Second quarter 2010 total revenues increased 48% compared to the second quarter 2009. Our consolidated 2010 results include the results of Affiliated Computer Services, Inc. ( ACS ). On a pro-forma[3] basis, second quarter 2010 total revenue grew 2%. Currency had a 1-percentage point negative impact on total revenues in the quarter. Total revenues included the following:

58% increase in annuity revenue[1] , or flat on a pro-forma[3] basis. This included a 1-percentage point negative impact from currency. The components of annuity revenue were as follows:

- Service, outsourcing and rentals revenue of $3,553 million increased 82% and decreased 1% on a pro-forma[3] basis, with a 1-percentage point negative impact from currency. Growth in Business Process

Table of Contents

Outsourcing revenue partially offset declines in technical service revenue driven by a continued but moderating decline in pages. Total digital pages declined 4% while color pages increased 9%.

- Supplies, paper and other sales of $861 million increased 11% or 7% on a pro-forma[3] basis, with a 1-percentage point negative impact from currency. This growth was driven by supplies purchases in developing markets and by our OEM partners.

12% increase in equipment sales revenue, including a 2-percentage point negative impact from currency. Growth in install activity was partially offset by the impact of product mix and price declines of 5% to 10%.

8% increase in color revenue[2], including a 1-percentage point negative impact from currency, reflects:

- 5% increase in color annuity revenue, including a 1-percentage point negative impact from currency. The increase was driven by higher color page volumes.
- 15% increase in color equipment sales revenue, including a 3-percentage point negative impact from currency. The increase was driven by higher installs from new products.

Total revenues for the six months ended June 30, 2010 increased 40% compared to the prior year period. Our consolidated 2010 results include the results of ACS subsequent to February 5, 2010, the effective date of the acquisition. On a pro-forma[3] basis, total revenue for the six months ended June 30, 2010 grew 3%. Currency had a negligible impact on total revenues. Total revenues included the following:

49% increase in annuity revenue[1] , or 2% on a pro-forma[3] basis. This included a 1-percentage point positive impact from currency. The components of annuity revenue were as follows:

- Service, outsourcing and rentals revenue of $6,423 million increased 68% or 1% on a pro-forma[3] basis, with a 1-percentage point positive impact from currency. This increase was driven by Business Process Outsourcing revenue that offset declines in technical service revenue driven by a continued but moderating decline in pages. Total digital pages declined 4% while color pages increased 9%.
- Supplies, paper and other sales of $1,717 million increased 15% or 10% on a pro-forma[3] basis, with no impact from currency. This growth was driven by channel supplies purchases.

10% increase in equipment sales revenue, including a 1-percentage point positive impact from currency. Growth in install activity was partially offset by the impact of product mix and price declines of 5% to 10%.

9% increase in color revenue[2], including a 1-percentage point positive impact from currency reflects:

- 8% increase in color annuity revenue, including a 1-percentage point positive impact from currency. The increase was driven by higher printer supplies purchases and higher page volumes.
- 12% increase in color equipment sales revenue, including a 1-percentage point positive impact from currency. The increase was driven by higher installs from new products.

## Net Income

Second quarter 2010 net income attributable to Xerox was $227 million, or $0.16 per diluted share. On an adjusted basis, net income attributable to Xerox was $342 million, or $0.24 per diluted share.

Second quarter 2009 net income attributable to Xerox was $140 million, or $0.16 per diluted share. On a comparable adjusted basis, net income attributable to Xerox was $158 million, or $0.18 per diluted share.

Net income attributable to Xerox for the six months ended June 30, 2010 was $185 million, or $0.14 per diluted share. On an adjusted basis, net income attributable to Xerox was $565 million, or $0.43 per diluted share.

Net income attributable to Xerox for the six months ended June 30, 2009 was $182 million, or $0.21 per diluted share. On a comparable adjusted basis, net income attributable to Xerox was $231 million, or $0.26 per diluted share.

Table of Contents

The adjustments to net income include:

| (in millions; except per share amounts) | Three Months Ended June 30, 2010 Net Income | EPS | 2009 Net Income | EPS | Six Months Ended June 30, 2010 Net Income | EPS | 2009 Net Income | EPS |
|---|---|---|---|---|---|---|---|---|
| **Reported** | $ 227 | $ 0.16 | $ 140 | $ 0.16 | $ 185 | $ 0.14 | $ 182 | $ 0.21 |
| **Adjustments:** | | | | | | | | |
| Xerox and Fuji Xerox restructuring charges | 12 | 0.01 | 9 | 0.01 | 169 | 0.13 | 31 | 0.03 |
| Acquisition-related costs | 14 | 0.01 | | | 50 | 0.04 | | |
| Amortization of intangible assets | 53 | 0.04 | 9 | 0.01 | 88 | 0.07 | 18 | 0.02 |
| ACS shareholder litigation settlement | 36 | 0.02 | | | 36 | 0.02 | | |
| Venezuela devaluation | | | | | 21 | 0.02 | | |
| Medicare subsidy tax law change | | | | | 16 | 0.01 | | |
| **Adjusted** | $ 342 | $ 0.24 | $ 158 | $ 0.18 | $ 565 | $ 0.43 | $ 231 | $ 0.26 |

(1) Annuity revenue is largely a function of the equipment placed at customer locations, the volume of prints and copies that our customers make on that equipment, the mix of color pages, as well as revenue associated from outsourcing services. Annuity revenue = Service, outsourcing and rentals + Supplies, paper and other sales + Finance income.

(2) Color revenues represent a subset of total revenues and exclude Global Imaging Systems ( GIS ) revenues.

(3) Growth on a pro-forma basis reflects the inclusion of ACS s adjusted results from February 6 through June 30 in 2009. See the Non-GAAP Financial Measures section for an explanation of these non-GAAP financial measures.

## Operations Review

| (in millions) | Three Months Ended June 30, Total Revenue | Segment Profit (Loss) | Segment Margin | Six Months Ended June 30, Total Revenue | Segment Profit (Loss) | Segment Margin |
|---|---|---|---|---|---|---|
| **2010** | | | | | | |
| Technology | $ 2,555 | $ 273 | 10.7% | $ 5,038 | $ 506 | 10.0% |
| Services | 2,529 | 319 | 12.6% | 4,372 | 522 | 11.9% |
| Other | 424 | (93) | (21.9)% | 819 | (197) | (24.1)% |
| **Total** | $ 5,508 | $ 499 | 9.1% | $ 10,229 | $ 831 | 8.1% |
| **2009** | | | | | | |
| Technology | $ 2,476 | $ 248 | 10.0% | $ 4,811 | $ 414 | 8.6% |
| Services | 850 | 61 | 7.2% | 1,683 | 92 | 5.5% |
| Other | 405 | (80) | (19.8)% | 791 | (175) | (22.1)% |
| **Total** | $ 3,731 | $ 229 | 6.1% | $ 7,285 | $ 331 | 4.5% |
| **2009 Pro-forma[1]** | | | | | | |
| Technology | $ 2,476 | $ 248 | 10.0% | $ 4,811 | $ 414 | 8.6% |
| Services | 2,510 | 282 | 11.2% | 4,299 | 455 | 10.6% |
| Other | 405 | (111) | (27.4)% | 791 | (222) | (28.1)% |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Total** | $ 5,391 | $ 419 | 7.8% | $ 9,901 | $ 647 | 6.5% |

(1) Results are discussed primarily on a pro-forma basis and include ACS s estimated results from February 6 through June 30 in 2009 since actual comparisons against the prior year are not meaningful. See the Non-GAAP Financial Measures section for an explanation of this non-GAAP financial measure.

Table of Contents

### 2010 Segment Reporting Change

In 2010, as a result of our acquisition of ACS, we realigned our internal financial reporting structure and began reporting our financial performance based on two primary segments Technology and Services. The Technology segment represents the combination of our former Production and Office segments excluding the document outsourcing business. The Services segment represents the combination of our document outsourcing business, which includes Xerox s historic business process services, and ACS s business process outsourcing and information technology outsourcing businesses. We believe this realignment will help us to better manage our business and view the markets we serve, which are primarily centered around equipment systems and outsourcing services. Our Technology segment operations involve the sale and support of a broad range of document systems from entry level to the high-end. Our Services segment operations involve delivery of a broad range of outsourcing services including document, business processing and IT outsourcing services. Our 2009 segment disclosures have been restated to reflect our new 2010 internal reporting structure. Refer to Note 4, Segment Reporting, in the Condensed Consolidated Financial Statements for descriptions of these segments.

### Technology

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

Table of Contents

**Revenue**

| (in millions) | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Change | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 | Change |
|---|---|---|---|---|---|---|
| Equipment sales | $ 816 | $ 738 | 11% | $ 1,546 | $ 1,413 | 9% |
| Post sale revenue(2) | 1,739 | 1,738 | % | 3,492 | 3,398 | 3% |
| **Total Revenue** | $ 2,555 | $ 2,476 | 3% | $ 5,038 | $ 4,811 | 5% |

Second quarter 2010 Technology revenue of $2,555 million increased 3%, including a 1-percentage point negative impact from currency. Total revenues included the following:

11% increase in equipment sales revenue with a 1-percentage point negative impact from currency driven by growth across most regions, with particularly strong growth in developing markets.

Post sale revenue was flat with a 1-percentage point negative impact from currency driven primarily by growth in supplies in developing markets and sales to our OEM partners.

Technology revenue mix for the second quarter was 22% entry, 57% mid-range and 21% high-end.

Technology revenue for the six months ended June 30, 2010 of $5,038 million increased 5%, including a 1-percentage point positive impact from currency. Total revenues included the following:

9% increase in equipment sales revenue with no impact from currency, driven by install growth in entry and mid-range, primarily in our indirect channels and developing markets.

3% increase in post sale revenue with a 1-percentage point positive impact from currency, driven primarily by growth in supplies in developing markets and sales to our OEM partners.

Technology revenue mix for the six months ended was 23% entry, 56% mid-range and 21% high-end.

**Segment Profit**

Second quarter 2010 Technology profit of $273 million increased $25 million from second quarter 2009, predominantly reflecting gross profit flow-through from higher revenue.

Technology profit for the six months ended June 30, 2010 of $506 million increased $92 million from prior year period, predominantly reflecting gross profit flow-through from higher revenue.

**Table of Contents**

## Installs

### Entry

Installs for the second quarter 2010:

- 78% increase in installs of A4 black-and-white multifunction devices driven by growth in developing markets.
- 44% increase in installs of A4 color multifunction devices driven by strong growth across all regions.
- 16% increase in installs of color printers due to higher sales to OEM partners.

Installs for the six months ended June 30, 2010:

- 52% increase in installs of A4 black-and-white multifunction devices driven by growth in developing markets.
- 44% increase in installs of A4 color multifunction devices driven by demand for new products.
- Installs of color printers were flat.

### Mid-Range

Installs for the second quarter 2010:

- 4% decrease in installs of mid-range black-and-white devices driven by lower demand in large enterprises and direct channels.
- 26% increase in installs of mid-range color devices driven primarily by demand for new products, such as the ColorQube™, WorkCenter® 7120 / 7700 and the continued strong demand for the Xerox 700.

Installs for the six months ended June 30, 2010:

- Installs of mid-range black-and-white devices were flat.
- 22% increase in installs of mid-range color devices driven primarily by demand for new products, such as the ColorQube™, WorkCenter® 7120 / 7700 and the continued strong demand for the Xerox 700.

### High-End

Installs for the second quarter 2010:

- 7% decrease in installs of high-end black-and-white systems, reflecting declines across most product segments.
- 24% increase in installs of high-end color systems reflecting strong demand for the recently launched Xerox Color 800 and 1000.

Installs for the six months ended June 30, 2010:

- 11% decrease in installs of high-end black-and-white systems, reflecting declines across most product segments.
- 20% increase in installs of high-end color systems reflecting increased installs for the 7002 digital press and the recently launched Xerox Color 800 and 1000.

Install activity percentages include installations for Document Outsourcing and the Xerox-branded product shipments to GIS. Descriptions of Entry , Mid-Range and High-End can be found in Note 4, Segment Reporting, in the Condensed Consolidated Financial Statements.

## Services

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

**Note:** Services total revenue and segment profit for the three and six months ended June 30, 2010 increased 198% and 423%, respectively, and 160% and 467%, respectively, on an actual basis primarily due to the inclusion of ACS in 2010. Since these comparisons are not meaningful, results for the Services segment are primarily discussed below on a pro-forma[1] basis, with ACS s 2009 estimated results from February 6 through June 30 included in our historical 2009 results (See Non-GAAP Financial Measures section for a further explanation and discussion of this non-GAAP measure).

Table of Contents

### Revenue

Second quarter 2010 Services total revenue of $2,529 million increased 198% or 1% on a pro-forma[1] basis. Currency did not impact total revenues in the quarter.

- BPO delivered pro-forma[1] revenue growth of 3% and represented 53% of total Services revenue.
- Document outsourcing decreased 2%, including a 1-percentage point negative currency impact and represented 33% of total Services revenue.
- Information technology outsourcing decreased 1% on a pro-forma[1] basis and represented 14% of total Services revenue.

Services total revenue for the six months ended June 30, 2010 of $4,372 million increased 160% or 2% on a pro-forma[1] basis. Currency had a 1-percentage point positive impact on total revenues in the quarter.

- BPO had strong pro-forma[1] revenue growth of 5% and represented 49% of total Services revenue.
- Document outsourcing decreased 1%, including a 1-percentage point positive currency impact, and represented 38% of total Services revenue.
- Information technology outsourcing on a pro-forma[1] basis declined 1% and represented 13% of total Services revenue.
- On a normalized basis, which would include a full six months of ACS results, we expect that BPO, DO and ITO would represent approximately 50%, 35% and 15% of Services revenue, respectively.

### Segment Profit

Second quarter 2010 Services profit of $319 million increased $258 million, or $37 million on a pro-forma[1] basis, from second quarter 2009 driven by BPO revenue growth and lower costs and expenses, driven by restructuring and synergy savings.

Services profit for the six months ended June 30, 2010 of $522 million increased $430, or $67 million on a pro-forma[1] basis, from the prior year period driven by BPO revenue growth and lower cost and expense driven by restructuring and synergy savings.

### Metrics

### Pipeline

Our BPO and ITO sales pipeline, including synergy opportunities, grew approximately 29% over the second quarter 2009. The DO sales pipeline grew approximately 7% over second quarter 2009.

The BPO and ITO 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. The DO sales pipeline includes all active deals with $10 million or greater in TCV.

### Signings

Signings ( Signings ) are defined as estimated future revenues from contracts signed during the period, including renewals. Services signings were strong in TCV. Combined with the previous three quarters; the trailing twelve month growth was 12% as compared to the comparable prior year period.

Signings were as follows:

| (in billions) | Three Months Ended June 30, 2010 | Six Months Ended June 30, 2010 |
|---|---|---|
| BPO | $ 2.8 | $ 5.7 |
| DO | 0.9 | 1.5 |
| ITO | 0.5 | 0.8 |
| **Total Signings** | $ 4.2 | $ 8.0 |

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

- Child support payment processing

**Table of Contents**

- Commercial healthcare
- Electronic payment cards
- Enterprise Print Services in both the U.S. and Europe
- Telecom and hardware services
- Transportation.

TCV represents estimated total revenue for future contracts for pipeline or signed contracts for Signings as applicable.

### Other

### Revenue

Second quarter 2010 Other revenue of $424 million increased 5%, including a 1-percentage point negative impact from currency. This was driven by an increase in GIS s network integration and electronic presentation systems and higher paper and supplies sales.

Other revenue for the six months ended June 30, 2010 of $819 million increased 4%, including a 1-percentage point positive impact from currency. This was driven by an increase in GIS s network integration and electronic presentation systems and higher paper and supplies sales.

Paper comprised approximately 60% of the 2010 and 2009 Other segment revenue.

### Segment Profit

Second quarter 2010 Other loss of $93 million increased $13 million from second quarter 2009, driven primarily by higher interest expense that offset the gross profit flow-through from higher revenue.

Other loss for the six months ended June 30, 2010 of $197 million increased $22 million from the prior year period, driven primarily by higher interest expense that offset the increase in gross profit flow through from higher revenue.

### Costs, Expenses and Other Income

### Gross Margin

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | Pro-forma[(1)] Change | 2010 | 2009 | Change | Pro-forma[(1)] Change |
| Sales | 34.6% | 33.5% | 1.1 pts | 1.4 pts | 35.0% | 33.2% | 1.8 pts | 2.0 pts |
| Service, outsourcing and rentals | 33.6% | 43.6% | (10.0) pts | pts | 34.1% | 42.6% | (8.5) pts | (0.2) pts |
| Financing income | 62.8% | 61.8% | 1.0 pts | 1.0 pts | 62.9% | 61.7% | 1.2 pts | 1.2 pts |
| **Total Gross Margin** | 34.8% | 40.2% | (5.4) pts | 0.4 pts | 35.4% | 39.5% | (4.1) pts | 0.5 pts |

**Note:** Total gross margin decreased 5.4-percentage points and 4.1-percentage points and service, outsourcing and rentals margins decreased 10.0-percentage points and 8.5-percentage points for the three and six months ended June 30, 2010, respectively, on an actual basis primarily due to the ACS acquisition. ACS, as a typical services based company, had a lower gross margin as compared to a technology based company, which typified Xerox before the acquisition. Since actual comparisons are not meaningful, gross margins are primarily discussed below on a pro-forma basis, with ACS s 2009 estimated results from February 6 through June 30 included in our historical 2009 results (See Non-GAAP Financial Measures section for a further explanation and discussion of this non-GAAP measure).

Total gross margin for second quarter 2010 of 34.8% decreased 5.4-percentage points and increased 0.4-percentage points on a pro-forma[1] basis as compared to the second quarter 2009 and included a 0.3-percentage point benefit from a duties refund as a result of a favorable settlement of a European import classification claim.

Table of Contents

Total gross margin for the six months ended June 30, 2010 of 35.4% decreased 4.1-percentage points, and increased 0.5-percentage points on a pro-forma[1] basis as compared to the prior year comparable period and included a 0.1-percentage point benefit from the European duties refund.

Sales gross margin increased 1.1-percentage points and 1.4-percentage points as compared to the second quarter 2009 on a pro-forma[1] basis and included the benefit from the duties refund. The positive impact of cost improvements and favorable mix more than offset the impact of price declines and unfavorable year-over-year transaction currency.

Sales gross margin for the six months ended June 30, 2010 increased 1.8-percentage points and 2.0-percentage points on a pro-forma[1] basis as compared to the prior year period. Sales gross margin benefited from cost improvements, favorable product mix and transaction currency as well as the duties refund, which more than offset the impact of price declines.

Service, outsourcing and rentals margin decreased 10-percentage points and was flat on a pro-forma[1] basis as compared to the second quarter 2009 as positive mix offset the impact of unfavorable year-over-year transaction currency.

Service, outsourcing and rentals margin for the six months ended June 30, 2010 decreased 8.5-percentage points and 0.2-percentage points on a pro-forma[1] basis as compared to the prior year period as price declines and mix were only partially offset by cost improvements.

Table of Contents

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

| (in millions) | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Change | Pro-forma[(1)] Change | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 | Change | Pro-forma[(1)] Change |
|---|---|---|---|---|---|---|---|---|
| R&D | $ 160 | $ 172 | $ (12) | $ (12) | $ 333 | $ 347 | $ (14) | $ (14) |
| Sustaining engineering | 34 | 30 | 4 | 4 | 66 | 59 | 7 | 7 |
| **Total RD&E Expenses** | $ 194 | $ 202 | $ (8) | $ (8) | $ 399 | $ 406 | $ (7) | $ (7) |
| **RD&E % Revenue** | 3.5% | 5.4% | (1.9) pts | (0.2) pts | 3.9% | 5.6% | (1.7) pts | (0.2) pts |

RD&E of $194 million and $399 million for the three and six months ended June 30, 2010 was $8 million and $7 million lower than the prior year comparable periods reflecting the benefits from restructuring and productivity improvements. We invest in technological research and development, particularly in color, software and services. We believe that our R&D spending is sufficient to remain technologically competitive. Xerox R&D is strategically coordinated with Fuji Xerox.

### Selling, Administrative and General Expenses (SAG)

| (in millions) | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Change | Pro-forma[(1)] Change | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 | Change | Pro-forma[(1)] Change |
|---|---|---|---|---|---|---|---|---|
| Total SAG | $ 1,163 | $ 1,013 | $ 150 | $ 9 | $ 2,262 | $ 2,017 | $ 245 | $ 28 |
| SAG % Revenue | 21.1% | 27.2% | (6.1) pts | (0.3) pts | 22.1% | 27.7% | (5.6) pts | (0.5) pts |

**Note:** SAG as a percent of revenue for the second quarter 2010 and six months ended June 30, 2010 decreased 6.1-percentage points and 5.6-percentage points, respectively, on an actual basis primarily due to the ACS acquisition. ACS, as a typical services based company, had lower SAG as a percent of revenue as compared to a technology based company, which typified Xerox before the acquisition. Since actual comparisons are not meaningful, SAG is primarily discussed below on a pro-forma basis, with ACS s 2009 estimated results from February 6 through June 30 included in our historical 2009 results (See Non-GAAP Financial Measures section for a further explanation and discussion of this non-GAAP measure).

SAG expenses of $1,163 million in the second quarter 2010 were $150 million higher than the second quarter 2009 and $9 million higher on a pro-forma[1] basis, including a $5 million favorable impact from currency. The pro-forma SAG expense increase reflects the following:

- $58 million increase in selling expenses reflecting, increased demand generation advertising and higher commissions partially offset by the benefits from restructuring and productivity improvements.
- $14 million decrease in general and administrative expenses, reflecting the benefits from restructuring and operational improvements.
- $35 million decrease in bad debt expenses to $46 million, reflecting an improving write-off trend. 2010 second quarter bad debt expense continues to remain less than one percent of receivables.

SAG expenses of $2,262 million for the six months ended June 30, 2010 were $245 million higher than the prior year period and $28 million higher on a pro-forma[1] basis, both including a $26 million unfavorable impact from currency. The pro-forma SAG expense increase reflects the following:

- $69 million increase in selling expenses reflecting increased demand generation advertising that offset the benefits from restructuring and productivity improvements.
- $8 million increase in general and administrative expenses, reflecting unfavorable currency that offset the benefits from restructuring and operational improvements.
- $49 million decrease in bad debt expenses to $102 million, reflecting an improving write-off trend.

### Restructuring and Asset Impairment Charges

During the second quarter 2010, we recorded an additional $11 million of net restructuring and asset impairment charges, which included approximately $16 million of severance costs related to headcount reductions of approximately 300 employees primarily in North America. These costs were partially offset by $6 million of net reversals for changes in estimated reserves from prior period initiatives.

Table of Contents

We recorded $206 million of net restructuring and asset impairment charges for the six months ended June 30, 2010, which included $199 million of severance costs related to headcount reductions of approximately 2,600 employees, lease termination and asset impairment charges of $19 million and $12 million of net reversals primarily due to changes in estimated reserves from prior year initiatives. Year-to-date actions applied almost equally to North America and Europe, with approximately 10% related to our developing market countries. Of these actions, approximately 45% were focused on gross margin improvements 30% on SAG reductions and 25% on the optimization of RD&E investments and include the following areas:

- Supply chain and manufacturing infrastructure
- Back office functions
- Technical service and managed service costs
- Development and engineering costs

We expect to incur additional restructuring costs of approximately $74 million over the remainder of the year for actions and initiatives which have not yet been finalized. We expect to realize savings in 2010 of approximately $140 million for our restructuring actions.

The restructuring reserve balance as of June 30, 2010 for all programs was $197 million, of which approximately $179 million is expected to be spent over the next twelve months. Refer to Note 9, Restructuring Programs, in the Condensed Consolidated Financial Statements for additional information regarding our restructuring programs.

### Acquisition-related Costs

Costs of $15 million and $63 million were incurred in the three and six months ended June 30, 2010, respectively, in connection with our acquisition of ACS. These costs include $11 million and $53 million, respectively, of transaction costs which represent external costs directly related to completing the acquisition of ACS and primarily include expenditures for investment banking, legal, accounting and other similar services. Legal costs include costs associated with the recently settled ACS shareholders litigation and were the primary component of the costs incurred during the second quarter 2010. The remainder of the acquisition-related costs represents external incremental costs directly related to the integration of ACS and Xerox. These costs include expenditures for consulting, systems integration and corporate communication services.

### Amortization of Intangible Assets

During the three and six months ended June 30, 2010, we recorded $85 million and $142 million, respectively, of expense related to the amortization of intangible assets, which is $70 million and $113 million higher than the prior year periods, respectively. These increases primarily reflect the amortization of intangibles associated with our acquisition of ACS. As a result of the ACS acquisition, amortization of acquired intangibles for 2010 is expected to be approximately $250 million higher than the prior year. Refer to Note 5, Acquisitions, in the Condensed Consolidated Financial Statements for additional information regarding the ACS acquisition.

### Worldwide Employment

Worldwide employment of 130,800 at June 30, 2010 increased approximately 77,200 from December 31, 2009, primarily due to additional headcount acquired as a result of the ACS acquisition.

Table of Contents

### Other Expenses, Net

| (in millions) | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 |
|---|---|---|---|---|
| Non-financing interest expense | $ 92 | $ 63 | $ 181 | $ 124 |
| Interest income | (4) | (6) | (9) | (11) |
| Loss (gains) on sales of businesses and assets | 1 | (7) | (1) | (9) |
| Currency (gains) losses, net | (2) | 1 | 20 | 21 |
| ACS shareholders litigation settlement | 36 | | 36 | |
| Litigation matters | 1 | 5 | 1 | 7 |
| All Other expenses, net | 4 | 16 | 10 | 23 |
| **Total Other Expenses, Net** | $ 128 | $ 72 | $ 238 | $ 155 |

**Non-Financing Interest Expense:** Non-financing interest expense for the three and six months ended June 30, 2010 of $92 million and $181 million, respectively, was $29 million and $57 million, respectively, higher than prior year periods due to higher debt balances primarily as a result of our $2 billion Senior Note offering used to finance the acquisition of ACS.

**Currency Losses, Net:** In January 2010, Venezuela announced a devaluation of the Bolivar to an official rate of 4.30 Bolivars to the dollar for our products. As a result of this devaluation, we recorded a currency loss of $21 million in the first quarter of 2010 for the re-measurement of our net Bolivar denominated monetary assets. First quarter 2009 currency losses were primarily due to the significant movement in exchange rates among the U.S. Dollar, Euro and Yen during the first quarter of 2009, as well as the increased cost of hedging, particularly in developing markets.

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

**All Other Expenses, Net:** All other expenses, net for the three and six months ended June 30, 2010 decreased $12 million and $13 million, respectively, driven in part by lower interest expense on the Brazil tax and labor contingencies.

Table of Contents

### Income Taxes

| (in millions) | Three Months Ended June 30, 2010 Pre-Tax Income | Three Months Ended June 30, 2010 Income Tax Expense | Three Months Ended June 30, 2010 Effective Tax Rate | Three Months Ended June 30, 2009 Pre-Tax Income | Three Months Ended June 30, 2009 Income Tax Expense | Three Months Ended June 30, 2009 Effective Tax Rate |
|---|---|---|---|---|---|---|
| **Reported** | $ 320 | $ 112 | 35.0% | $ 197 | $ 59 | 29.9% |
| **Adjustments:** | | | | | | |
| Xerox restructuring charge | 11 | 4 | | | | |
| Acquisition-related costs | 15 | 1 | | | | |
| Amortization of intangible assets | 85 | 32 | | 15 | 6 | |
| ACS shareholders litigation settlement | 36 | | | | | |
| **Adjusted** | $ 467 | $ 149 | 31.9% | $ 212 | $ 65 | 30.7% |

Table of Contents

| (in millions) | Six Months Ended June 30, 2010 Pre-Tax Income | Six Months Ended June 30, 2010 Income Tax Expense | Effective Tax Rate | Six Months Ended June 30, 2009 Pre-Tax Income | Six Months Ended June 30, 2009 Income Tax Expense | Effective Tax Rate |
|---|---|---|---|---|---|---|
| **Reported** | $ 310 | $ 134 | 43.2% | $ 275 | $ 78 | 28.4% |
| **Adjustments:** | | | | | | |
| Xerox restructuring charge | 206 | 64 | | | | |
| Acquisition-related costs | 63 | 13 | | | | |
| Amortization of intangible assets | 142 | 54 | | 29 | 11 | |
| Venezuela devaluation | 21 | | | | | |
| Medicare subsidy tax law change(1) | | (16) | | | | |
| ACS shareholders litigation settlement | 36 | | | | | |
| **Adjusted** | $ 778 | $ 249 | 32.0% | $ 304 | $ 89 | 29.3% |

(1) Medicare Subsidy Tax Law Change - Beginning in 2013, we will no longer be able to claim an income tax deduction related to prescription drug benefits provided to retirees and reimbursed under the Medicare Part D retiree drug subsidy.

Effective tax rate for the three and six months ended June 30, 2010 was 35.0% and 43.2%, respectively. On an adjusted basis the tax rate for the three and six months ended June 30, 2010 was 31.9%[3] and 32.0%[3], respectively. The adjusted tax rate for the three months was lower than the U.S. statutory rate primarily due to tax benefits associated with the utilization of foreign tax credits partially offset by tax expense associated with tax law changes. The adjusted tax rate for the six months was lower than the U.S. statutory rate due to the geographical mix of income before taxes and the related tax rates in those jurisdictions and the remeasurement of certain unrecognized tax positions.

The effective tax rate for the three and six months ended June 30, 2009 was 29.9% and 28.4%, which was lower than the U.S. statutory tax rate primarily due to the net tax benefits from the geographical mix of income before taxes and the related tax rates in those jurisdictions.

Our effective tax rate is based on nonrecurring events as well as recurring factors, including the geographical mix of income and the related tax rates in those jurisdictions and available foreign tax credits. In addition, our effective tax rate will change based on discrete or other nonrecurring events that may not be predictable. We anticipate that our effective tax rate for the remaining quarters of 2010 will be approximately 32%, excluding the effects of any discrete events.

### Equity in Net Income (Loss) of Unconsolidated Affiliates

| (in millions) | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 |
|---|---|---|---|---|
| Total equity in net income (loss) of unconsolidated affiliates | $ 28 | $ 9 | $ 26 | $ (1) |
| Fuji Xerox after-tax restructuring costs(1) | $ 5 | $ 9 | $ 27 | $ 31 |

(1) Represents our 25% share of Fuji Xerox after-tax restructuring costs.

Equity in net income (loss) of unconsolidated affiliates primarily reflects our 25% share of Fuji Xerox. The increase in equity income for the three and six months ended June 30, 2010 was due to an increase in Fuji Xerox s net income, which was primarily driven by higher revenue and cost improvements.

(1)

Results are discussed primarily on a pro-forma basis and include ACS s estimated results from February 6 through June 30 in 2009 since actual comparisons against the prior year would not otherwise be meaningful. See the Non-GAAP Financial Measures section for an explanation of these non-GAAP financial measures.

Table of Contents

(2) Post sale revenue does not include outsourcing revenue which is reported in our Services segment.
(3) See the Non-GAAP Financial Measures section for an explanation of this non-GAAP financial measure.

## Capital Resources and Liquidity

### Cash Flow Analysis

The following table summarizes our cash and cash equivalents for the six months ended June 30, 2010 and 2009:

| (in millions) | Six Months Ended June 30, 2010 | 2009 | Change |
|---|---|---|---|
| Net cash provided by operating activities | $ 1,053 | $ 631 | $ 422 |
| Net cash used in investing activities | (1,696) | (243) | (1,453) |
| Net cash used in financing activities | (2,022) | (400) | (1,622) |
| Effect of exchange rate changes on cash and cash equivalents | (52) | 4 | (56) |
| Decrease in cash and cash equivalents | (2,717) | (8) | (2,709) |
| Cash and cash equivalents at beginning of period | 3,799 | 1,229 | 2,570 |
| Cash and Cash Equivalents at End of Period | $ 1,082 | $ 1,221 | $ (139) |

### Cash Flows from Operating Activities

Net cash provided by operating activities was $1,053 million in the six months ended June 30, 2010 reflecting the inclusion of ACS as well as approximately $95 million of cash outflows for acquisition related costs. The $422 million increase in cash from the six months ended June 30, 2009 was primarily due to the following:

- $510 million increase in pre-tax income before depreciation and amortization, stock-based compensation, litigation, restructuring and the Venezuelan currency devaluation.
- $460 million increase due to higher accounts payable and accrued compensation primarily related to higher inventory purchases and the timing of accounts payable payments as well as increased compensation, benefit and other accruals.
- $71 million increase due to lower restructuring payments.
- $64 million increase primarily from the settlement of derivative contracts.
- $398 million decrease due to an increase in accounts receivable of $440 million reflecting higher revenues partially offset by collections of $42 million of deferred proceeds from prior quarter sales of receivables.
- $280 million decrease as a result of higher inventory levels reflecting increased activity.

### Cash Flows from Investing Activities

Net cash used in investing activities was $1,696 million for the six months ended June 30, 2010. The $1,453 million decrease in cash from the six months ended June 30, 2009 was primarily due to the following:

- $1,383 million decrease primarily due to the acquisitions of ACS of $1,495 million and IBS of $29 million in 2010, as compared to $145 million for GIS s acquisition of ComDoc, Inc. in 2009.
- $99 million decrease due to higher capital expenditures (including internal use software) primarily as a result of the inclusion of ACS in 2010.

### Cash Flows from Financing Activities

Net cash used in financing activities was $2,022 million for the six months ended June 30, 2010. The $1,622 million decrease in cash from the six months ended June 30, 2009 was primarily due to the following:

- $1,769 million decrease from higher net payments on other debt. 2010 reflects the repayments of $1,733 million of ACS s debt on the acquisition date and $950 million of Senior Notes, net payments of $40 million on other debt and $14 million of debt issuance costs for the bridge loan facility commitment, which was terminated in December 2009. These payments were offset by net proceeds of $702 million from borrowings under the Credit Facility. 2009 reflects the repayment of the 2009 Senior Notes of $879 million, net payments of $96 million on the Credit Facility and $41 million primarily for foreign short-term borrowings. These payments were partially offset by proceeds from the issuance of $750 million in Senior Notes.

$117 million increase due to proceeds from the issuance of common stock primarily as a result of the exercise of stock options issued under the former ACS plans.

$37 million increase from lower net repayments on secured debt.

**Table of Contents**

## ACS Acquisition

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

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

Refer to Note 5, Acquisitions, in the Condensed Consolidated Financial Statements for additional information regarding the ACS acquisition.

## Customer Financing Activities

The following represents our Total finance assets, net associated with our lease and finance operations:

| (in millions) | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Total Finance receivables, net [1] | $ 6,392 | $ 7,027 |
| Equipment on operating leases, net | 504 | 551 |
| **Total Finance Assets, net** | $ 6,896 | $ 7,578 |

(1) Includes (i) billed portion of finance receivables, net, (ii) finance receivables, net and (iii) finance receivables due after one year, net as included in our Condensed Consolidated Balance Sheets.

The reduction of $682 million in Total finance assets, net includes unfavorable currency of $383 million.

Table of Contents

Our lease contracts permit customers to pay for equipment over time rather than at the date of installation; therefore, we maintain a certain level of debt (that we refer to as financing debt) to support our investment in these lease contracts, which are reflected in Total Finance assets, net. For this financing aspect of our business, we maintain an assumed 7:1 leverage ratio of debt to equity as compared to our finance assets. Based on this leverage, the following represents the breakdown of total debt between financing debt and core debt:

| (in millions) | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Financing debt [1] | $ 6,034 | $ 6,631 |
| Core debt | 3,583 | 2,633 |
| **Total Debt** | $ 9,617 | $ 9,264 |

(1) Financing debt includes $5,593 million and $6,149 million as of June 30, 2010 and December 31, 2009, respectively, of debt associated with Total finance receivables, net and is the basis for our calculation of equipment financing interest expense. The remainder of the financing debt is associated with Equipment on operating leases.

Table of Contents

The following summarizes our debt as of June 30, 2010 and December 31, 2009:

| (in millions) | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Principal debt balance | $ 9,398 | $ 9,122 |
| Net unamortized discount | (1) | (11) |
| Fair value adjustments | 220 | 153 |
| Total Debt | 9,617 | 9,264 |
| Less: Current maturities and short-term debt | (358) | (988) |
| **Total Long-term Debt** | $ 9,259 | $ 8,276 |

### Sales of Accounts Receivables

We have facilities in the U.S., Canada and several countries in Europe that enable us to sell to third-parties, on an on-going basis, certain accounts receivables without recourse. 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:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (in millions) | 2010 | 2009 | 2010 | 2009 |
| Accounts receivable sales | $ 535 | $ 373 | $ 1,012 | $ 611 |
| Deferred proceeds | 73 | | 115 | |
| Fees associated with sales | 3 | 3 | 7 | 6 |
| Estimated increase (decrease) on operating cash flows[1] | 86 | 111 | (68) | 135 |

(1) Represents the difference between current and prior period receivable sales adjusted for the effects of the deferred proceeds and currency.

Refer to Note 6, Sales of Accounts Receivables, in the Condensed Consolidated Financial Statements for additional information.

Table of Contents

### Liquidity and Financial Flexibility

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

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

Table of Contents

The following is a discussion of our liquidity position as of June 30, 2010:

As of June 30, 2010, total cash and cash equivalents was $1.1 billion and our borrowing capacity under our Credit Facility was $1.3 billion, reflecting $702 million of outstanding borrowings and no letters of credit.

Cash flows from operations were $1.1 billion for the six months ended June 30, 2010 and we expect full year cash flow from operations of $2.6 billion. Over the past two 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 $2.2 billion and $939 million for the years ended December 31, 2009 and 2008, respectively.

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):

| Year | Amount |
|---|---|
| Q3 2010 | $ 311 |
| Q4 2010 | 9 |
| 2011 | 802 |
| 2012 | 1,119 |
| 2013 | 1,658 |
| 2014 | 795 |
| 2015 | 1,251 |
| 2016 | 951 |
| 2017 | 501 |
| 2018 | 1,001 |
| 2019 and thereafter | 1,000 |
| **Total** | $ 9,398 |

We currently plan to call our $550 million 7.625% Senior Notes due in 2013 in the fourth quarter 2010. If the Notes are redeemed, we expect to incur a loss on extinguishment of approximately $15 million representing the call premium of approximately $7 million as well as the write-off of unamortized debt issuance costs of $8 million. Prior to the planned redemption, the Senior Notes continue to be accounted for and classified in accordance with their original terms.

Table of Contents

### Contractual Cash Obligations and Other Commercial Commitments and Contingencies

In connection with our acquisition of ACS, we assumed liabilities under contractual obligations and commercial commitments as noted in the following table as of June 30, 2010:

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 and Thereafter | Total |
|---|---|---|---|---|---|---|---|
| **Contractual Cash Obligations:** | | | | | | | |
| Long-term debt, including capital lease obligations [1] | $ 15 | $ 25 | $ 17 | $ 6 | $ 1 | $ 261 | $ 325 |
| Minimum operating lease commitments | 410 | 274 | 141 | 79 | 52 | 100 | 1,056 |
| **Total Contractual Cash Obligations** | $ 425 | $ 299 | $ 158 | $ 85 | $ 53 | $ 361 | $ 1,381 |
| **Other Commercial Commitments[2]:** | | | | | | | |
| Surety bonds | $ 400 | $ 271 | $ 4 | $ 3 | $ | $ 1 | $ 679 |
| Letters of credit | 9 | 69 | | | | | 78 |
| **Total Other Commercial Commitments** | $ 409 | $ 340 | $ 4 | $ 3 | $ | $ 1 | $ 757 |

(1) Principal portion only.

(2) Certain contracts, primarily governmental, require surety bonds or letters of credit as a guarantee of performance. Refer to Note 16, Contingencies in the Condensed Consolidated Financial Statements for additional information.

Table of Contents

### Financial Risk Management

We are exposed to market risk from changes in 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. These derivative financial instruments are utilized to hedge economic exposures, as well as to reduce earnings and cash flow volatility resulting from shifts in market rates. We enter into limited types of derivative contracts, including interest rate swap agreements, foreign currency spot, forward and swap contracts and net purchased foreign currency options to manage interest rate and foreign currency exposures. Our primary foreign currency market exposures include the Yen, Euro and Pound Sterling. The fair market values of all our derivative contracts change with fluctuations in interest rates and/or currency rates and are designed so that any changes in their values are offset by changes in the values of the underlying exposures. Derivative financial instruments are held solely as risk management tools and not for trading or speculative purposes.

We are required to recognize all derivative instruments as either assets or liabilities at fair value in the balance sheet. As permitted, certain of these derivative contracts have been designated for hedge accounting treatment. Certain of our derivatives that do not qualify for hedge accounting are effective as economic hedges. These derivative contracts are likewise required to be recognized each period at fair value and therefore do result in some level of volatility. The level of volatility will vary with the type and amount of derivative hedges outstanding, as well as fluctuations in the currency and interest rate markets during the period. The related cash flow impacts of all of our derivative activities are reflected as cash flows from operating activities.

By their nature, all derivative instruments involve, to varying degrees, elements of market and credit risk. The market risk associated with these instruments resulting from currency exchange and interest rate movements is expected to offset the market risk of the underlying transactions, assets and liabilities being hedged. We do not believe there is significant risk of loss in the event of non-performance by the counterparties associated with these instruments because these transactions are executed with a diversified group of major financial institutions. Further, our policy is to deal with counterparties having a minimum investment grade or better credit rating. Credit risk is managed through the continuous monitoring of exposures to such counterparties.

The current market events have not required 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 11    Financial Instruments    for further discussion and information on our financial risk management strategies.

### Non-GAAP Financial Measures

We have reported our financial results in accordance with generally accepted accounting principles (  GAAP  ). In addition, we have discussed the non-GAAP measures described below. A reconciliation of these non-GAAP financial measures to the most directly comparable financial measures calculated and presented in accordance with GAAP are set forth below.

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.

### Adjusted Earnings Measures

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

Net income and Earnings per share (  EPS  )    three and six months actual and EPS guidance for third quarter and full-year 2010, and Effective tax rate.

Table of Contents

The above have been adjusted for the following items:

**Restructuring and asset impairment charges (including those incurred by Fuji Xerox):** Restructuring and asset impairment charges consist of costs primarily related to severance and benefits for employees terminated pursuant to formal restructuring and workforce reduction plans. We exclude these charges because we believe that these historical costs do not reflect expected future operating expenses and do not contribute to a meaningful evaluation of our current or past operating performance. In addition, such charges are inconsistent in amount and frequency. Such charges are expected to yield future benefits and savings with respect to our operational performance.

**Acquisition-related costs:** We incurred significant expenses in connection with our acquisition of ACS which we generally would not have otherwise incurred in the periods presented as a part of our continuing operations. Acquisition-related costs include transaction and integration costs, which represent external incremental costs directly related to completing the acquisition and the integration of ACS and Xerox. We believe it is useful for investors to understand the effects of these costs on our total operating expenses.

**Amortization of intangible assets:** The amortization of intangible assets is driven by our acquisition activity which can vary in size, nature and timing as compared to other companies within our industry and from period to period. Accordingly, due to the incomparability of acquisition activity among companies and from period to period, we believe exclusion of the amortization associated with intangible assets acquired through our acquisitions allows investors to better compare and understand our results. The use of intangible assets contributed to our revenues earned during the periods presented and will contribute to our future period revenues as well. Amortization of intangible assets will recur in future periods.

**Other discrete, unusual or infrequent costs and expenses:** In addition, we have also excluded the following additional items given the discrete, unusual or infrequent nature of these items on our results of operations for the period 1) ACS shareholders litigation settlement (Qtr 2); 2) Venezuela devaluation (Qtr 1) and 3) Medicare subsidy tax law change (income tax effect only)(Qtr 1). 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.

Table of Contents

**Net Income and EPS reconciliation:**

| (in millions; except per share amounts) | Three Months Ended June 30, 2010 Net Income | Three Months Ended June 30, 2010 EPS | Three Months Ended June 30, 2009 Net Income | Three Months Ended June 30, 2009 EPS |
|---|---|---|---|---|
| **Reported** | $ 227 | $ 0.16 | $ 140 | $ 0.16 |
| **Adjustments:** | | | | |
| Xerox and Fuji Xerox restructuring charges | 12 | 0.01 | 9 | 0.01 |
| Acquisition-related costs | 14 | 0.01 | | |
| Amortization of intangible assets | 53 | 0.04 | 9 | 0.01 |
| ACS shareholders litigation settlement | 36 | 0.02 | | |
| **Adjusted** | $ 342 | $ 0.24 | $ 158 | $ 0.18 |

| (in millions; except per share amounts) | Six Months Ended June 30, 2010 Net Income | Six Months Ended June 30, 2010 EPS | Six Months Ended June 30, 2009 Net Income | Six Months Ended June 30, 2009 EPS |
|---|---|---|---|---|
| **Reported** | $ 185 | $ 0.14 | $ 182 | $ 0.21 |
| **Adjustments:** | | | | |
| Xerox and Fuji Xerox restructuring charges | 169 | 0.13 | 31 | 0.03 |
| Acquisition-related costs | 50 | 0.04 | | |
| Amortization of intangible assets | 88 | 0.07 | 18 | 0.02 |
| ACS shareholders litigation settlement | 36 | 0.02 | | |
| Venezuela devaluation | 21 | 0.02 | | |
| Medicare subsidy tax law change | 16 | 0.01 | | |
| **Adjusted** | $ 565 | $ 0.43 | $ 231 | $ 0.26 |

Table of Contents

### Effective Tax reconciliation:

| (in millions) | Three Months Ended June 30, 2010 Pre-Tax Income | Three Months Ended June 30, 2010 Income Tax Expense | Effective Tax Rate | Three Months Ended June 30, 2009 Pre-Tax Income | Three Months Ended June 30, 2009 Income Tax Expense | Effective Tax Rate |
|---|---|---|---|---|---|---|
| **Reported** | $ 320 | $ 112 | 35.0% | $ 197 | $ 59 | 29.9% |
| **Adjustments:** | | | | | | |
| Xerox restructuring charge | 11 | 4 | | | | |
| Acquisition-related costs | 15 | 1 | | | | |
| Amortization of intangible assets | 85 | 32 | | 15 | 6 | |
| ACS shareholders litigation settlement | 36 | | | | | |
| **Adjusted** | $ 467 | $ 149 | 31.9% | $ 212 | $ 65 | 30.7% |

| (in millions) | Six Months Ended June 30, 2010 Pre-Tax Income | Six Months Ended June 30, 2010 Income Tax Expense | Effective Tax Rate | Six Months Ended June 30, 2009 Pre-Tax Income | Six Months Ended June 30, 2009 Income Tax Expense | Effective Tax Rate |
|---|---|---|---|---|---|---|
| **Reported** | $ 310 | $ 134 | 43.2% | $ 275 | $ 78 | 28.4% |
| **Adjustments:** | | | | | | |
| Xerox restructuring charge | 206 | 64 | | | | |
| Acquisition-related costs | 63 | 13 | | | | |
| Amortization of intangible assets | 142 | 54 | | 29 | 11 | |
| Venezuela devaluation | 21 | | | | | |
| Medicare subsidy tax law change | | (16) | | | | |
| ACS shareholders litigation settlement | 36 | | | | | |
| **Adjusted** | $ 778 | $ 249 | 32.0% | $ 304 | $ 89 | 29.3% |

### Pro-forma Basis

To better understand the trends in our business, we discuss our 2010 operating results by comparing them against adjusted 2009 results which include ACS historical results for the comparable period. Accordingly, we have included ACS s 2009 estimated results for the comparable period February 6, 2009 through June 30, 2009 in our reported 2009 results. We refer to comparisons against these adjusted 2009 results as pro-forma basis comparisons. ACS 2009 historical results have been adjusted to reflect fair value adjustments related to property, equipment and computer software as well as customer contract costs. In addition, adjustments were made for deferred revenue, exited businesses and other material non-recurring costs associated with the acquisition. We believe comparisons on a pro-forma basis are more meaningful than the actual comparisons given the size and nature of the ACS acquisition. We believe the pro-forma basis comparisons allow investors to have better understanding and additional perspective of the expected trends in our business as well as the impact of the ACS acquisition on the Company s operations.

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.

**Table of Contents**

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:

**Pro-forma:**

| | Three Months Ended June 30, | | | | |
|---|---|---|---|---|---|
| **Total Xerox** (in millions) | As Reported 2010 | As Reported 2009 | Pro-forma 2009 [(1)] | Change | Pro-forma Change |
| **Revenue:** | | | | | |
| Equipment sales | $ 930 | $ 828 | $ 828 | 12% | 12% |
| Supplies, paper and other | 861 | 774 | 808 | 11% | 7% |
| Sales | 1,791 | 1,602 | 1,636 | 12% | 9% |
| Service, outsourcing and rentals | 3,553 | 1,951 | 3,577 | 82% | (1)% |
| Finance income | 164 | 178 | 178 | (8)% | (8)% |
| **Total Revenues** | $ 5,508 | $ 3,731 | $ 5,391 | 48% | 2% |
| Service, outsourcing and rentals | $ 3,553 | $ 1,951 | $ 3,577 | 82% | (1)% |
| Add: Finance income | 164 | 178 | 178 | | |
| Add: Supplies, paper and other sales | 861 | 774 | 808 | | |
| **Annuity Revenue** | $ 4,578 | $ 2,903 | $ 4,563 | 58% | % |
| **Gross Profit:** | | | | | |
| Sales | $ 619 | $ 537 | $ 543 | | |
| Service, outsourcing and rentals | 1,194 | 851 | 1,200 | | |
| Finance income | 103 | 110 | 110 | | |
| **Total** | $ 1,916 | $ 1,498 | $ 1,853 | | |
| **Gross Margin:** | | | | | |
| Sales | 34.6% | 33.5% | 33.2% | 1.1 pts | 1.4 pts |
| Service, outsourcing and rentals | 33.6% | 43.6% | 33.6% | (10.0) pts | pts |
| Finance income | 62.8% | 61.8% | 61.8% | 1.0 pts | 1.0 pts |
| **Total** | 34.8% | 40.2% | 34.4% | (5.4) pts | 0.4 pts |
| **RD&E** | $ 194 | $ 202 | $ 202 | | |
| **RD&E % Revenue** | 3.5% | 5.4% | 3.7% | (1.9) pts | (0.2) pts |
| **SAG** | $ 1,163 | $ 1,013 | $ 1,154 | | |
| **SAG % Revenue** | 21.1% | 27.2% | 21.4% | (6.1) pts | (0.3) pts |

| | Six Months Ended June 30, | | | | |
|---|---|---|---|---|---|
| **Total Xerox** (in millions) | As Reported 2010 | As Reported 2009 | Pro-forma 2009 [(1)] | Change | Pro-forma Change |
| **Revenue:** | | | | | |
| Equipment sales | $ 1,752 | $ 1,598 | $ 1,598 | 10% | 10% |
| Supplies, paper and other | 1,717 | 1,498 | 1,555 | 15% | 10% |
| Sales | 3,469 | 3,096 | 3,153 | 12% | 10% |
| Service, outsourcing and rentals | 6,423 | 3,831 | 6,390 | 68% | 1% |
| Finance income | 337 | 358 | 358 | (6)% | (6)% |

| | | | | | |
|---|---|---|---|---|---|
| **Total Revenues** | $ 10,229 | $ 7,285 | $ 9,901 | 40% | 3% |
| | | | | | |
| Service, outsourcing and rentals | $ 6,423 | $ 3,831 | $ 6,390 | 68% | 1% |
| Add: Finance income | 337 | 358 | 358 | | |
| Add: Supplies, paper and other sales | 1,717 | 1,498 | 1,555 | | |
| | | | | | |
| **Annuity Revenue** | $ 8,477 | $ 5,687 | $ 8,303 | 49% | 2% |
| | | | | | |
| **Gross Profit:** | | | | | |
| Sales | $ 1,215 | $ 1,027 | $ 1,039 | | |
| Service, outsourcing and rentals | 2,193 | 1,631 | 2,193 | | |
| Finance income | 212 | 221 | 221 | | |
| | | | | | |
| **Total** | $ 3,620 | $ 2,879 | $ 3,453 | | |

Table of Contents

| | | | | | |
|---|---|---|---|---|---|
| **Gross Margin:** | | | | | |
| Sales | 35.0% | 33.2% | 33.0% | 1.8 pts | 2.0 pts |
| Service, outsourcing and rentals | 34.1% | 42.6% | 34.3% | (8.5) pts | (0.2) pts |
| Finance income | 62.9% | 61.7% | 61.7% | 1.2 pts | 1.2 pts |
| **Total** | 35.4% | 39.5% | 34.9% | (4.1) pts | 0.5 pts |
| **RD&E** | $ 399 | $ 406 | $ 406 | | |
| **RD&E % Revenue** | 3.9% | 5.6% | 4.1% | (1.7) pts | (0.2) pts |
| **SAG** | $ 2,262 | $ 2,017 | $ 2,234 | | |
| **SAG % Revenue** | 22.1% | 27.7% | 22.6% | (5.6) pts | (0.5) pts |

(1) Pro-forma reflects ACS s 2009 estimated results from April 1 through June 30 for the second quarter and February 6 through June 30 for the six months ended June 30, 2009, 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, certain non-recurring product sales and other material non-recurring costs associated with the acquisition.

**Services Segment:**

| | Three Months Ended June 30, | | | | |
|---|---|---|---|---|---|
| (in millions) | As Reported 2010 | As Reported 2009 | Pro-forma 2009 (1) | Change | Pro-forma Change |
| Document Outsourcing | $ 836 | $ 850 | $ 850 | (2)% | (2)% |
| Business Processing Outsourcing (2) | 1,341 | | 1,306 | * | 3% |
| Information Technology Outsourcing | 352 | | 354 | * | (1)% |
| **Total Revenue Services** | $ 2,529 | $ 850 | $ 2,510 | 198% | 1% |
| **Segment Profit Services** | $ 319 | $ 61 | $ 282 | * | 13% |
| **Segment Margin Services** | 12.6% | 7.2% | 11.2% | | |

* Percent change not meaningful.

| | Six Months Ended June 30, | | | | |
|---|---|---|---|---|---|
| (in millions) | As Reported 2010 | As Reported 2009 | Pro-forma 2009 (1) | Change | Pro-forma Change |
| Document Outsourcing | $ 1,667 | $ 1,683 | $ 1,683 | (1)% | (1)% |
| Business Processing Outsourcing (2) | 2,154 | | 2,057 | * | 5% |
| Information Technology Outsourcing | 551 | | 559 | * | (1)% |
| **Total Revenue Services** | $ 4,372 | $ 1,683 | $ 4,299 | 160% | 2% |
| **Segment Profit Services** | $ 522 | $ 92 | $ 455 | * | 15% |
| **Segment Margin Services** | 11.9% | 5.5% | 10.6% | | |

* Percent change not meaningful.

(1) Pro-forma reflects ACS s 2009 estimated results from April 1 through June 30 for the second quarter and February 6 through June 30 for the six months ended June 30, 2009, 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, certain non-recurring product sales and other material non-recurring costs associated with the acquisition.

(2) BPO does not include, at this time, historic Xerox BPO services; those are included in Document Outsourcing.

## ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information set forth under the caption Financial Risk Management of this Quarterly Report on Form 10-Q is hereby incorporated by reference in answer to this Item.

Table of Contents

## ITEM 4 CONTROLS AND PROCEDURES

### (a) Evaluation of Disclosure Controls and Procedures

The Company s management evaluated, with the participation of our principal executive officer and principal financial officer, or persons performing similar functions, the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms relating to Xerox Corporation, including our consolidated subsidiaries, and was accumulated and communicated to the Company s management, including the principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

### (b) Changes in Internal Controls

In connection with the evaluation required by paragraph (d) of Rule 13a-15 under the Exchange Act, there was no change identified in our internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

## PART II OTHER INFORMATION

### ITEM 1 LEGAL PROCEEDINGS

The information set forth under Note 16 - Contingencies contained in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this Item.

### ITEM 1A RISK FACTORS

Reference is made to the Risk Factors set forth in Part I, Item 1A of our 2009 Annual Report. The Risk Factors remain applicable from our 2009 Annual Report, with the exception of the following changes:

***Our significant debt could adversely affect our financial health and pose challenges for conducting our business.***

We have and will continue to have a significant amount of debt and other obligations, primarily to support our customer financing activities. As of June 30, 2010, we had $9.6 billion of total debt and a $649 million liability to a subsidiary trust issuing preferred securities. The total value of financing activities, shown on the balance sheet as Finance receivables and Equipment on operating lease, was $6.9 billion at June 30, 2010. The total cash and cash equivalents was $1.1 billion at June 30, 2010. Our substantial debt and other obligations could have important consequences. For example, it could (i) increase our vulnerability to general adverse economic and industry conditions; (ii) limit our ability to obtain additional financing for future working capital, capital expenditures, acquisitions and other general corporate requirements; (iii) increase our vulnerability to interest rate fluctuations because a portion of our debt has variable interest rates; (iv) require us to dedicate a substantial portion of our cash flows from operations to service debt and other obligations thereby reducing the availability of our cash flows from operations for other purposes; (v) limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; (vi) place us at a competitive disadvantage compared to our competitors that have less debt; and (vii) become due and payable upon a change in control. If new debt is added to our current debt levels such as the incurrence of debt to partially fund acquisitions, these related risks could increase.

***We need to maintain adequate liquidity in order to have sufficient cash to meet operating cash flow requirements and to repay maturing debt and other obligations. If we fail to comply with the covenants contained in our various borrowing agreements, it may adversely affect our liquidity, results of operations and financial condition.***

Our liquidity is a function of our ability to successfully generate cash flows from a combination of efficient operations and improvement therein, access to capital markets, securitizations and funding from third parties. As of June 30, 2010, total cash and cash equivalents was $1.1 billion, and our borrowing capacity under our Credit Facility was $1.3 billion, reflecting $702 million outstanding borrowings. We believe our liquidity (including operating and other cash flows that we expect to generate) will be sufficient to meet operating requirements as they occur; however, our ability to maintain sufficient liquidity going forward depends on our ability to generate cash from operations and access to the capital markets, secured borrowings, securitizations and funding from third parties, all of which are subject to general economic, financial, competitive, legislative, regulatory and other market factors that are beyond our control.

The Credit Facility contains affirmative and negative covenants including limitations on: (i) liens of Xerox and certain of our subsidiaries securing debt, (ii) certain fundamental changes to corporate structure, (iii) changes in nature of business and (iv) limitations on debt incurred by certain subsidiaries. The Credit Facility contains financial maintenance covenants, including maximum leverage (debt for borrowed money divided by consolidated EBITDA, as defined) and a minimum interest coverage ratio (consolidated EBITDA divided by consolidated interest expense, as defined). The indentures governing our outstanding senior notes contain affirmative and negative covenants including limitations on: issuance of secured debt and preferred stock; investments and acquisitions; mergers; certain transactions with affiliates; creation of liens; asset transfers; hedging transactions; payment of dividends and certain other payments. They do not, however, contain any financial maintenance covenants, except the fixed charge coverage ratio applicable to certain types of payments. At June 30, 2010, we were in compliance with the covenants and other provisions of the Credit Facility and the senior notes. Any failure to be in compliance with any material provision or covenant of the Credit Facility or the senior notes could have a material adverse effect on our liquidity, results of operations and financial condition.

## ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

### (a) Sales of Unregistered Securities during the Quarter ended June 30, 2010

During the quarter ended June 30, 2010, Registrant issued the following securities in transactions which were not registered under the Securities Act of 1933, as amended (the Act ).

### Dividend Equivalent

(a) Securities issued on April 30, 2010: Registrant issued 1,677 DSUs, representing the right to receive shares of Common stock, par value $1 per share, at a future date.

(b) No underwriters participated. The shares were issued to each of the non-employee Directors of Registrant: Glenn A. Britt, Richard J. Harrington, William Curt Hunter, Robert A. McDonald, N. J. Nicholas, Jr., Charles Prince, Ann N. Reese and Mary Agnes Wilderotter and to a retired Director, Vernon E. Jordan, Jr.

(c) The DSUs were issued at a deemed purchase price of $9.69 per DSU (aggregate price $16,250), based upon the market value on the date of record, in payment of the dividend equivalents due to DSU holders pursuant to Registrant s 2004 Equity Compensation Plan for Non-Employee Directors.

(d) Exemption from registration under the Act was claimed based upon Section 4(2) as a sale by an issuer not involving a public offering.

### (b) Issuer Purchases of Equity Securities during the Quarter ended June 30, 2010

Repurchases of Xerox Common Stock, par value $1.00 per share include the following:

**Board Authorized Share Repurchase Programs:** We did not purchase Common stock during the second quarter of 2010.

Of the cumulative $4.5 billion of share repurchase authority previously granted by our Board of Directors, exclusive of fees and expenses, approximately $2.9 billion has been used through June 30, 2010. Repurchases may be made on the open market, or through derivative or negotiated transactions. Open-market repurchases will be made in compliance with the Securities and Exchange Commission s Rule 10b-18, and are subject to market conditions, as well as applicable legal and other considerations.

**Repurchases Related to Stock Compensation Programs (1):**

| | Total Number of Shares Purchased | Average Price Paid per Share(2) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased under the Plans or Programs |
|---|---|---|---|---|
| April 1 through 30 | 54,611 | $ 9.99 | n/a | n/a |
| May 1 through 31 | 161,371 | $ 10.02 | n/a | n/a |
| June 1 through 30 | | | n/a | n/a |
| Total | 215,982 | | n/a | n/a |

(1) These repurchases are made under a provision in our restricted stock compensation programs for the indirect repurchase of shares through a net-settlement feature upon the vesting of shares in order to satisfy minimum statutory tax-withholding requirements.

(2) Exclusive of fees and costs.

**Table of Contents**

## ITEM 6 EXHIBITS

| | |
|---|---|
| 3(a) | Restated Certificate of Incorporation of Registrant filed with the Department of State of New York on November 7, 2003, as amended by Certificate of Amendment to Certificate of Incorporation filed with the Department of State of New York on August 19, 2004, Certificate of Change filed with the Department of State of the State of New York on October 31, 2007, Certificate of Amendment to Certificate of Incorporation filed with the Department of State of the State of New York on May 29, 2008. Certificate of Amendment to Certificate of Incorporation filed with the Department of State of the State of New York on February 13, 2009 and Certificate of Amendment to Certificate of Incorporation filed with the Department of State of the State of New York on February 3, 2010. |
| | Incorporated by reference to Exhibit 3.1 to Registrant s Current Report on Form 8-K dated February 5, 2010. |
| 3(b) | By-Laws of Registrant, as amended through May 21, 2009. |
| | Incorporated by reference to Exhibit 3(b) to Registrant s Current Report on Form 8-K dated May 21, 2009. |
| 10(k)(3) | Amendment No. 2 dated May 17, 2010 to Registrant s Deferred Compensation Plan for Directors, as amended and restated December 5, 2007. |
| 12 | Computation of Ratio of Earnings to Fixed Charges. |
| 31(a) | Certification of CEO pursuant to Rule 13a-14(a) or Rule 15d-14(a). |
| 31(b) | Certification of CFO pursuant to Rule 13a-14(a) or Rule 15d-14(a). |
| 32 | Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase. |
| 101.INS | XBRL Instance Document. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase. |
| 101.SCH | XBRL Taxonomy Extension Schema Linkbase. |

Table of Contents

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**XEROX CORPORATION**

(Registrant)

By: /s/ Gary R. Kabureck
**Gary R. Kabureck**

**Vice President and**

**Chief Accounting Officer**

**(Principal Accounting Officer)**

Date: August 2, 2010

**Table of Contents**

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