NCR CORP
Form 10-Q
November 03, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014
Commission File Number 001-00395

NCR CORPORATION
(Exact name of registrant as specified in its charter)

Maryland	31-0387920
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3097 Satellite Boulevard
Duluth, GA 30096
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (937) 445-5000

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 þ No o
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 þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	þ	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ
As of October 15, 2014, there were approximately 168.4 million shares of common stock issued and outstanding.

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Part I. Financial Information

Item 1. FINANCIAL STATEMENTS

NCR Corporation
Condensed Consolidated Statements of Operations (Unaudited)

In millions, except per share amounts	Three months ended September 30		Nine months ended September 30	
	2014	2013	2014	2013
Product revenue	$721	$701	$2,077	$2,111
Service revenue	926	807	2,746	2,342
Total revenue	1,647	1,508	4,823	4,453
Cost of products	547	524	1,554	1,577
Cost of services	696	569	1,969	1,666
Selling, general and administrative expenses	232	217	724	678
Research and development expenses	59	53	186	163
Restructuring-related charges	72	—	72	—
Total operating expenses	1,606	1,363	4,505	4,084
Income from operations	41	145	318	369
Interest expense	(46)	(23)	(135)	(70)
Other (expense), net	(14)	(3)	(24)	(4)
(Loss) income from continuing operations before income taxes	(19)	119	159	295
Income tax (benefit) expense	(19)	19	14	44
Income from continuing operations	—	100	145	251
Income (loss) from discontinued operations, net of tax	15	—	15	(1)
Net income	15	100	160	250
Net income attributable to noncontrolling interests	—	2	2	5
Net income attributable to NCR	$15	$98	$158	$245
Amounts attributable to NCR common stockholders:				
Income from continuing operations	$—	$98	$143	$246
Income (loss) from discontinued operations, net of tax	15	—	15	(1)
Net income	$15	$98	$158	$245
Income per share attributable to NCR common stockholders:				
Income per common share from continuing operations				
Basic	$—	$0.59	$0.85	$1.49
Diluted	$—	$0.58	$0.84	$1.46
Net income per common share				
Basic	$0.09	$0.59	$0.94	$1.48
Diluted	$0.09	$0.58	$0.92	$1.45
Weighted average common shares outstanding				
Basic	168.2	166.2	167.7	165.1
Diluted	171.3	170.0	171.1	168.8

See Notes to Condensed Consolidated Financial Statements.

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NCR Corporation
Condensed Consolidated Statements of Comprehensive Income (Unaudited)

In millions	Three months ended September 30		Nine months ended September 30	
	2014	2013	2014	2013
Net income	$15	$100	$160	$250
Other comprehensive income (loss):				
Currency translation adjustments				
Currency translation adjustments	(47)	7	(17)	(49)
Derivatives				
Unrealized gain (loss) on derivatives	1	(3)	(1)	3
Losses on derivatives arising during the period	1	1	4	4
Less income tax expense	—	—	(1)	(3)
Securities				
Unrealized gain on securities	—	—	—	3
Less income tax expense	—	(1)	—	(1)
Employee benefit plans				
New prior service cost	—	(3)	—	(3)
Amortization of prior service benefit	(4)	(5)	(15)	(27)
Net (loss) gain arising during the period	—	(12)	—	36
Amortization of actuarial loss	—	3	1	6
Less income tax benefit (expense)	1	1	5	(9)
Other comprehensive loss	(48)	(12)	(24)	(40)
Total comprehensive (loss) income	(33)	88	136	210
Less comprehensive income attributable to noncontrolling interests:				
Net income	—	2	2	5
Currency translation adjustments	(2)	(1)	(2)	(4)
Amounts attributable to noncontrolling interests	(2)	1	—	1
Comprehensive (loss) income attributable to NCR common stockholders	$(31)	$87	$136	$209

See Notes to Condensed Consolidated Financial Statements.

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NCR Corporation
Condensed Consolidated Balance Sheets (Unaudited)

In millions, except per share amounts	September 30, 2014	December 31, 2013
Assets		
Current assets		
Cash and cash equivalents	$424	$528
Restricted cash	—	1,114
Accounts receivable, net	1,454	1,339
Inventories	777	790
Other current assets	557	568
Total current assets	3,212	4,339
Property, plant and equipment, net	398	352
Goodwill	2,773	1,534
Intangibles, net	962	494
Prepaid pension cost	506	478
Deferred income taxes	245	441
Other assets	514	470
Total assets	$8,610	$8,108
Liabilities and stockholders' equity		
Current liabilities		
Short-term borrowings	$85	$34
Accounts payable	705	670
Payroll and benefits liabilities	203	191
Deferred service revenue and customer deposits	529	525
Other current liabilities	486	461
Total current liabilities	2,008	1,881
Long-term debt	3,660	3,320
Pension and indemnity plan liabilities	513	532
Postretirement and postemployment benefits liabilities	172	169
Income tax accruals	189	189
Environmental liabilities	48	121
Other liabilities	76	99
Total liabilities	6,666	6,311
Commitments and Contingencies (Note 10)		
Redeemable noncontrolling interest	12	14
Stockholders' equity		
NCR stockholders' equity		
Preferred stock: par value $0.01 per share, 100.0 shares authorized, no shares issued and outstanding as of September 30, 2014 and December 31, 2013	—	—
Common stock: par value $0.01 per share, 500.0 shares authorized, 168.4 and 166.6 shares issued and outstanding as of September 30, 2014 and December 31, 2013, respectively	2	2
Paid-in capital	446	433
Retained earnings	1,530	1,372
Accumulated other comprehensive loss	(60)	(38)
Total NCR stockholders' equity	1,918	1,769
Noncontrolling interests in subsidiaries	14	14

Total stockholders’ equity	1,932	1,783
Total liabilities and stockholders’ equity	$8,610	$8,108

See Notes to Condensed Consolidated Financial Statements.

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NCR Corporation
Condensed Consolidated Statements of Cash Flows (Unaudited)

In millions	Nine months ended September 30 2014	2013
Operating activities		
Net income	$160	$250
Adjustments to reconcile net income to net cash provided by operating activities:		
(Income) loss from discontinued operations	(15)	1
Depreciation and amortization	211	149
Stock-based compensation expense	26	34
Deferred income taxes	(28)	(8)
Gain on sale of property, plant and equipment and other assets	(2)	(14)
Impairment of long-lived and other assets	8	—
Changes in assets and liabilities:		
Receivables	(77)	(152)
Inventories	14	(41)
Current payables and accrued expenses	33	(24)
Deferred service revenue and customer deposits	2	21
Employee benefit plans	(12)	(152)
Other assets and liabilities	(85)	(48)
Net cash provided by operating activities	235	16
Investing activities		
Expenditures for property, plant and equipment	(88)	(80)
Proceeds from sales of property, plant and equipment	—	10
Additions to capitalized software	(109)	(75)
Business acquisitions, net	(1,647)	(696)
Changes in restricted cash	1,114	—
Other investing activities, net	4	5
Net cash used in investing activities	(726)	(836)
Financing activities		
Tax withholding payments on behalf of employees	(28)	(28)
Short term borrowings, net	2	(1)
Payments on term credit facilities	(20)	(35)
Borrowings on term credit facility	250	300
Payments on revolving credit facility	(528)	(845)
Borrowings on revolving credit facility	690	845
Debt issuance costs	(3)	(12)
Proceeds from employee stock plans	10	52
Other financing activities	(3)	—
Net cash provided by financing activities	370	276
Cash flows from discontinued operations		
Net cash provided by (used in) operating activities	28	(51)
Effect of exchange rate changes on cash and cash equivalents	(11)	(14)
Decrease in cash and cash equivalents	(104)	(609)
Cash and cash equivalents at beginning of period	528	1,069
Cash and cash equivalents at end of period	$424	$460

See Notes to Condensed Consolidated Financial Statements.

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NCR Corporation
Notes to Condensed Consolidated Financial Statements (Unaudited)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying Condensed Consolidated Financial Statements have been prepared by NCR Corporation (NCR, the Company, we or us) without audit pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC) and, in the opinion of management, include all adjustments (consisting of normal, recurring adjustments, unless otherwise disclosed) necessary for a fair statement of the consolidated results of operations, financial position, and cash flows for each period presented. The consolidated results for the interim periods are not necessarily indicative of results to be expected for the full year. The 2013 year-end Condensed Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States (GAAP). These financial statements should be read in conjunction with NCR's Form 10-K for the year ended December 31, 2013.

On January 10, 2014, the Company completed its acquisition of Digital Insight Corporation (Digital Insight). As a result of the acquisition, the results of Digital Insight are included for the period from January 10, 2014 to September 30, 2014. See Note 4, "Acquisitions," for additional information.

Use of Estimates The preparation of financial statements in accordance with GAAP requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ from those estimates.

Evaluation of Subsequent Events The Company evaluated subsequent events through the date that our Condensed Consolidated Financial Statements were issued. No matters were identified that required adjustment of the Condensed Consolidated Financial Statements or additional disclosure.

Out of Period Adjustment During the third quarter of 2014, the Company recorded $5 million in income tax expense related to an error in the calculation of foreign income taxable in the United States for 2013. The Company determined the impact of this error was not material to the previously filed annual or interim financial statements and the effect of correcting this error in the nine months ended September 30, 2014 was not material and is not expected to be material to the 2014 annual financial statements.

Reclassifications Certain prior-period amounts have been reclassified in the accompanying Condensed Consolidated Financial Statements and Notes thereto in order to conform to the current period presentation.

Related Party Transactions In 2011, concurrent with the sale of a noncontrolling interest in our subsidiary, NCR Brasil - Indústria de Equipamentos para Automação S.A., (NCR Manaus) to Scopus Tecnologia Ltda. (Scopus), we entered into a Master Purchase Agreement (MPA) with Banco Bradesco SA (Bradesco), the parent of Scopus. Through the MPA, Bradesco agreed to purchase up to 30,000 ATMs from us over the 5-year term of the agreement. Pricing of the ATMs will adjust over the term of the MPA using certain formulas which are based on prevailing market pricing. We recognized revenue related to Bradesco totaling $22 million and $54 million during the three and nine months ended September 30, 2014 as compared to $24 million and $101 million during the three and nine months ended September 30, 2013. As of September 30, 2014 and December 31, 2013, we had $15 million and $9 million, respectively, in receivables outstanding from Bradesco.

Recent Accounting Pronouncements

Adopted

In February 2013, the Financial Accounting Standards Board (FASB) issued changes to the accounting for obligations resulting from joint and several liability arrangements. These changes require an entity to measure those joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. The total amount of the obligation is determined as the sum of (i) the amount the reporting entity agreed to pay on the basis of its arrangement with its co-obligors, and (ii) any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance also requires an entity to disclose the nature and amount of the obligation as well as other information about the obligation. Examples of obligations subject to these requirements include debt arrangements, settled litigation and judicial rulings. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, with early adoption permitted. The implementation of the amended accounting guidance on January 1, 2014 did not have an impact on our consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements (Unaudited)—(Continued)

In March 2013, the FASB issued amendments to address the accounting for the cumulative translation adjustment when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The amendments are effective prospectively for fiscal years, and interim reporting periods within those years, beginning after December 15, 2013, with early adoption permitted. The initial adoption on January 1, 2014 did not have an impact on our consolidated financial statements.

Issued

In April 2014, the FASB issued changes to the criteria for determining which disposals are required to be presented as discontinued operations. The changes require a disposal of a component of an entity or a group of components of an entity to be reported in discontinued operations if the disposal represents a strategic shift that has, or will have, a major effect on an entity's operations and financial results when any of the following occurs: (i) the component of an entity or group of components of an entity meets the criteria to be classified as held for sale, (ii) the component of an entity or group or components of an entity is disposed of by sale, or (iii) the component of an entity or group of components of an entity is disposed of other than by sale. The amendments apply on a prospective basis to disposals of components of an entity that occur within annual periods beginning on or after December 15, 2014 and interim periods within those years, with early adoption permitted. The implementation of the amended accounting guidance on January 1, 2015 is not expected to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued a new revenue recognition standard, superseding previous revenue recognition guidance. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard will be effective for the first interim period within annual periods beginning after December 15, 2016, with no early adoption permitted, and can be adopted either retrospectively to each prior reporting period presented or as a cumulative effect adjustment as of the date of adoption. The Company is evaluating the impact that adopting this guidance will have on its consolidated financial statements.

In August 2014, the FASB issued new guidance related to disclosures around going concern, including management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related disclosures when conditions or events raise substantial doubt about an entity's ability to continue as a going concern. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted. The impact of adopting this guidance on January 1, 2017 is not expected to have a material impact on our consolidated financial statements.

2. RESTRUCTURING PLAN

On July 29, 2014, we announced a restructuring plan to strategically reallocate resources so that we can focus on our highest growth, highest margin opportunities in the software-driven consumer transaction technologies industry. The program is centered on ensuring that our people and processes are aligned with our continued transformation and includes: rationalizing our product portfolio to eliminate overlap and redundancy; taking steps to end-of-life older commodity product lines that are costly to maintain and provide low margins; moving lower productivity services positions to our new centers of excellence due to the positive impact of services innovation; and reducing layers of management and organizing around divisions to improve decision-making, accountability and strategic execution.

As a result of the restructuring plan, the Company recorded a total charge of $130 million in the three and nine months ended September 30, 2014. Of the total charge, the Company recorded $55 million for inventory related charges of which $9 million is included in Cost of products and $46 million is included in Cost of services; $65 million for severance and other employee related costs which is included in Restructuring-related charges; $8 million for asset related charges of which $5 million is included in Restructuring-related charges and $3 million is included in Other expense, net; and $2 million for other exit costs which is included in Restructuring-related charges. The Company expects to achieve annualized run-rate savings of approximately $90 million beginning in 2016. The Company expects that it may identify additional restructuring-related opportunities in connection with this restructuring plan, and may incur additional charges through 2015 related to such additional opportunities. Such additional charges are not reasonably estimable at this time as the Company is in the process of defining the nature and scope of these additional opportunities and quantifying the impact thereof.

Severance and other employee related costs Of the $65 million recorded, $61 million was recorded as a discrete cost in accordance with ASC 712, Employers' Accounting for Postemployment Benefits, when the severance liability was determined to be probable and reasonably estimable. The remaining $4 million of employee related costs was recorded in accordance with ASC 420, Exit or

Disposal Cost Obligations. The Company made $7 million and $2 million in severance-related payments under ASC 712 and ASC 420, respectively, related to the restructuring plan in the three and nine months ended September 30, 2014.

Inventory related charges The Company recorded $55 million of inventory related charges for rationalizing its product portfolio to eliminate overlap and redundancy and end-of-lifeing older commodity product lines that are costly to maintain and provide low margins.

Asset related charges The Company recorded $8 million for asset related charges, which includes $5 million for the write-off of certain internal and external use capitalized software for projects where the Company has redirected resources to highest growth opportunities and abandoned certain projects. Additionally, the charge includes a $3 million other than temporary impairment for an investment that is no longer considered strategic. See Note 13, “Fair Value of Assets and Liabilities,” for additional information.

Other exit costs The Company recorded $2 million for lease and other contract termination costs.

The results by segment, as disclosed in Note 14, "Segment Information," exclude the impact of these costs, which is consistent with the manner by which management assesses the performance and evaluates the results of each segment. The following table summarizes the costs recorded in accordance with ASC 420, Exit or Disposal Cost Obligations, and ASC 712, Employers’ Accounting for Postemployment Benefits, and the remaining liabilities as of September 30, 2014, which are included in the consolidated balance sheet in other current liabilities.

In millions	2014
Employee Severance and Other Exist Costs	
Beginning balance as of January 1	$—
Cost recognized during the period	67
Utilization	(9)
Ending balance as of September 30	$58

3. SUPPLEMENTAL FINANCIAL INFORMATION

The components of accounts receivable are summarized as follows:

In millions	September 30, 2014	December 31, 2013
Accounts receivable		
Trade	$1,431	$1,318
Other	41	39
Accounts receivable, gross	1,472	1,357
Less: allowance for doubtful accounts	(18)	(18)
Total accounts receivable, net	$1,454	$1,339

The components of inventory are summarized as follows:

In millions	September 30, 2014	December 31, 2013
Inventories		
Work in process and raw materials	$161	$135
Finished goods	215	202
Service parts	401	453
Total inventories	$777	$790

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The components of other current assets are summarized as follows:

In millions	September 30, 2014	December 31, 2013
Other current assets		
Current deferred tax assets	$295	$262
Other	262	306
Total other current assets	$557	$568

4. ACQUISITIONS

Acquisition of Digital Insight Corporation On January 10, 2014, NCR completed its acquisition of Digital Insight Corporation, for which it paid an aggregate purchase price of approximately $1,648 million, which includes $5 million that was withheld by the Company as a source of recovery for possible claims pursuant to the acquisition agreement and was paid to the sellers in the third quarter of 2014 pursuant to the terms of such agreement. The purchase price was paid from the net proceeds of the December 2013 offer and sale of NCR's 5.875% and 6.375% senior unsecured notes and borrowings under NCR's senior secured credit facility, including borrowings under the Company's December 2013 incremental facility agreement. As a result of the acquisition, Digital Insight became a wholly owned subsidiary of NCR.

Digital Insight