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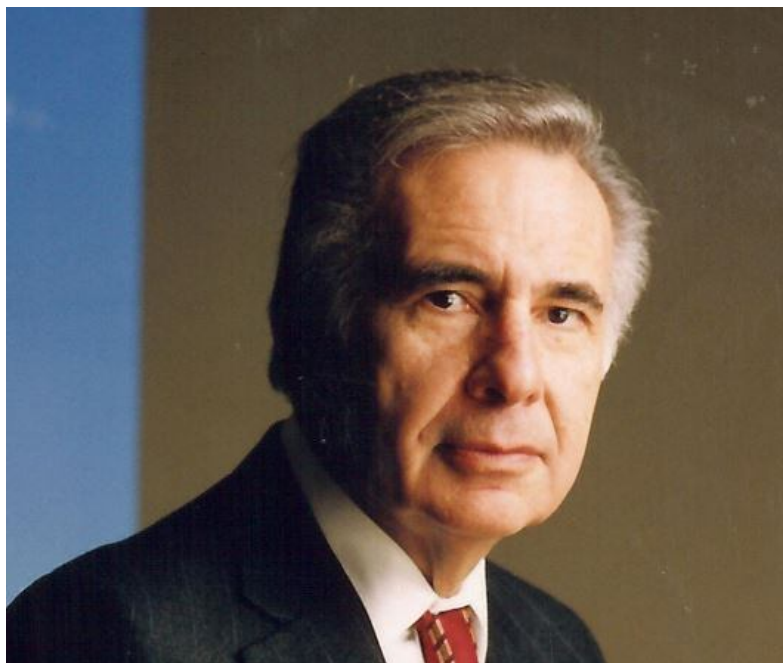
Carl Icahn Bought Xerox and You Should Too

There's a potential gold mine in Xerox with new management and spin-off value

March 28, 2016 | About: [XRX +0.72%](#) [EBAY +0.52%](#) [PYPL -0.13%](#)

Why did such an investment genius such as Carl Icahn buy a dead-end copier company that made multiple blunders, including basically giving away the GUI operating system that runs every computer on the planet?

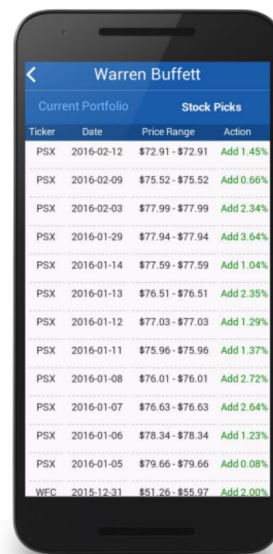
The company and Icahn have completed an agreement that paves the way for Xerox to split in two, giving Icahn the ability to select three directors for the Business Process Outsourcing segment. Icahn tweeted: 'We believe the separation will greatly enhance value for \$XRX shareholders.' Like his deal with **eBay** (NASDAQ:EBAY) and **PayPal** (NASDAQ:PYPL), when times are tough, let's break up.



Spin-off filing document

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XRX Price Chart

- [Peter Lynch Chart of XRX](#)



Icahn obviously feels strongly about the company because Xerox makes up 3% of his total holdings with more than 92 million shares, and a big win could move the needle for him. He's continued to add to his stake as well.

From a pure numbers standpoint, it's not a very attractive play without Icahn guiding the decisions and helping push the company forward. Over the last 15 years, Xerox has generated over \$10 billion in net income, but gross margin and return on equity have both dropped as the services sector has shifted.

Granted, it pays a solid 2.6% dividend that it can easily cover with net income and with a fairly certain spinoff happening in the near future, a pop of 30% to 50% this year could be in the cards. One really great aspect of the company has been its ability to pay down debt and buy back shares, boosting the value to owners without needing to grow rapidly.

That said, many analysts have a neutral overall growth outlook for the firm, and we will keep a cautious eye on the company as it looks to split into by the end of 2016. In fact, I don't think it'll grow at all and Icahn know this as well, and after a spin-off he'll likely dump the stocks if they don't show signs of higher market values.

The two entities would comprise the Document Technology division (\$11 billion in annual sales) and the Business Processing Outsourcing (BPO) unit (\$7 billion in sales). The former's top line has been in a meaningful downtrend in recent years, entails the sale of copiers and multifunction printers, and offers document management outsourcing services -- yawn -- while the latter is a leader in the processing of medical claims and EZPass billing. The BPO is definitely the exciting part considering as [Warren Buffett](#) ([Trades](#), [Portfolio](#)) once quipped:

"In an inflationary world (a la the U.S. circa 2016), a toll bridge (like company) would be a great thing to own because you've laid out the capital costs. You built it in old dollars and you don't have to keep replacing it."

This is what BPO is to Icahn, literally. Of the two separate companies, BPO is a higher quality

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Xerox is prominent in document technology business (40% of revenue) because of its scale, offerings and long standing brand. The overall print market is large, but even with a total spend of \$50 billion globally, the margins are low and profit in decline. Xerox's brand position and low CapEx need are small advantages in a very competitive marketplace.

While Xerox continues to pound out roughly \$1.2 billion in free cash flow annually, the real value in this spinoff is the BPO segment. It will generate \$722 million in pre-tax profit for 2015, benefiting from Obamacare legislation requiring hospitals to run more efficiently, and the overall trend towards automating business functions to ensure cost reductions. However, management has done a poor job in terms of project management as there have been significant cost overruns and margin pressures in recent years, hence the need for Icahn's leadership.



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