

XEROX CORP
Form 10-Q
October 29, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: September 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)

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

| | |
|-----------------------------|--|
| Class | Outstanding at September 30, 2010 |
| Common Stock, \$1 par value | 1,387,197,214 shares |

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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 relate to us, 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 quarters ended March 31, 2010 and June 30, 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.

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XEROX CORPORATION

FORM 10-Q

September 30, 2010

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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 September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------------|------------------------------------|----------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues | | | | |
| Sales | \$ 1,700 | \$ 1,555 | \$ 5,169 | \$ 4,651 |
| Service, outsourcing and rentals | 3,567 | 1,942 | 9,990 | 5,773 |
| Finance income | 161 | 178 | 498 | 536 |
| Total Revenues | 5,428 | 3,675 | 15,657 | 10,960 |
| Costs and Expenses | | | | |
| Cost of sales | 1,127 | 1,031 | 3,381 | 3,100 |
| Cost of service, outsourcing and rentals | 2,417 | 1,113 | 6,647 | 3,313 |
| Equipment financing interest | 61 | 67 | 186 | 204 |
| Research, development and engineering expenses | 189 | 209 | 588 | 615 |
| Selling, administrative and general expenses | 1,136 | 1,007 | 3,398 | 3,024 |
| Restructuring and asset impairment charges | 4 | (2) | 210 | (5) |
| Acquisition-related costs | 5 | 9 | 68 | 9 |
| Amortization of intangible assets | 85 | 15 | 227 | 44 |
| Other expenses, net | 76 | 68 | 314 | 223 |
| Total Costs and Expenses | 5,100 | 3,517 | 15,019 | 10,527 |
| Income before Income Taxes and Equity Income | 328 | 158 | 638 | 433 |
| Income tax expense | 98 | 44 | 232 | 122 |
| Equity in net income of unconsolidated affiliates | 26 | 15 | 52 | 14 |
| Net Income | 256 | 129 | 458 | 325 |
| Less: Net income attributable to noncontrolling interests | 6 | 6 | 23 | 20 |
| Net Income Attributable to Xerox | \$ 250 | \$ 123 | \$ 435 | \$ 305 |
| Basic Earnings per Share | \$ 0.18 | \$ 0.14 | \$ 0.32 | \$ 0.35 |
| Diluted Earnings per Share | \$ 0.17 | \$ 0.14 | \$ 0.32 | \$ 0.35 |

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) | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| Assets | | |
| Cash and cash equivalents | \$ 975 | \$ 3,799 |
| Accounts receivable, net | 3,172 | 1,702 |
| Billed portion of finance receivables, net | 214 | 226 |
| Finance receivables, net | 2,249 | 2,396 |
| Inventories | 1,177 | 900 |
| Other current assets | 1,110 | 708 |
| Total current assets | 8,897 | 9,731 |
| Finance receivables due after one year, net | 4,099 | 4,405 |
| Equipment on operating leases, net | 515 | 551 |
| Land, buildings and equipment, net | 1,660 | 1,309 |
| Investments in affiliates, at equity | 1,256 | 1,056 |
| Intangible assets, net | 3,447 | 598 |
| Goodwill | 8,613 | 3,422 |
| Deferred tax assets, long-term | 565 | 1,640 |
| Other long-term assets | 1,795 | 1,320 |
| Total Assets | \$ 30,847 | \$ 24,032 |
| Liabilities and Equity | | |
| Short-term debt and current portion of long-term debt | \$ 1,636 | \$ 988 |
| Accounts payable | 1,762 | 1,451 |
| Accrued compensation and benefits costs | 898 | 695 |
| Other current liabilities | 1,948 | 1,327 |
| Total current liabilities | 6,244 | 4,461 |
| Long-term debt | 7,860 | 8,276 |
| Liability to subsidiary trust issuing preferred securities | 649 | 649 |
| Pension and other benefit liabilities | 1,974 | 1,884 |
| Post-retirement medical benefits | 947 | 999 |
| Other long-term liabilities | 768 | 572 |
| Total Liabilities | 18,442 | 16,841 |
| Series A Convertible Preferred Stock | 349 | |
| Common stock | 1,388 | 871 |
| Additional paid-in capital | 6,479 | 2,493 |
| Retained earnings | 5,912 | 5,674 |
| Accumulated other comprehensive loss | (1,871) | (1,988) |
| Xerox shareholders' equity | 11,908 | 7,050 |
| Noncontrolling interests | 148 | 141 |

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|--|-----------|-----------|
| Total Equity | 12,056 | 7,191 |
| Total Liabilities and Equity | \$ 30,847 | \$ 24,032 |
| Shares of common stock issued and outstanding | 1,387,197 | 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 September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Cash Flows from Operating Activities: | | | | |
| Net income | \$ 256 | \$ 129 | \$ 458 | \$ 325 |
| Adjustments required to reconcile net income to cash flows from operating activities: | | | | |
| Depreciation and amortization | 284 | 176 | 804 | 513 |
| Provision for receivables | 48 | 61 | 141 | 207 |
| Provision for inventory | 7 | 15 | 24 | 44 |
| Net gain on sales of businesses and assets | (15) | (6) | (16) | (15) |
| Undistributed equity in net income of unconsolidated affiliates | (26) | (12) | (35) | (6) |
| Stock-based compensation | 29 | 23 | 86 | 54 |
| Provision for litigation, net | | | 36 | |
| Payments for litigation, net | | | (36) | (28) |
| Restructuring and asset impairment charges | 4 | (2) | 210 | (5) |
| Payments for restructurings | (54) | (66) | (148) | (231) |
| Contributions to pension benefit plans | (142) | (38) | (205) | (97) |
| (Increase) decrease in accounts receivable and billed portion of finance receivables | (183) | 5 | (318) | 310 |
| Collections of deferred proceeds from sales of receivables | 73 | | 115 | |
| (Increase) decrease in inventories | (113) | 77 | (311) | 159 |
| Increase in equipment on operating leases | (72) | (58) | (194) | (185) |
| Decrease in finance receivables | 69 | 116 | 270 | 347 |
| (Increase) decrease in other current and long-term assets | (56) | 17 | (43) | 61 |
| Increase (decrease) in accounts payable and accrued compensation | 134 | 138 | 321 | (135) |
| (Decrease) increase in other current and long-term liabilities | (4) | 9 | (70) | (129) |
| Net change in income tax assets and liabilities | 76 | 26 | 183 | 60 |
| Net change in derivative assets and liabilities | 73 | 22 | 69 | (46) |
| Other operating, net | (22) | (22) | 78 | 38 |
| Net cash provided by operating activities | 366 | 610 | 1,419 | 1,241 |
| Cash Flows from Investing Activities: | | | | |
| Cost of additions to land, buildings and equipment | (100) | (21) | (234) | (69) |
| Proceeds from sales of land, buildings and equipment | 15 | 7 | 40 | 16 |
| Cost of additions to internal use software | (45) | (19) | (114) | (75) |
| Acquisitions, net of cash acquired | (146) | | (1,674) | (145) |
| Net change in escrow and other restricted investments | 13 | 1 | 19 | (2) |
| Other investing, net | (3) | 1 | 1 | 1 |
| Net cash used in investing activities | (266) | (31) | (1,962) | (274) |
| Cash Flows from Financing Activities: | | | | |
| Net payments on secured financings | (3) | (10) | (6) | (50) |
| Net payments on other debt | (147) | (605) | (2,182) | (871) |
| Common stock dividends | (59) | (37) | (156) | (112) |
| Preferred stock dividends | (6) | | (9) | |
| Proceeds from issuances of common stock | 3 | 1 | 120 | 1 |
| Repurchases related to stock-based compensation | (12) | | (14) | (11) |
| Excess tax benefits from stock-based compensation | 2 | | 12 | |
| Other financing | (9) | (3) | (18) | (11) |

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|--|---------------|-----------------|---------------|-----------------|
| Net cash used in financing activities | (231) | (654) | (2,253) | (1,054) |
| Effect of exchange rate changes on cash and cash equivalents | 24 | 13 | (28) | 17 |
| Decrease in cash and cash equivalents | (107) | (62) | (2,824) | (70) |
| Cash and cash equivalents at beginning of period | 1,082 | 1,221 | 3,799 | 1,229 |
| Cash and Cash Equivalents at End of Period | \$ 975 | \$ 1,159 | \$ 975 | \$ 1,159 |

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

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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 context 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 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.

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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 includes 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.

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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 guidance as outlined below.

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.

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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 most of 2010, the ability to obtain U.S. Dollars has been severely restricted. As a result, starting in the second quarter, we began to re-measure our net Bolivar denominated monetary transactions based on rates available in alternative markets including the Transaction System for Foreign Currency Denominated Securities (SITME). The average rate in the third quarter of 2010 was approximately 6.02 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 because 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. 2010-26. Other than those ASUs 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.

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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 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 products and supplies, as well as the associated technical service and financing of those 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)

Business Process Outsourcing

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.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------|-------------------------------------|---------------|------------------------------------|-----------------|
| | Revenue | Profit (Loss) | Revenue | Profit (Loss) |
| 2010 | | | | |
| Technology | \$ 2,466 | \$ 247 | \$ 7,504 | \$ 753 |
| Services | 2,554 | 286 | 6,926 | 808 |
| Other | 408 | (79) | 1,227 | (276) |
| Total | \$ 5,428 | \$ 454 | \$ 15,657 | \$ 1,285 |
| 2009 | | | | |
| Technology | \$ 2,399 | \$ 234 | \$ 7,210 | \$ 648 |
| Services | 865 | 58 | 2,548 | 150 |
| Other | 411 | (88) | 1,202 | (263) |
| Total | \$ 3,675 | \$ 204 | \$ 10,960 | \$ 535 |

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|---------------|------------------------------------|---------------|
| | 2010 | 2009 | 2010 | 2009 |
| Reconciliation to Pre-tax Income | | | | |
| Segment Profit | \$ 454 | \$ 204 | \$ 1,285 | \$ 535 |
| Reconciling items: | | | | |
| Restructuring and asset impairment charges | (4) | 2 | (210) | 5 |
| Restructuring charges of Fuji Xerox | (6) | (9) | (33) | (40) |
| Acquisition-related costs | (5) | (9) | (68) | (9) |
| Amortization of intangible assets | (85) | (15) | (227) | (44) |
| Venezuelan devaluation costs | | | (21) | |
| ACS shareholders litigation settlement | | | (36) | |
| Equity in net income of unconsolidated affiliates | (26) | (15) | (52) | (14) |
| Pre-tax Income | \$ 328 | \$ 158 | \$ 638 | \$ 433 |

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 |

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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 |

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| | |
|-----------------------------|-----|
| Pension liabilities | 39 |
| Other long-term liabilities | 247 |

Net Assets Acquired \$ 6,512

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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) |

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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 approximately \$2.3 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;
finalization of estimates associated with the repatriation of earnings from ACS's foreign subsidiaries; and
allocation of goodwill among reporting units.

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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 | | Nine Months | |
|----------------------------|---------------------|----------|---------------------|-----------|
| | Ended September 30, | | Ended September 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Revenue | \$ 5,428 | \$ 5,343 | \$ 16,276 | \$ 15,915 |
| Net income Xerox | 250 | 181 | 421 | 500 |
| Basic earnings per-share | 0.18 | 0.13 | 0.29 | 0.35 |
| Diluted earnings per-share | 0.17 | 0.13 | 0.29 | 0.35 |

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 September 30, 2010.

Other Acquisitions:**TMS Health (TMS)**

In October 2010, ACS acquired TMS, a U.S. based teleservices company that provides customer care services to the pharmaceutical, biotech and healthcare industries, for approximately \$48 in cash. Through TMS, ACS will improve communication between pharmaceutical companies, physicians, consumers and pharmacists. By providing customer education, product sales and marketing, and clinical trial solutions, ACS builds on the IT and BPO services it already delivers to the healthcare and pharmaceutical industries.

Georgia Duplicating Products

In September 2010, GIS acquired Georgia Duplicating Products, an office equipment supplier, for approximately \$21 net of cash acquired. This acquisition furthers our strategy of supporting business customers across the U.S. with an expanding network of office technology providers. The operating results of Georgia Duplicating Products are not material to our financial statements and are 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.

ExcellerateHRO, LLP (EHRO)

In July 2010, ACS acquired EHRO, a global benefits administration and relocation services provider, for \$125 net of cash acquired. This acquisition establishes ACS as one of the world's largest pension plan administrators and as a leading provider of outsourced health and welfare and relocation services. The operating results of EHRO are not material to our financial statements and are primarily included within our Services segment from the date of acquisition. The purchase price was primarily allocated to intangible assets (consisting of customer relationships of \$34 and software of \$8) and goodwill of \$75 based on third-party valuations and management's estimates.

Irish Business Systems Limited

In January 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 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.

Table of Contents**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 \$108 at September 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 September 30, 2010. Accounts receivables sales were as follows:

| | Three Months | | Nine Months | |
|--|-----------------------------|--------|-----------------------------|--------|
| | Ended September 30, 2010 | 2009 | Ended September 30, 2010 | 2009 |
| Accounts receivable sales | \$ 574 | \$ 349 | \$ 1,586 | \$ 960 |
| Deferred proceeds | 97 | | 212 | |
| Fees associated with sales | 3 | 3 | 10 | 9 |
| Estimated (decrease) increase to operating cash flows ⁽¹⁾ | (11) | (34) | (81) | 98 |

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

Note 7 Inventories

The following is a summary of Inventories by major category:

| | September 30, 2010 | December 31, 2009 |
|--------------------------|-----------------------|----------------------|
| Finished goods | \$ 1,008 | \$ 772 |
| Work-in-process | 63 | 43 |
| Raw materials | 106 | 85 |
| Total Inventories | \$ 1,177 | \$ 900 |

Note 8 Investment in Affiliates, at Equity

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

| | Three Months | | Nine Months | |
|-------------------|-----------------------------|-------|-----------------------------|------|
| | Ended September 30, 2010 | 2009 | Ended September 30, 2010 | 2009 |
| Fuji Xerox | \$ 23 | \$ 13 | \$ 41 | \$ 6 |
| Other investments | 3 | 2 | 11 | 8 |

| | | | | |
|--|-------|-------|-------|-------|
| Total Equity in Net Income of Unconsolidated Affiliates | \$ 26 | \$ 15 | \$ 52 | \$ 14 |
|--|-------|-------|-------|-------|

Fuji Xerox

Equity in net income 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 for the nine months ended September 30, 2010 and 2009 includes after-tax restructuring charges of \$33 and \$40, respectively, primarily reflecting Fuji Xerox's continued cost-reduction initiatives.

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Condensed financial data of Fuji Xerox was as follows:

| | Three Months | | Nine Months | |
|---|-----------------------------|----------|-----------------------------|----------|
| | Ended September 30, 2010 | 2009 | Ended September 30, 2010 | 2009 |
| Summary of Operations: | | | | |
| Revenues | \$ 2,860 | \$ 2,442 | \$ 8,326 | \$ 7,364 |
| Costs and expenses | 2,655 | 2,363 | 7,894 | 7,331 |
| Income before income taxes | 205 | 79 | 432 | 33 |
| Income tax expense | 97 | 26 | 204 | |
| Net Income | 108 | 53 | 228 | 33 |
| Less: Net income noncontrolling interests | 1 | | 3 | |
| Net Income Fuji Xerox | \$ 107 | \$ 53 | \$ 225 | \$ 33 |
| Weighted Average Rate ⁽¹⁾ | 85.79 | 93.58 | 89.43 | 94.84 |

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

Note 9 Restructuring Programs

In 2010, we recorded \$210 of net restructuring and asset impairment charges, which included \$206 of severance costs related to headcount reductions of approximately 2,700 employees, lease termination and asset impairment charges of \$22 and \$18 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 50% were focused on gross margin improvements, 25% 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 \$120 in 2010 beyond the \$280 full year amount that was previously disclosed for actions and initiatives which have not yet been finalized. The additional restructuring is related to continued cost-reduction activities and acquisition synergies as well as to address the impact of adverse currency.

Information related to restructuring program activity during the nine months ended September 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 | 206 | 17 | 5 | 228 |
| Reversals of prior accruals | (14) | (4) | | (18) |
| Net current period charges ⁽²⁾ | 192 | 13 | 5 | 210 |
| Charges against reserve and currency | (139) | (9) | (5) | (153) |

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

| | Three Months Ended September 30, ⁽¹⁾ | | Nine Months Ended September 30, ⁽¹⁾ | |
|--|---|---------------|--|---------------|
| | 2010 | 2009 | 2010 | 2009 |
| Technology | \$ 2 | \$ | \$ 138 | \$ (4) |
| Services | 2 | (1) | 47 | (1) |
| Other | | (1) | 25 | |
| Total Net Restructuring Charges | \$ 4 | \$ (2) | \$ 210 | \$ (5) |

(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 September 30, | | Nine Months Ended September 30, | |
|---------------------------------|--|--------|---------------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Interest expense ⁽¹⁾ | \$ 148 | \$ 131 | \$ 454 | \$ 392 |
| Interest income ⁽²⁾ | 165 | 182 | 511 | 551 |

(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.

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

As of September 30, 2010 and December 31, 2009, pay variable/receive fixed interest rate swaps with notional amounts of \$950 and \$2,350 and net asset fair values of \$46 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 September 30, 2010:

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| Debt Instrument | Year First Designated | Notional Amount | Net Fair Value | Weighted Average Interest Rate Paid | Interest Rate Received | Basis | Maturity |
|-----------------------|-----------------------|-----------------|----------------|-------------------------------------|------------------------|-------|----------|
| Senior Notes due 2013 | 2009 | \$ 200 | \$ 7 | 3.91% | 5.65% | Libor | 2013 |
| Senior Notes due 2014 | 2009 | 350 | 16 | 6.06% | 8.25% | Libor | 2014 |
| Senior Notes due 2015 | 2010 | 300 | 18 | 1.71% | 4.25% | Libor | 2015 |
| Senior Notes due 2016 | 2009 | 100 | 5 | 3.96% | 6.40% | Libor | 2016 |
| Total | | \$ 950 | \$ 46 | | | | |

Terminated Swaps

During the nine months ended September 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 \$2,500. The fair value adjustment of \$(67) to the debt instruments, is being amortized to interest income over the remaining term of the related notes.

Table of Contents**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 and purchase option contracts, to hedge the following foreign currency exposures, thereby reducing volatility of earnings or protecting fair values of assets and liabilities:

Foreign currency-denominated assets and liabilities
Forecasted purchases and sales in foreign currency

Summary of Foreign Exchange Hedging Positions

At September 30, 2010, we had outstanding forward exchange and purchased option contracts with gross notional values of \$2,286, which is reflective of the amounts that are normally outstanding at any point during the year. These contracts generally mature in 12 months or less.

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

| | Gross Notional Value | Fair Value Asset (Liability) ⁽¹⁾ |
|---------------------------------------|----------------------------|---|
| Currency Hedged (Buy/Sell) | | |
| Euro/U.S. Dollar | \$ 421 | \$ 24 |
| Japanese Yen/Euro | 323 | (12) |
| Japanese Yen/U.S. Dollar | 280 | 6 |
| U.K. Pound Sterling/Euro | 262 | (5) |
| U.S. Dollar/Euro | 226 | (5) |
| Swiss Franc/Euro | 163 | (1) |
| Swedish Krona/Euro | 97 | 1 |
| Euro/U.K. Pound Sterling | 85 | 2 |
| U.K. Pound Sterling/Swiss Franc | 74 | (5) |
| Danish Krone/Euro | 59 | |
| All Other | 296 | 1 |
| Total Foreign Exchange Hedging | \$ 2,286 | \$ 6 |

(1) Represents the net receivable (payable) amount included in the Condensed Consolidated Balance Sheet at September 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. 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 zero and \$1 as of September 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 | September 30, 2010 | December 31, 2009 |
|--|------------------------------|-----------------------|----------------------|
| Derivatives Designated as Hedging Instruments | | | |
| Foreign exchange contracts forwards | Other current assets | \$ 8 | \$ 4 |
| Interest rate swaps | Other long-term assets | 46 | 10 |
| | Total Assets | \$ 54 | \$ 14 |
| Foreign exchange contracts forwards | Other current liabilities | \$ 8 | \$ 3 |
| Interest rate swaps | Other long-term liabilities | | 9 |
| | Total Liabilities | \$ 8 | \$ 12 |
| Derivatives NOT Designated as Hedging Instruments | | | |
| Foreign exchange contracts forwards | Other current assets | \$ 36 | \$ 12 |
| Foreign exchange contracts forwards | Other current liabilities | \$ 30 | \$ 12 |
| Summary of Derivatives | Total Derivative Assets | \$ 90 | \$ 26 |
| | Total Derivative Liabilities | 38 | 24 |
| | Total Net Derivative Asset | \$ 52 | \$ 2 |

Summary of Derivative Instruments Gains (Losses)

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

| Derivatives in Fair Value | Location of Gain (Loss) | Derivative Gain (Loss) Recognized in Income Three Months Ended September 30, | | Hedged Item Gain (Loss) Recognized in Income Three Months Ended September 30, | |
|---------------------------|-------------------------|--|-------|--|---------|
| | | 2010 | 2009 | 2010 | 2009 |
| Relationships | Recognized in Income | | | | |
| Interest rate contracts | Interest expense | \$ 35 | \$ 16 | \$ (35) | \$ (16) |

| Derivatives in Fair Value | Location of Gain (Loss) | Derivative Gain (Loss) Recognized in Income | Hedged Item Gain (Loss) Recognized in Income Nine Months |
|---------------------------|-------------------------|---|--|
| Relationships | Recognized in Income | | |

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| | | Nine Months Ended September 30, | | Ended September 30, | |
|-------------------------|------------------|------------------------------------|--------|---------------------|--------|
| Interest rate contracts | Interest expense | \$2103 | \$2009 | \$20163 | \$2009 |

| Derivatives in Cash Flow | Derivative Gain (Loss) Recognized in OCI (Effective Portion) | Three Months Ended September 30, | | Location of Derivative Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Gain (Loss) Reclassified from AOCI to Income (Effective Portion) | |
|-------------------------------------|--|-------------------------------------|------|--|---|--------|
| | | 2010 | 2009 | | 2010 | 2009 |
| Hedging Relationships | | | | | | |
| Interest rate contracts | \$ | \$ | 1 | Interest expense | \$ | \$ |
| Foreign exchange contracts forwards | (2) | 9 | | Cost of sales | 7 | (2) |
| Total Cash Flow Hedges | \$ (2) | \$ 10 | | | \$ 7 | \$ (2) |

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| Derivatives in Cash Flow | Derivative Gain (Loss) | | Location of Derivative | Gain (Loss) Reclassified | |
|-------------------------------------|------------------------|---------------|--------------------------|--------------------------|-------------|
| | Recognized in OCI | | Gain (Loss) Reclassified | from AOCI to | |
| | (Effective Portion) | | from AOCI into Income | Income | |
| | Nine Months | | | (Effective Portion) | |
| Hedging Relationships | Ended September 30, | | | Nine Months | |
| | 2010 | 2009 | (Effective Portion) | 2010 | 2009 |
| Interest rate contracts | \$ | \$ (1) | Interest expense | \$ | \$ |
| Foreign exchange contracts forwards | 23 | (1) | Cost of sales | 18 | 1 |
| Total Cash Flow Hedges | \$ 23 | \$ (2) | | \$ 18 | \$ 1 |

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 | | Nine Months | |
|---|------------------------------------|--------------------------|---------|--------------------------|-------|
| | | Ended September 30, 2010 | 2009 | Ended September 30, 2010 | 2009 |
| Foreign exchange contracts forwards | Other expense | \$ (2) | \$ (12) | \$ 87 | \$ 33 |

During the three months ended September 30, 2010 and 2009, we recorded Currency losses, net of \$0 and \$5, respectively. During the nine months ended September 30, 2010 and 2009, we recorded Currency losses, net of \$20 and \$26, respectively. Currency 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.

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 September 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 | \$ 44 | \$ | \$ 44 | \$ |
| Interest rate swaps | 46 | | 46 | |
| Deferred compensation investments in cash surrender life insurance | 66 | | 66 | |
| Deferred compensation investments in mutual funds | 28 | | 28 | |

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| | | | | | | |
|--------------|----|-----|----|----|-----|----|
| Total | \$ | 184 | \$ | \$ | 184 | \$ |
|--------------|----|-----|----|----|-----|----|

Liabilities:

| | | | | | | |
|--|----|----|----|----|----|----|
| Foreign exchange contracts-forwards | \$ | 38 | \$ | \$ | 38 | \$ |
| Deferred compensation plan liabilities | | 91 | | | 91 | |

| | | | | | | |
|--------------|----|-----|----|----|-----|----|
| Total | \$ | 129 | \$ | \$ | 129 | \$ |
|--------------|----|-----|----|----|-----|----|

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| | 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.

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:

| | September 30, 2010 | | December 31, 2009 | |
|--|--------------------|---------------|--------------------|---------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash and cash equivalents | \$ 975 | \$ 975 | \$ 3,799 | \$ 3,799 |
| Accounts receivable, net | 3,172 | 3,172 | 1,702 | 1,702 |
| Short-term debt | 1,636 | 1,684 | 988 | 1,004 |
| Long-term debt | 7,860 | 8,518 | 8,276 | 8,569 |
| Liability to subsidiary trust issuing preferred securities | 649 | 677 | 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.

Table of Contents**Note 13 Employee Benefit Plans**

The components of Net periodic benefit cost and Other changes in plan assets and benefit obligations were as follows:

| | Pension Benefits | | | | Retiree Health | | | |
|---|------------------------------------|--------------|-----------------------------------|---------------|------------------------------------|--------------|-----------------------------------|--------------|
| | Three Months Ended September 30 | | Nine Months Ended September 30 | | Three Months Ended September 30 | | Nine Months Ended September 30 | |
| | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 |
| Components of Net Periodic Benefit Costs: | | | | | | | | |
| Service cost | \$ 45 | \$ 44 | \$ 133 | \$ 129 | \$ 2 | \$ 1 | \$ 6 | \$ 5 |
| Interest cost | 119 | 128 | 357 | 371 | 13 | 15 | 41 | 46 |
| Expected return on plan assets | (118) | (132) | (354) | (382) | | | | |
| Recognized net actuarial loss | 18 | 6 | 53 | 18 | | | | |
| Amortization of prior service credit | (6) | (5) | (16) | (16) | (8) | (10) | (21) | (31) |
| Recognized settlement loss | 9 | 27 | 55 | 55 | | | | |
| Net periodic benefit cost | 67 | 68 | 228 | 175 | 7 | 6 | 26 | 20 |
| Other changes in plan assets and benefit obligations recognized in Other comprehensive income: | | | | | | | | |
| Net actuarial loss (gain) ⁽³⁾ | 43 | | 43 | | (9) | | (9) | |
| Prior service cost (credit) ⁽²⁾ | (17) | | (17) | | (31) | | (31) | |
| Amortization of net prior service credit | 6 | 5 | 16 | 16 | 8 | 10 | 21 | 31 |
| Amortization of net actuarial losses | (27) | (33) | (108) | (73) | | | | |
| Total recognized in Other comprehensive income⁽¹⁾ | 5 | (28) | (66) | (57) | (32) | 10 | (19) | 31 |
| Total recognized in Net periodic benefit cost and Other comprehensive income | \$ 72 | \$ 40 | \$ 162 | \$ 118 | \$ (25) | \$ 16 | \$ 7 | \$ 51 |

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

(2) As a result of a renegotiation of the contract with our largest union, we amended our union pension plan for this population to freeze the final average pay formula of the pension plan effective January 1, 2013 and our union retiree health benefits plan to eliminate a portion of the subsidy currently paid to current and future Medicare-eligible retirees effective January 1, 2011. These amendments are generally consistent with amendments previously made to our salaried employee retirement plans. We will have negotiations with other unions representing employees in these plans in 2011. The future income statement impact from these amendments is not material.

(3) Represents adjustments as a result of the plan amendments noted above as well as the actual valuation results based on January 1, 2010 plan census data for the U.S. and Canadian defined benefit plans and the U.S. retiree medical plan.

The following table provides a summary of the components of the Net change in benefit plans included within Other comprehensive income as reported in Note 14, Shareholders' Equity:

| (Expense)/benefit | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-------|------------------------------------|---------|
| | 2010 | 2009 | 2010 | 2009 |
| Other changes in plan assets and benefit obligations | \$ 27 | \$ 18 | \$ 85 | \$ (26) |
| Income tax | (9) | (7) | (31) | 12 |

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| | | | | |
|--|----------------|--------------|---------------|-----------------|
| Fuji Xerox changes in defined benefit plans ⁽¹⁾ | (1) | (12) | 32 | (43) |
| Currency, net | (39) | 17 | 14 | (83) |
| Other, net | 3 | | | |
| Net Change in Benefit Plans | \$ (19) | \$ 16 | \$ 100 | \$ (140) |

(1) Represents our share of Fuji Xerox's changes.

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During the nine months ended September 30, 2010, we made contributions of \$205 and \$67 to our pension plans and our other post-retirement benefit plans, respectively. We presently anticipate contributing an additional \$39 to our pension plans and \$30 to our other post-retirement benefit plans in 2010 for a total of \$244 for pension plans and \$97 for other post-retirement benefit plans.

Note 14 Shareholders Equity

| | 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 | | | 435 | | 435 | 23 | 458 |
| Translation adjustments | | | | 15 | 15 | | 15 |
| Changes in benefit plans ⁽²⁾ | | | | 100 | 100 | | 100 |
| Other unrealized gains, net | | | | 2 | 2 | | 2 |
| Comprehensive Income | | | | | \$ 552 | \$ 23 | \$ 575 |
| ACS Acquisition ⁽³⁾ | 490 | 3,825 | | | 4,315 | | 4,315 |
| Cash dividends declared common stock ⁽⁴⁾ | | | (182) | | (182) | | (182) |
| Cash dividends declared preferred stock ⁽⁵⁾ | | | (15) | | (15) | | (15) |
| Stock option and incentive plans | 27 | 167 | | | 194 | | 194 |
| Tax loss on stock option and incentive plans, net | | (6) | | | (6) | | (6) |
| Distributions to noncontrolling interests | | | | | | (16) | (16) |
| Balance at September 30, 2010 | \$ 1,388 | \$ 6,479 | \$ 5,912 | \$ (1,871) | \$ 11,908 | \$ 148 | \$ 12,056 |
| | 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 | | | 305 | | 305 | 20 | 325 |
| Translation adjustments | | | | 590 | 590 | | 590 |
| Net changes in benefit plans ⁽²⁾ | | | | (140) | (140) | | (140) |
| Other unrealized losses, net | | | | (1) | (1) | | (1) |
| Comprehensive Income | | | | | \$ 754 | \$ 20 | \$ 774 |
| Cash dividends declared common stock ⁽⁴⁾ | | | (114) | | (114) | | (114) |
| Stock option and incentive plans | 4 | 37 | | | 41 | | 41 |
| Tax loss on stock option and incentive plans, net | | (21) | | | (21) | | (21) |
| Distributions to noncontrolling interests | | | | | | (7) | (7) |
| Balance at September 30, 2009 | \$ 870 | \$ 2,463 | \$ 5,532 | \$ (1,967) | \$ 6,898 | \$ 133 | \$ 7,031 |

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- (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 and third quarters of 2010.

Table of Contents**Comprehensive Income**

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------------|------------------------------------|---------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income attributable to Xerox | \$ 250 | \$ 123 | \$ 435 | \$ 305 |
| Translation adjustments | 559 | 138 | 15 | 590 |
| Changes in benefit plans | (19) | 16 | 100 | (140) |
| Other unrealized (losses) gains, net | (8) | 8 | 2 | (1) |
| Comprehensive Income Xerox | 782 | 285 | 552 | 754 |
| Net income to noncontrolling interests | 6 | 6 | 23 | 20 |
| Translation adjustments noncontrolling interests | 1 | | | |
| Comprehensive Income Noncontrolling Interests | 7 | 6 | 23 | 20 |
| Total Comprehensive Income | \$ 789 | \$ 291 | \$ 575 | \$ 774 |

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 September 30, 2010 and December 31, 2009, respectively:

| | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Cumulative translation adjustments | \$ (785) | \$ (800) |
| Benefit plans net actuarial losses and prior service credits ⁽¹⁾ | (1,090) | (1,190) |
| Other unrealized gains, net | 4 | 2 |

| | | | | |
|---|----|---------|----|---------|
| Total Accumulated Other Comprehensive Loss | \$ | (1,871) | \$ | (1,988) |
|---|----|---------|----|---------|

(1) Includes our share of Fuji Xerox see Note 13 for additional information.

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 September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|---------|
| | 2010 | 2009 | 2010 | 2009 |
| Basic Earnings per Share: | | | | |
| Net income attributable to Xerox | \$ 250 | \$ 123 | \$ 435 | \$ 305 |
| Accrued dividends on preferred stock | (6) | | (15) | |
| Adjusted Net Income Available to Common Shareholders | \$ 244 | \$ 123 | \$ 420 | \$ 305 |
| Weighted-average common shares outstanding | 1,387,110 | 871,304 | 1,301,950 | 869,544 |
| Basic Earnings per Share | \$ 0.18 | \$ 0.14 | \$ 0.32 | \$ 0.35 |
| Diluted Earnings per Share: | | | | |
| Net income attributable to Xerox | \$ 250 | \$ 123 | \$ 435 | \$ 305 |
| Accrued dividends on preferred stock | (6) | | (15) | |
| Adjusted Net Income Available to Common Shareholders | \$ 244 | \$ 123 | \$ 420 | \$ 305 |
| Weighted-average common shares outstanding | 1,387,110 | 871,304 | 1,301,950 | 869,544 |
| Common shares issuable with respect to: | | | | |
| Stock options | 11,691 | 708 | 11,795 | 425 |
| Restricted stock and performance shares | 15,912 | 8,769 | 15,036 | 5,188 |
| Convertible securities | 1,992 | 1,992 | | |
| Adjusted Weighted Average Common Shares Outstanding | 1,416,705 | 882,773 | 1,328,781 | 875,157 |
| Diluted Earnings per Share | \$ 0.17 | \$ 0.14 | \$ 0.32 | \$ 0.35 |

The following represents total shares excluded from the computation of diluted earnings per share as a result of the treasury stock method for stock options, restricted stock and performance shares or the if-converted method for convertible securities (shares in thousands):

| | | | | |
|---|-----------|-----------|-----------|-----------|
| Stock options | 70,747 | 43,767 | 70,643 | 44,050 |
| Restricted stock and performance shares | 24,147 | 20,914 | 25,022 | 24,495 |
| Convertible preferred stock | 26,966 | | 26,966 | |
| Convertible securities | | | 1,992 | 1,992 |
| | 121,860 | 64,681 | 124,623 | 70,537 |
| Dividends per common share | \$ 0.0425 | \$ 0.0425 | \$ 0.1275 | \$ 0.1275 |

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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 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 \$1,254 and \$1,225 as of September 30, 2010 and December 31, 2009, respectively, with the increase primarily related to currency movement, partially offset by the favorable resolution of a large municipal service tax matter. 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 September 30, 2010 we had \$273 of escrow cash deposits for matters we are disputing, and there are liens on certain Brazilian assets with a net book value of \$19 and additional letters of credit of approximately \$157. 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.

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[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 refile. In February 2007, the Court granted the motion of the International Brotherhood of Electrical Workers Welfare Fund of Local 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. On November 6, 2008, the defendants filed a motion for summary judgment. Briefing with respect to the motion is complete. The Court has not yet rendered a decision. The parties also filed motions to exclude the testimony of certain expert witnesses. On April 22, 2009, the Court denied plaintiffs motions to exclude the testimony of two of defendants expert witnesses. On September 30, 2010, the Court denied plaintiffs motion to exclude the testimony of another of defendants expert witnesses. The Court also granted defendants motion to exclude the testimony of one of plaintiffs expert witnesses, and granted in part and denied in part defendants motion to exclude the testimony of plaintiffs two remaining expert witnesses. 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.

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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 Texas Actions did not admit to any wrongdoing as part of the Settlement, which provided 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 Delaware court approved the Settlement at a hearing held on August 24, 2010. The Settlement is now final. In light of the Delaware court's approval of the Settlement, on October 13, 2010, the Texas court signed an order dismissing the Texas action.

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 September 30, 2010, \$682 of our outstanding surety bonds and \$55 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.

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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 September 30, 2010, we serviced a FFEL portfolio of approximately 4 million loans with an outstanding principal balance of approximately \$52.5 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 September 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.

Note 17 Subsequent Event

In October 2010, we redeemed our \$550 7.625% Senior Notes due in 2013 and our \$25 6.00% Medium-term Notes due 2014. We incurred a loss on extinguishment of approximately \$15, representing the call premium of approximately \$7 on our Senior Notes as well as the write-off of unamortized debt costs of \$8. As a result, the Notes were included in short-term debt on the balance sheet at September 30, 2010.

On October 15, 2010 ACS acquired TMS Health, a U.S. based teleservices company that provides customer care services to the pharmaceutical, biotech and healthcare industries, for approximately \$48 in cash. Refer to Note 5 Acquisitions, for further information.

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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 Xerox 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 recover the impact of inflation and devaluation. 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 nine months ended September 30, 2010 reflected revenue growth and operational cost and expense improvements. We completed the acquisition of Affiliated Computer Services, Inc. (ACS) on February 5, 2010, and their results subsequent to that date through September 30, 2010 are included in our results. Total revenue of \$5.4 billion and \$15.7 billion for the three and nine months ended September 30, 2010, respectively, reflects an increase of 48% and 43%, respectively, from the prior year. Currency had a 2-percentage point unfavorable impact for the third quarter and had no impact for the nine months ended September 30, 2010. 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 September 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-forma³ basis, total revenue for the three and nine months ended September 30, 2010 increased 2% and 3%, respectively, with currency having a 2-percentage point unfavorable impact on the three month period and no impact on the nine month period.

Net income attributable to Xerox for the three and nine months ended September 30, 2010 was \$250 million and \$435 million, respectively, and included \$64 million and \$444 million, respectively, of after-tax costs and expenses related to restructuring, intangibles amortization, acquisition-related costs and other discrete and unusual items. Net income attributable to Xerox for the three and nine months ended September 30, 2009 was \$123 million and \$305 million, respectively, and included \$27 million and \$76 million, respectively, of similar after-tax costs and expenses.

Cash flow from operations was \$1.4 billion for the nine months ended September 30, 2010. Cash used in investing activities of \$2.0 billion primarily reflects the net cash consideration of \$1.5 billion for the ACS acquisition. Cash used in financing activities was \$2.3 billion primarily reflecting the repayment of ACS's debt of \$1.7 billion as well as net payments on other debt.

Table of Contents**Summary Results****Revenues**

| (in millions) | Three Months Ended September 30, | | | Pro-forma (3) % Change | % of Total Revenue | |
|----------------------------------|-------------------------------------|-----------------|------------|---------------------------|-----------------------|-------------|
| | 2010 | 2009 | % Change | | 2010 | 2009 |
| Revenue: | | | | | | |
| Equipment sales | \$ 907 | \$ 802 | 13% | 13% | 17% | 22% |
| Supplies, paper and other | 793 | 753 | 5% | 1% | 14% | 20% |
| Sales | 1,700 | 1,555 | 9% | 7% | 31% | 42% |
| Service, outsourcing and rentals | 3,567 | 1,942 | 84% | 1% | 66% | 53% |
| Finance income | 161 | 178 | (10)% | (10)% | 3% | 5% |
| Total Revenues | \$ 5,428 | \$ 3,675 | 48% | 2% | 100% | 100% |
| Segments: | | | | | | |
| Technology | \$ 2,466 | \$ 2,399 | 3% | 3% | 45% | 65% |
| Services | 2,554 | 865 | 195% | 2% | 47% | 24% |
| Other | 408 | 411 | (1)% | (1)% | 8% | 11% |
| Total Revenues | \$ 5,428 | \$ 3,675 | 48% | 2% | 100% | 100% |
| Memo: | | | | | | |
| Annuity Revenue ⁽¹⁾ | \$ 4,521 | \$ 2,873 | 57% | % | 83% | 78% |
| Color ⁽²⁾ | \$ 1,515 | \$ 1,411 | 7% | 7% | 28% | 38% |

| (in millions) | Nine Months Ended September 30, | | | Pro-forma ⁽³⁾ % Change | % of Total Revenue | |
|----------------------------------|------------------------------------|------------------|------------|--------------------------------------|-----------------------|-------------|
| | 2010 | 2009 | % Change | | 2010 | 2009 |
| Revenue: | | | | | | |
| Equipment sales | \$ 2,659 | \$ 2,400 | 11% | 11% | 17% | 22% |
| Supplies, paper and other | 2,510 | 2,251 | 12% | 7% | 16% | 20% |
| Sales | 5,169 | 4,651 | 11% | 9% | 33% | 42% |
| Service, outsourcing and rentals | 9,990 | 5,773 | 73% | 1% | 64% | 53% |
| Finance income | 498 | 536 | (7)% | (7)% | 3% | 5% |
| Total Revenues | \$ 15,657 | \$ 10,960 | 43% | 3% | 100% | 100% |
| Segments: | | | | | | |
| Technology | \$ 7,504 | \$ 7,210 | 4% | 4% | 48% | 66% |
| Services | 6,926 | 2,548 | 172% | 2% | 44% | 23% |
| Other | 1,227 | 1,202 | 2% | 2% | 8% | 11% |
| Total Revenues | \$ 15,657 | \$ 10,960 | 43% | 3% | 100% | 100% |

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| Memo | | | | | | |
|--------------------------------|-----------|----------|-----|----|-----|-----|
| Annuity Revenue ⁽¹⁾ | \$ 12,998 | \$ 8,560 | 52% | 1% | 83% | 78% |
| Color ⁽²⁾ | \$ 4,597 | \$ 4,232 | 9% | 9% | 29% | 39% |

Third quarter 2010 total revenues increased 48% compared to the third quarter 2009. Our consolidated 2010 results include the results of Affiliated Computer Services, Inc. (ACS). On a pro-forma³ basis, third quarter 2010 total revenue grew 2%. Currency had a 2-percentage point negative impact on total revenues in the quarter. Total revenues included the following:

57% increase in annuity revenue¹ or flat on a pro-forma³ basis. This included a 2-percentage point negative impact from currency. The components of annuity revenue were as follows:

- Service, outsourcing and rentals revenue of \$3,567 million increased 84% or 1% on a pro-forma³ basis, with a 1-percentage point negative impact from currency. Growth of 8% in Business Process Outsourcing revenue partially offset the decline in pages. The digital pages trend has stabilized at a 4% decline while color pages are growing at 9%.

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- Supplies, paper and other sales of \$793 million increased 5% or 1% on a pro-forma³ basis, with a 1-percentage point negative impact from currency. An increase in supplies revenue of 4% offset a decline in paper revenue.

13% 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%.

7% increase in color revenue², including a 3-percentage point negative impact from currency, reflects:

- 2% increase in color annuity revenue, including a 3-percentage point negative impact from currency. The increase was driven by higher color page volumes.
- 23% increase in color equipment sales revenue, including a 3-percentage point negative impact from currency. The increase was driven by strong installs of new products.

Total revenues for the nine months ended September 30, 2010 increased 43% 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-forma³ basis, total revenue for the nine months ended September 30, 2010 grew 3%. Currency had a negligible impact on total revenues. Total revenues included the following:

52% increase in annuity revenue¹, or 1% on a pro-forma³ basis and no impact from currency. The components of annuity revenue were as follows:

- Service, outsourcing and rentals revenue of \$9,990 million increased 73% or 1% on a pro-forma³ basis, with no impact from currency. This increase was driven by Business Process Outsourcing revenue that offset declines in technical service revenue driven by a continued but stabilizing decline in pages. Total digital pages declined 4% while color pages increased 9%.
- Supplies, paper and other sales of \$2,510 million increased 12% or 7% on a pro-forma³ basis, with no impact from currency. This growth was driven by supplies revenues which offset a decline in paper sales.

11% increase in equipment sales revenue including negligible impact from currency. Growth in install activity was partially offset by price declines of 5% to 10%.

9% increase in color revenue², including a negligible impact from currency and reflects:

- 6% increase in color annuity revenue, with no impact from currency. The increase was driven by higher printer supplies purchases and higher page volumes.
- 15% increase in color equipment sales revenue, including a 1-percentage point negative impact from currency. The increase was driven by higher installs of new products.

- (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 September 30 in 2009. See the Non-GAAP Financial Measures section for an explanation of these non-GAAP financial measures.

Net Income

Third quarter 2010 net income attributable to Xerox was \$250 million, or \$0.17 per diluted share. On an adjusted basis, net income attributable to Xerox was \$314 million, or \$0.22 per diluted share.

Third quarter 2009 net income attributable to Xerox was \$123 million, or \$0.14 per diluted share. On a comparable adjusted basis, net income attributable to Xerox was \$150 million, or \$0.17 per diluted share.

Net income attributable to Xerox for the nine months ended September 30, 2010 was \$435 million, or \$0.32 per diluted share. On an adjusted basis, net income attributable to Xerox was \$879 million, or \$0.65 per diluted share.

Net income attributable to Xerox for the nine months ended September 30, 2009 was \$305 million, or \$0.35 per diluted share. On a comparable adjusted basis, net income attributable to Xerox was \$381 million, or \$0.44 per diluted share.

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The adjustments to net income include:

| (in millions; except per share amounts) | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|--|-------------------------------------|---------|---------------|---------|------------------------------------|---------|---------------|---------|
| | 2010 | | 2009 | | 2010 | | 2009 | |
| | Net Income | EPS | Net Income | EPS | Net Income | EPS | Net Income | EPS |
| As Reported | \$ 250 | \$ 0.17 | \$ 123 | \$ 0.14 | \$ 435 | \$ 0.32 | \$ 305 | \$ 0.35 |
| Adjustments: | | | | | | | | |
| Xerox and Fuji Xerox restructuring charges | 8 | 0.01 | 9 | 0.01 | 177 | 0.13 | 40 | 0.05 |
| Acquisition-related costs | 3 | | 8 | 0.01 | 53 | 0.04 | 8 | 0.01 |
| Amortization of intangible assets | 53 | 0.04 | 10 | 0.01 | 141 | 0.10 | 28 | 0.03 |
| ACS shareholder litigation settlement | | | | | 36 | 0.03 | | |
| Venezuela devaluation costs | | | | | 21 | 0.02 | | |
| Medicare subsidy tax law change | | | | | 16 | 0.01 | | |
| | 64 | 0.05 | 27 | 0.03 | 444 | 0.33 | 76 | 0.09 |
| Adjusted | \$ 314 | \$ 0.22 | \$ 150 | \$ 0.17 | \$ 879 | \$ 0.65 | \$ 381 | \$ 0.44 |

Operations Review

| (in millions) | Three Months Ended September 30, Segment | | | Nine Months Ended September 30, Segment | | |
|-------------------------------------|--|------------------|-------------------|---|------------------|-------------------|
| | Total Revenue | Profit (Loss) | Segment Margin | Total Revenue | Profit (Loss) | Segment Margin |
| 2010 | | | | | | |
| Technology | \$ 2,466 | \$ 247 | 10.0% | \$ 7,504 | \$ 753 | 10.0% |
| Services | 2,554 | 286 | 11.2% | 6,926 | 808 | 11.7% |
| Other | 408 | (79) | (19.4)% | 1,227 | (276) | (22.5)% |
| Total | \$ 5,428 | \$ 454 | 8.4% | \$ 15,657 | \$ 1,285 | 8.2% |
| 2009 | | | | | | |
| Technology | \$ 2,399 | \$ 234 | 9.8% | \$ 7,210 | \$ 648 | 9.0% |
| Services | 865 | 58 | 6.7% | 2,548 | 150 | 5.9% |
| Other | 411 | (88) | (21.4)% | 1,202 | (263) | (21.9)% |
| Total | \$ 3,675 | \$ 204 | 5.6% | \$ 10,960 | \$ 535 | 4.9% |
| 2009 Pro-forma⁽¹⁾ | | | | | | |
| Technology | \$ 2,399 | \$ 234 | 9.8% | \$ 7,210 | \$ 648 | 9.0% |
| Services | 2,507 | 258 | 10.3% | 6,806 | 713 | 10.5% |
| Other | 411 | (117) | (28.5)% | 1,202 | (339) | (28.2)% |
| Total | \$ 5,317 | \$ 375 | 7.1% | \$ 15,218 | \$ 1,022 | 6.7% |

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- (1) Results are discussed primarily on a pro-forma basis and include ACS's estimated results from February 6 through September 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.

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 and business process outsourcing businesses 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.

Table of Contents**Technology**

Our Technology segment includes the sale of products and supplies, as well as the associated technical service and financing of those products.

Revenue

| (in millions) | Three Months | | | Nine Months | | |
|----------------------------------|-----------------------------|-----------------|-----------|-----------------------------|-----------------|-----------|
| | Ended September 30, 2010 | 2009 | Change | Ended September 30, 2010 | 2009 | Change |
| Equipment sales | \$ 805 | \$ 702 | 15% | \$ 2,351 | \$ 2,115 | 11% |
| Post sale revenue ⁽¹⁾ | 1,661 | 1,697 | (2)% | 5,153 | 5,095 | 1% |
| Total Revenue | \$ 2,466 | \$ 2,399 | 3% | \$ 7,504 | \$ 7,210 | 4% |

(1) Post sale revenue does not include outsourcing revenue which is reported in our Services segment.

Third quarter 2010 Technology revenue of \$2,466 million increased 3%, including a 2-percentage point negative impact from currency. Total revenues included the following:

15% increase in equipment sales revenue with a 2-percentage point negative impact from currency driven by growth across all product categories and geographical regions.

2% decrease in post sale revenue with a 2-percentage point negative impact from currency.

Technology revenue mix is 22% entry, 56% mid-range and 22% high-end.

Technology revenue for the nine months ended September 30, 2010 of \$7,504 million increased 4%, with negligible impact from currency. Total revenues included the following:

11% increase in equipment sales revenue with 1-percentage point negative impact from currency, driven by install growth across all product categories and geographical regions.

1% increase in post sale revenue with no impact from currency, driven primarily by growth in supplies in developing markets and sales to our OEM partners.

Technology revenue mix is 22% entry, 56% mid-range and 22% high-end.

Segment Profit

Third quarter 2010 Technology profit of \$247 million increased \$13 million from third quarter 2009. The increase in revenues and the lower cost and expense driven by restructuring more than offset the negative mix impact on gross profit from the increased percentage of equipment revenues.

Technology profit for the nine months ended September 30, 2010 of \$753 million increased \$105 million from prior year period, predominantly reflecting gross profit flow-through from higher revenue.

Installs**Entry**

Installs for the third quarter 2010:

65% increase in installs of A4 black-and-white multifunction devices driven by growth across all regions.

44% increase in installs of A4 color multifunction devices driven by strong growth across all regions.

13% increase in installs of color printers driven by higher sales of Xerox-branded products and sales to OEM partners.

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Installs for the nine months ended September 30, 2010:

- 57% 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.
- 4% increase in installs of color printers driven by higher sales of Xerox-branded products and sales to OEM partners.

Mid-Range

Installs for the third quarter 2010:

- 22% increase in installs of mid-range black-and-white devices driven by growth in our recently launched mid-range products.
- 47% increase in installs of mid-range color devices primarily driven by demand for new products, such as the WorkCentre® 7120 / 7700 and the continued strong demand for the ColorQube™ and Xerox 700.

Installs for the nine months ended September 30, 2010:

- 7% increase in installs of mid-range black-and-white devices driven by growth in our recently launched mid-range products.
- 30% increase in installs of mid-range color devices driven primarily by demand for new products, such as the ColorQube™, WorkCentre® 7435, Docucolor 250/252 and the continued strong demand for the Xerox 700.

High-End

Installs for the third quarter 2010:

- 2% increase in installs of high-end black-and-white systems.
- 54% increase in installs of high-end color systems, reflecting strong demand for the recently launched Xerox Color 800 and 1000.

Installs for the nine months ended September 30, 2010:

- 6% decrease in installs of high-end black-and-white systems, reflecting declines across most product segments.
- 31% 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. Entry , Mid-Range and High-End are defined 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 nine months ended September 30, 2010 increased 195% and 172%, respectively, and 393% and 439%, 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-forma² basis, with ACS's 2009 estimated results from February 6 through September 30 included in our historical 2009 results (See Non-GAAP Financial Measures section for a further explanation and discussion of this non-GAAP measure).

Revenue

Third quarter 2010 Services total revenue of \$2,554 million increased 195% or 2% on a pro-forma² basis and included a 1-percentage point negative impact from currency.

BPO revenue delivered pro-forma² revenue growth of 8% and represented 56% of total Services revenue. BPO growth was driven by healthcare services, customer care, financial services and healthcare payer services.

DO revenue decreased 5%, including a 2-percentage point negative currency impact, and represented 31% of total Services revenue. The decrease was due to lower equipment sales and the continued impact of the weak economy on usage levels.

ITO revenue decreased 2% on a pro-forma² basis and represented 13% of total Services revenue.

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Services total revenue for the nine months ended September 30, 2010 of \$6,926 million increased 172% or 2% on a pro-forma² basis. Currency had no impact on total revenues.

BPO revenue had strong pro-forma² revenue growth of 6% and represented 52% of total Services revenue. BPO growth was driven by healthcare services, customer care, financial services and healthcare payer services.

DO revenue decreased 3%, including no impact from currency, and represented 35% of total Services revenue.

ITO revenue on a pro-forma² basis declined 2% and represented 13% of total Services revenue.

On a normalized basis, which would include a full nine months of ACS results, we expect that BPO, DO and ITO would represent approximately 50%, 35% and 15% of Services revenue, respectively.

Segment Profit

Third quarter 2010 Services profit of \$286 million increased \$228 million, or \$28 million on a pro-forma² basis, from third quarter 2009 driven primarily by BPO revenue growth.

Services profit for the nine months ended September 30, 2010 of \$808 million increased \$658, or \$95 million on a pro-forma² 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 40% over the third quarter 2009. This 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 grew approximately 16% over the third quarter 2009. 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 an estimated \$3.0 billion in TCV for the third quarter. Combined with the previous three quarters, the trailing twelve month growth was 26% as compared to the comparable prior year period.

Signings were as follows:

| (in billions) | Three Months | Nine Months |
|-----------------------|-----------------------------|-----------------------------|
| | Ended September 30, 2010 | Ended September 30, 2010 |
| BPO | \$ 2.0 | \$ 7.7 |
| DO | 0.8 | 2.3 |
| ITO | 0.2 | 1.0 |
| Total Signings | \$ 3.0 | \$ 11.0 |

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
- Commercial healthcare
- Customer Care
- Electronic payment cards

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Enterprise Print Services in the U.S., Europe and the developing markets
Government Healthcare
Telecom and hardware services
Transportation

TCV represents the estimated future contract revenue for pipeline or Signings contracts.

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Other

Revenue

Third quarter 2010 Other revenue of \$408 million decreased 1%, including a 2-percentage point negative impact from currency. Increases in network integration and electronic presentation systems and Wide Format equipment sales offset a decline in paper sales and the impact of currency.

Other revenue for the nine months ended September 30, 2010 of \$1,227 million increased 2%, including negligible impact from currency. This increase was driven by GIS's network integration and electronic presentation systems and supplies sales partially offset by a decrease in paper sales.

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

Segment Profit

Third quarter 2010 Other loss of \$79 million improved \$9 million from third quarter 2009, driven primarily by higher gross profit reflecting an increase in gross margins as a result of the mix of revenues.

Other loss for the nine months ended September 30, 2010 of \$276 million increased \$13 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 | | | | Nine Months Ended | | | |
|----------------------------------|--------------------|--------------|------------------|---------------------------------|--------------------|--------------|------------------|---------------------------------|
| | September 30, 2010 | 2009 | Change | Pro-forma ⁽²⁾ Change | September 30, 2010 | 2009 | Change | Pro-forma ⁽²⁾ Change |
| Sales | 33.7% | 33.7% | pts | 0.6 pts | 34.6% | 33.3% | 1.3 pts | 1.6 pts |
| Service, outsourcing and rentals | 32.2% | 42.7% | (10.5) pts | (0.7) pts | 33.5% | 42.6% | (9.1) pts | (0.3) pts |
| Financing income | 62.1% | 62.4% | (0.3) pts | (0.3) pts | 62.7% | 61.9% | 0.8 pts | 0.8 pts |
| Total Gross Margin | 33.6% | 39.8% | (6.2) pts | (0.3) pts | 34.8% | 39.6% | (4.8) pts | 0.2 pts |

Note: Total gross margin decreased 6.2-percentage points and 4.8-percentage points and service, outsourcing and rentals margins decreased 10.5-percentage points and 9.1-percentage points for the three and nine months ended September 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 September 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 third quarter 2010 of 33.6% decreased 6.2-percentage points, or 0.3-percentage points on a pro-forma² basis, as compared to the third quarter 2009. Third quarter 2009 results included a benefit of 0.3-percentage points related to a favorable property tax adjustment in North America.

Total gross margin for the nine months ended September 30, 2010 of 34.8% decreased 4.8-percentage points, or increased 0.2-percentage points on a pro-forma² basis, as compared to the prior year comparable period and included a 0.1-percentage point benefit from the European duties refund. 2009 included a benefit of 0.1-percentage points related to a favorable property tax adjustment in North America.

Sales gross margin was flat, or increased 0.6-percentage points on a pro-forma² basis, as compared to the third quarter 2009. On a pro-forma basis, the positive impact of cost improvements more than offset the impact of price declines and unfavorable year-over-year transaction

currency.

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Sales gross margin for the nine months ended September 30, 2010 increased 1.3-percentage points, or 1.6-percentage points on a pro-forma² basis, as compared to the prior year period. Sales gross margin benefited from cost improvements, favorable product mix and the European duties refund, which more than offset the impact of price declines.

Service, outsourcing and rentals margin decreased 10.5-percentage points and 0.7 on a pro-forma² basis, as compared to the third quarter 2009. On a pro-forma basis, the positive impact of cost reductions was more than offset by negative mix, a third quarter 2009 favorable property tax adjustment in North America and the impact of unfavorable year-over-year transaction currency.

Service, outsourcing and rentals margin for the nine months ended September 30, 2010 decreased 9.1-percentage points, or 0.3-percentage points on a pro-forma² basis, as compared to the prior year period as price declines and mix were only partially offset by cost improvements.

Research, Development and Engineering Expenses (RD&E)

| (in millions) | Three Months Ended September 30, | | | Pro-forma ⁽²⁾ Change | Nine Months Ended September 30, | | | Pro-forma ⁽²⁾ Change |
|--------------------------------|----------------------------------|---------------|----------------|------------------------------------|---------------------------------|---------------|----------------|------------------------------------|
| | 2010 | 2009 | Change | | 2010 | 2009 | Change | |
| R&D | \$ 157 | \$ 175 | \$ (18) | \$ (18) | \$ 490 | \$ 522 | \$ (32) | \$ (32) |
| Sustaining engineering | 32 | 34 | (2) | (2) | 98 | 93 | 5 | 5 |
| Total RD&E Expenses | \$ 189 | \$ 209 | \$ (20) | \$ (20) | \$ 588 | \$ 615 | \$ (27) | \$ (27) |

RD&E % Revenue 3.5% 5.7% (2.2) pts (0.4) pts 3.8% 5.6% (1.8) pts (0.2) pts
RD&E of \$189 million and \$588 million for the three and nine months ended September 30, 2010, respectively was \$20 million and \$27 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 September 30, | | | Pro-forma ⁽²⁾ Change | Nine Months Ended September 30, | | | Pro-forma ⁽²⁾ Change |
|---------------|----------------------------------|----------|-----------|------------------------------------|---------------------------------|----------|-----------|------------------------------------|
| | 2010 | 2009 | Change | | 2010 | 2009 | Change | |
| Total SAG | \$ 1,136 | \$ 1,007 | \$ 129 | \$ (18) | \$ 3,398 | \$ 3,024 | \$ 374 | \$ 10 |
| SAG % Revenue | 20.9% | 27.4% | (6.5) pts | (0.8) pts | 21.7% | 27.6% | (5.9) pts | (0.6) pts |

Note: SAG as a percent of revenue for the third quarter 2010 and nine months ended September 30, 2010 decreased 6.5-percentage points and 5.9-percentage points, respectively, on an actual basis primarily due to the ACS acquisition. ACS, as a typical service 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 September 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 \$1,136 million in the third quarter 2010 were \$129 million higher, and \$18 million lower on a pro-forma² basis, than the third quarter 2009, including a \$18 million favorable impact from currency. The SAG expense increase reflects the following on a pro-forma basis:

\$32 million increase in selling expenses, reflecting increased demand generation and brand advertising and higher commissions partially offset by the benefits from restructuring and productivity improvements.

\$36 million decrease in general and administrative expenses, reflecting the benefits from restructuring and operational improvements.

\$14 million decrease in bad debt expenses to \$46 million, reflecting an improving write-off trend. 2010 third quarter bad debt expense continues to remain less than one percent of receivables.

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SAG expenses of \$3,398 million for the nine months ended September 30, 2010 were \$374 million higher than the prior year period, or \$10 million higher on a pro-forma² basis, both including an \$8 million unfavorable impact from currency. The pro-forma SAG expense increase reflects the following:

\$101 million increase in selling expenses reflecting increased demand generation brand advertising that offset the benefits from restructuring and productivity improvements.

\$28 million decrease in general and administrative expenses, reflecting benefits from restructuring and operational improvements.

\$63 million decrease in bad debt expenses to \$148 million, reflecting an improving write-off trend.

Restructuring and Asset Impairment Charges

During the third quarter 2010, we recorded an additional \$4 million of net restructuring and asset impairment charges, which included \$7 million of severance costs related to headcount reductions of approximately 100 employees for new actions primarily in North America and \$3 million of lease cancellations and asset impairment charges. These costs were partially offset by \$6 million of net reversals for changes in estimated reserves from prior period initiatives.

We recorded \$210 million of net restructuring and asset impairment charges for the nine months ended September 30, 2010, which included \$206 million of severance costs related to headcount reductions of approximately 2,700 employees, lease termination and asset impairment charges of \$22 million and \$18 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 50% were focused on gross margin improvements 25% 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 \$120 million in 2010 beyond the \$280 million full year amount that was previously disclosed for actions and initiatives which have not yet been finalized. The additional restructuring is related to continued cost-reduction activities and acquisition synergies as well as to address the impact of adverse currency.

The restructuring reserve balance as of September 30, 2010 for all programs was \$131 million, of which approximately \$114 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 \$5 million and \$68 million were incurred in the three and nine months ended September 30, 2010, respectively, in connection with our acquisition of ACS. These costs include \$1 million and \$54 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. 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, corporate communication services and consolidation of facilities.

Amortization of Intangible Assets

During the three and nine months ended September 30, 2010, we recorded \$85 million and \$227 million, respectively, of expense related to the amortization of intangible assets, which is \$70 million and \$183 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.

Table of Contents**Worldwide Employment**

Worldwide employment of 133,200 at September 30, 2010 increased approximately 79,600 from December 31, 2009, primarily due to additional headcount acquired as a result of the ACS acquisition.

Other Expenses, Net

| (in millions) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------------|--------------------|---------------|
| | September 30, 2010 | 2009 | September 30, 2010 | 2009 |
| Non-financing interest expense | \$ 87 | \$ 64 | \$ 268 | \$ 188 |
| Interest income | (4) | (4) | (13) | (15) |
| Gains on sales of businesses and assets | (15) | (6) | (16) | (15) |
| Currency losses, net | | 5 | 20 | 26 |
| ACS shareholders litigation settlement | | | 36 | |
| Litigation matters | 2 | 1 | 3 | 8 |
| All Other expenses, net | 6 | 8 | 16 | 31 |
| Total Other Expenses, Net | \$ 76 | \$ 68 | \$ 314 | \$ 223 |

Non-Financing Interest Expense: Non-financing interest expense for the three and nine months ended September 30, 2010 of \$87 million and \$268 million, respectively, was \$23 million and \$80 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.

Gains on Sales of Businesses and Assets: Third quarter 2010 gains on sales of businesses and assets of \$15 million was \$9 million higher than third quarter 2009 due to the sale of a facility in Latin America.

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 nine months ended September 30, 2010 decreased \$15 million driven in part by lower interest expense on the Brazil tax and labor contingencies.

Income Taxes

| (in millions) | Three Months Ended September 30, 2010 | | | Three Months Ended September 30, 2009 | | |
|--------------------|---------------------------------------|-------------|--------------------|---------------------------------------|--------------------|--------------------|
| | Pre-Tax Income | Tax Expense | Effective Tax Rate | Pre-Tax Income | Income Tax Expense | Effective Tax Rate |
| As Reported | \$ 328 | \$ 98 | 29.9% | \$ 158 | \$ 44 | 27.8% |

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| (in millions) | Nine Months Ended September 30, 2010 Income | | | Nine Months Ended September 30, 2009 | | |
|--|---|----------------|-----------------------|---|-----------------------|-----------------------|
| | Pre-Tax Income | Tax Expense | Effective Tax Rate | Pre-Tax Income | Income Tax Expense | Effective Tax Rate |
| As Reported | \$ 638 | \$ 232 | 36.4% | \$ 433 | \$ 122 | 28.2% |
| Adjustments: | | | | | | |
| Xerox restructuring charge | 210 | 66 | | | | |
| Acquisition-related costs | 68 | 15 | | 9 | 1 | |
| Amortization of intangible assets | 227 | 86 | | 44 | 16 | |
| Venezuela devaluation costs | 21 | | | | | |
| Medicare subsidy tax law change ⁽¹⁾ | | (16) | | | | |
| ACS shareholders litigation settlement | 36 | | | | | |
| Adjusted | \$ 1,200 | \$ 383 | 31.9% | \$ 486 | \$ 139 | 28.6% |

(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.

The effective tax rate for the three and nine months ended September 30, 2010 was 29.9% and 36.4%, respectively. On an adjusted basis the tax rate for the three and nine months ended September 30, 2010 was 31.8%³ and 31.9%³, respectively. The adjusted tax rate for the three and nine months was lower than the U.S. statutory rate primarily due to the net tax benefits from the geographical mix of income before taxes and the related tax rates in these jurisdictions as well as the settlement and re-measurement of certain previously unrecognized tax benefits. These benefits were partially offset by the incremental U.S. tax cost on foreign income.

The effective tax rate for the three and nine months ended September 30, 2009 was 27.8% and 28.2%, respectively, 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 adjusted effective tax rate for the fourth quarter of 2010 will be approximately 32%.

Equity in Net Income of Unconsolidated Affiliates

| (in millions) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------|------------------------------------|-------|
| | 2010 | 2009 | 2010 | 2009 |
| Total equity in net income of unconsolidated affiliates | \$ 26 | \$ 15 | \$ 52 | \$ 14 |
| Fuji Xerox after-tax restructuring costs ⁽¹⁾ | \$ 6 | \$ 9 | \$ 33 | \$ 40 |

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

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

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- (1) Post sale revenue does not include outsourcing revenue which is reported in our Services segment.
- (2) Results are discussed primarily on a pro-forma basis and include ACS's estimated results from February 6 through September 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.
- (3) See the Non-GAAP Financial Measures section for an explanation of this non-GAAP financial measure.

Table of Contents**Capital Resources and Liquidity****Cash Flow Analysis**

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

| (in millions) | Nine Months Ended September 30, | | Change |
|--|------------------------------------|-----------------|-----------------|
| | 2010 | 2009 | |
| Net cash provided by operating activities | \$ 1,419 | \$ 1,241 | \$ 178 |
| Net cash used in investing activities | (1,962) | (274) | (1,688) |
| Net cash used in financing activities | (2,253) | (1,054) | (1,199) |
| Effect of exchange rate changes on cash and cash equivalents | (28) | 17 | (45) |
| Decrease in cash and cash equivalents | (2,824) | (70) | (2,754) |
| Cash and cash equivalents at beginning of period | 3,799 | 1,229 | 2,570 |
| Cash and Cash Equivalents at End of Period | \$ 975 | \$ 1,159 | \$ (184) |

Cash Flows from Operating Activities

Net cash provided by operating activities was \$1,419 million in the nine months ended September 30, 2010 and includes approximately \$109 million of cash outflows for acquisition-related costs. The \$178 million increase in cash from the nine months ended September 30, 2009 was primarily due to the following:

- \$800 million increase in pre-tax income before depreciation and amortization, stock-based compensation, litigation, restructuring and the Venezuelan currency devaluation.
- \$456 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.
- \$115 million increase primarily from the early termination of certain interest rate swaps.
- \$83 million increase due to lower restructuring payments.
- \$513 million decrease due to an increase in accounts receivable of \$628 million reflecting higher revenues partially offset by collections of \$115 million of deferred proceeds from prior quarter sales of receivables.
- \$470 million decrease as a result of higher inventory levels reflecting increased activity.
- \$137 million decrease as a result of up-front costs and other customer related spending associated with services contracts.
- \$108 million decrease primarily due to contributions to our U.S. pension plans. No 2009 contributions were made to our U.S. pension plans due to the availability of prior years' credit balances.
- \$77 million decrease due to lower net run-off of finance receivables as a result of higher equipment sales revenue.

Cash Flows from Investing Activities

Net cash used in investing activities was \$1,962 million for the nine months ended September 30, 2010. The \$1,688 million increase in the use of cash from the nine months ended September 30, 2009 was primarily due to the following:

- \$1,529 million increase primarily due to the acquisitions of ACS for \$1,495 million, ExcellerateHRO, LLP for \$125 million, IBS for \$29 million and Georgia Duplicating Products for \$21 million in 2010, as compared to \$145 million for GIS's acquisition of ComDoc, Inc. in 2009.
- \$204 million increase 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

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Net cash used in financing activities was \$2,253 million for the nine months ended September 30, 2010. The \$1,199 million increase in the use of cash from the nine months ended September 30, 2009 was primarily due to the following:

\$1,311 million increase 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 \$87 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 \$602 million from borrowings under the Credit Facility. 2009 reflects the repayment of the 2009 Senior Notes of \$879 million, net payments of \$448 million for the two Zero Coupon Notes, net payments of \$246 million on the Credit Facility and net payments of \$48 million primarily for foreign short-term borrowings. These payments were partially offset by proceeds from the issuance of \$750 million in Senior Notes.

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\$119 million decrease 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.

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) | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Total Finance receivables, net ⁽¹⁾ | \$ 6,562 | \$ 7,027 |
| Equipment on operating leases, net | 515 | 551 |
| Total Finance Assets, net | \$ 7,077 | \$ 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 \$501 million in Total finance assets, net includes unfavorable currency of \$91 million.

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) | September 30, 2010 | December 31, 2009 |
|-------------------------------|-----------------------|----------------------|
| Financing debt ⁽¹⁾ | \$ 6,192 | \$ 6,631 |
| Core debt | 3,304 | 2,633 |
| Total Debt | \$ 9,496 | \$ 9,264 |

(1) Financing debt includes \$5,742 million and \$6,149 million as of September 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.

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

| (in millions) | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| Principal debt balance | \$ 9,248 | \$ 9,122 |
| Net unamortized discount | | (11) |
| Fair value adjustments | 248 | 153 |
| Total Debt | 9,496 | 9,264 |
| Less: Current maturities and short-term debt | (1,636) | (988) |
| Total Long-term Debt | \$ 7,860 | \$ 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:

| (in millions) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|--------|---------------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Accounts receivable sales | \$ 574 | \$ 349 | \$ 1,586 | \$ 960 |
| Deferred proceeds | 97 | | 212 | |
| Fees associated with sales | 3 | 3 | 10 | 9 |
| Estimated (decrease) increase to operating cash flows ⁽¹⁾ | (11) | (34) | (81) | 98 |

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

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

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.

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

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As of September 30, 2010, total cash and cash equivalents was \$975 million and our borrowing capacity under our Credit Facility was \$1.4 billion, reflecting \$602 million of outstanding borrowings and no letters of credit.

Cash flows from operations were \$1.4 billion for the nine months ended September 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. Cash flows from operations in 2008 included \$615 million in net payments for our securities litigation.

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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 |
|---------------------|-----------------|
| Q4 2010 | \$ 588 |
| 2011 | 1,057 |
| 2012 | 1,120 |
| 2013 | 1,010 |
| 2014 | 770 |
| 2015 | 1,251 |
| 2016 | 950 |
| 2017 | 501 |
| 2018 | 1,001 |
| 2019 and thereafter | 1,000 |
| Total | \$ 9,248 |

In October 2010, we redeemed our \$550 million 7.625% Senior Notes due in 2013 and our \$25 million 6.00% Medium-term Notes due 2014. We incurred a loss on extinguishment of approximately \$15 million representing the call premium of approximately \$7 million on our Senior Notes as well as the write-off of unamortized debt costs of \$8 million. As a result, the Notes were included in short-term debt on the balance sheet at September 30, 2010.

In October 2010, the Board approved a commercial paper program, thus enabling the Company to diversify its sources of liquidity.

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 September 30, 2010:

| (in millions) | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 and Thereafter | Total |
|--|---------------|---------------|---------------|---------------|--------------|---------------------------|-----------------|
| Contractual Cash Obligations: | | | | | | | |
| Long-term debt, including capital lease obligations ⁽¹⁾ | \$ 7 | \$ 27 | \$ 20 | \$ 8 | \$ 1 | \$ 251 | \$ 314 |
| Minimum operating lease commitments | 462 | 364 | 224 | 105 | 56 | 75 | 1,286 |
| Total Contractual Cash Obligations | \$ 469 | \$ 391 | \$ 244 | \$ 113 | \$ 57 | \$ 326 | \$ 1,600 |
| Other Commercial Commitments⁽²⁾: | | | | | | | |
| Surety bonds | \$ 307 | \$ 364 | \$ 5 | \$ 5 | \$ | \$ 1 | \$ 682 |
| Letters of credit | | 73 | | | | | 73 |
| Total Other Commercial Commitments | \$ 307 | \$ 437 | \$ 5 | \$ 5 | \$ | \$ 1 | \$ 755 |

(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.

Financial Risk Management

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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.

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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), and
Effective tax rate.

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

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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.

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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 (Q2); 2) Venezuela devaluation costs (Q1) and 3) Medicare subsidy tax law change (income tax effect only)(Q1). 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.

Net Income and EPS reconciliation:

| (in millions; except per share amounts) | Three Months Ended September 30, 2010 | | Three Months Ended September 30, 2009 | |
|--|--|---------|--|---------|
| | Net Income | EPS | Net Income | EPS |
| As Reported | \$ 250 | \$ 0.17 | \$ 123 | \$ 0.14 |
| Adjustments: | | | | |
| Xerox and Fuji Xerox restructuring charges | 8 | 0.01 | 9 | 0.01 |
| Acquisition-related costs | 3 | | 8 | 0.01 |
| Amortization of intangible assets | 53 | 0.04 | 10 | 0.01 |
| Adjusted | \$ 314 | \$ 0.22 | \$ 150 | \$ 0.17 |

Average shares for the calculation of adjusted EPS for the third quarter 2010 were 1,444 million and include 27 million of shares associated with the Series A convertible preferred stock. Accordingly, the quarterly dividends of \$6 million associated with those shares are excluded from adjusted net income. Each period we evaluate the dilutive effect of the Series A convertible preferred stock on an if-converted basis.

| (in millions; except per share amounts) | Nine Months Ended September 30, 2010 | | Nine Months Ended September 30, 2009 | |
|--|---|---------|---|---------|
| | Net Income | EPS | Net Income | EPS |
| As Reported | \$ 435 | \$ 0.32 | \$ 305 | \$ 0.35 |
| Adjustments: | | | | |
| Xerox and Fuji Xerox restructuring charges | 177 | 0.13 | 40 | 0.05 |
| Acquisition-related costs | 53 | 0.04 | 8 | 0.01 |
| Amortization of intangible assets | 141 | 0.10 | 28 | 0.03 |
| ACS shareholders litigation settlement | 36 | 0.03 | | |
| Venezuela devaluation costs | 21 | 0.02 | | |
| Medicare subsidy tax law change | 16 | 0.01 | | |
| Adjusted | \$ 879 | \$ 0.65 | \$ 381 | \$ 0.44 |

Average shares for the calculation of adjusted EPS for the 2010 year-to-date period were 1,355 million and include 24 million shares, which represents a pro-rata portion of the 27 million of shares associated with the Series A convertible preferred stock. Accordingly, the year-to-date dividends of \$15 million associated with those shares are excluded from adjusted net income. Each period we evaluate the dilutive effect of the Series A convertible preferred stock on an if-converted basis.

Table of Contents**Effective Tax reconciliation:**

| (in millions) | Three Months Ended September 30, 2010 | | | Three Months Ended September 30, 2009 | | |
|-----------------------------------|--|-----------------------|-----------------------|--|-----------------------|-----------------------|
| | Pre-Tax Income | Income Tax Expense | Effective Tax Rate | Pre-Tax Income | Income Tax Expense | Effective Tax Rate |
| As Reported | \$ 328 | \$ 98 | 29.9% | \$ 158 | \$ 44 | 27.8% |
| Adjustments: | | | | | | |
| Xerox restructuring charge | 4 | 2 | | | | |
| Acquisition-related costs | 5 | 2 | | 9 | 1 | |
| Amortization of intangible assets | 85 | 32 | | 15 | 5 | |
| Adjusted | \$ 422 | \$ 134 | 31.8% | \$ 182 | \$ 50 | 27.5% |

| (in millions) | Nine Months Ended September 30, 2010 | | | Nine Months Ended September 30, 2009 | | |
|--|---|-----------------------|-----------------------|---|-----------------------|-----------------------|
| | Pre-Tax Income | Income Tax Expense | Effective Tax Rate | Pre-Tax Income | Income Tax Expense | Effective Tax Rate |
| As Reported | \$ 638 | \$ 232 | 36.4% | \$ 433 | \$ 122 | 28.2% |
| Adjustments: | | | | | | |
| Xerox restructuring charge | 210 | 66 | | | | |
| Acquisition-related costs | 68 | 15 | | 9 | 1 | |
| Amortization of intangible assets | 227 | 86 | | 44 | 16 | |
| Venezuela devaluation costs | 21 | | | | | |
| Medicare subsidy tax law change | | (16) | | | | |
| ACS shareholders litigation settlement | 36 | | | | | |
| Adjusted | \$ 1,200 | \$ 383 | 31.9% | \$ 486 | \$ 139 | 28.6% |

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 September 30, 2009 in our reported 2009 results. We refer to comparisons against these adjusted 2009 results as pro-forma basis comparisons. ACS's 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.

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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:

| Total Xerox (in millions) | Three Months Ended September 30, | | | Change | Pro-forma Change |
|--------------------------------------|----------------------------------|------------------|-------------------------------|------------------|------------------|
| | As Reported 2010 | As Reported 2009 | Pro-forma 2009 ⁽¹⁾ | | |
| Revenue: | | | | | |
| Equipment sales | \$ 907 | \$ 802 | \$ 802 | 13% | 13% |
| Supplies, paper and other | 793 | 753 | 788 | 5% | 1% |
| Sales | 1,700 | 1,555 | 1,590 | 9% | 7% |
| Service, outsourcing and rentals | 3,567 | 1,942 | 3,549 | 84% | 1% |
| Finance income | 161 | 178 | 178 | (10)% | (10)% |
| Total Revenues | \$ 5,428 | \$ 3,675 | \$ 5,317 | 48% | 2% |
| Service, outsourcing and rentals | \$ 3,567 | \$ 1,942 | \$ 3,549 | 84% | 1% |
| Add: Finance income | 161 | 178 | 178 | | |
| Add: Supplies, paper and other sales | 793 | 753 | 788 | | |
| Annuity Revenue | \$ 4,521 | \$ 2,873 | \$ 4,515 | 57% | % |
| Gross Profit: | | | | | |
| Sales | \$ 573 | \$ 524 | \$ 527 | | |
| Service, outsourcing and rentals | 1,150 | 829 | 1,167 | | |
| Finance income | 100 | 111 | 111 | | |
| Total | \$ 1,823 | \$ 1,464 | \$ 1,805 | | |
| Gross Margin: | | | | | |
| Sales | 33.7% | 33.7% | 33.1% | pts | 0.6 pts |
| Service, outsourcing and rentals | 32.2% | 42.7% | 32.9% | (10.5) pts | (0.7) pts |
| Finance income | 62.1% | 62.4% | 62.4% | (0.3) pts | (0.3) pts |
| Total | 33.6% | 39.8% | 33.9% | (6.2) pts | (0.3) pts |
| RD&E | \$ 189 | \$ 209 | \$ 209 | | |
| RD&E % Revenue | 3.5% | 5.7% | 3.9% | (2.2) pts | (0.4) pts |
| SAG | \$ 1,136 | \$ 1,007 | \$ 1,154 | | |
| SAG % Revenue | 20.9% | 27.4% | 21.7% | (6.5) pts | (0.8) pts |

| Total Xerox (in millions) | Nine Months Ended September 30, | | | Change | Pro-forma Change |
|----------------------------------|---------------------------------|------------------|-------------------------------|--------|------------------|
| | As Reported 2010 | As Reported 2009 | Pro-forma 2009 ⁽¹⁾ | | |
| Revenue: | | | | | |
| Equipment sales | \$ 2,659 | \$ 2,400 | \$ 2,400 | 11% | 11% |
| Supplies, paper and other | 2,510 | 2,251 | 2,343 | 12% | 7% |
| Sales | 5,169 | 4,651 | 4,743 | 11% | 9% |
| Service, outsourcing and rentals | 9,990 | 5,773 | 9,939 | 73% | 1% |

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| | | | | | |
|--------------------------------------|------------------|------------------|------------------|------------|-----------|
| Finance income | 498 | 536 | 536 | (7)% | (7)% |
| Total Revenues | \$ 15,657 | \$ 10,960 | \$ 15,218 | 43% | 3% |
| Service, outsourcing and rentals | \$ 9,990 | \$ 5,773 | \$ 9,939 | 73% | 1% |
| Add: Finance income | 498 | 536 | 536 | | |
| Add: Supplies, paper and other sales | 2,510 | 2,251 | 2,343 | | |
| Annuity Revenue | \$ 12,998 | \$ 8,560 | \$ 12,818 | 52% | 1% |
| Gross Profit: | | | | | |
| Sales | \$ 1,788 | \$ 1,551 | \$ 1,566 | | |
| Service, outsourcing and rentals | 3,343 | 2,460 | 3,360 | | |
| Finance income | 312 | 332 | 332 | | |
| Total | \$ 5,443 | \$ 4,343 | \$ 5,258 | | |

Table of Contents**Gross Margin:**

| | | | | | |
|----------------------------------|----------|----------|----------|-------|-------|
| Sales | | | | 1.3 | 1.6 |
| | 34.6% | 33.3% | 33.0% | pts | pts |
| Service, outsourcing and rentals | | | | (9.1) | (0.3) |
| | 33.5% | 42.6% | 33.8% | pts | pts |
| Finance income | | | | 0.8 | 0.8 |
| | 62.7% | 61.9% | 61.9% | pts | pts |
| Total | | | | (4.8) | 0.2 |
| | 34.8% | 39.6% | 34.6% | pts | pts |
| RD&E | \$ 588 | \$ 615 | \$ 615 | | |
| RD&E % Revenue | | | | (1.8) | (0.2) |
| | 3.8% | 5.6% | 4.0% | pts | pts |
| SAG | \$ 3,398 | \$ 3,024 | \$ 3,388 | | |
| SAG % Revenue | | | | (5.9) | (0.6) |
| | 21.7% | 27.6% | 22.3% | pts | pts |

- (1) Pro-forma reflects ACS's 2009 estimated results from July 1 through September 30 for the three months and February 6 through September 30 for the nine months ended September 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:

| (in millions) | Three Months Ended September 30, | | | | |
|------------------------------------|----------------------------------|---------------------|----------------------------------|---------|---------------------|
| | As Reported 2010 | As Reported 2009 | Pro-forma 2009 ⁽¹⁾ | Change | Pro-forma Change |
| Document Outsourcing | \$ 796 | \$ 841 | \$ 841 | (5)% | (5)% |
| Business Processing Outsourcing | 1,424 | 24 | 1,318 | * | 8% |
| Information Technology Outsourcing | 341 | | 348 | * | (2)% |
| Less: Intra-Segment Eliminations | (7) | | | * | * |
| Total Revenue Services | \$ 2,554 | \$ 865 | \$ 2,507 | 195% | 2% |
| Segment Profit Services | \$ 286 | \$ 58 | \$ 258 | 393% | 11% |
| Segment Margin Services | 11.2% | 6.7% | 10.3% | 4.5 pts | 0.9 pts |

* Percent change not meaningful.

| (in millions) | Nine Months Ended September 30, | | | | |
|------------------------------------|---------------------------------|---------------------|----------------------------------|---------|---------------------|
| | As Reported 2010 | As Reported 2009 | Pro-forma 2009 ⁽¹⁾ | Change | Pro-forma Change |
| Document Outsourcing | \$ 2,407 | \$ 2,478 | \$ 2,478 | (3)% | (3)% |
| Business Processing Outsourcing | 3,634 | 70 | 3,421 | * | 6% |
| Information Technology Outsourcing | 892 | | 907 | * | (2)% |
| Less: Intra-Segment Eliminations | (7) | | | * | * |
| Total Revenue Services | \$ 6,926 | \$ 2,548 | \$ 6,806 | 172% | 2% |
| Segment Profit Services | \$ 808 | \$ 150 | \$ 713 | 439% | 13% |
| Segment Margin Services | 11.7% | 5.9% | 10.5% | 5.8 pts | 1.2 pts |

* Percent change not meaningful.

- (1) Pro-forma reflects ACS's 2009 estimated results from July 1 through September 30 for the three months and February 6 through September 30 for the nine months ended September 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.

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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.

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.

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 September 30, 2010, we had \$9.5 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 \$7.1 billion at September 30, 2010. The total cash and cash equivalents was \$975 million at September 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

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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.

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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 September 30, 2010, total cash and cash equivalents was \$975 million, and our borrowing capacity under our Credit Facility was \$1.4 billion, reflecting \$602 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 September 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 September 30, 2010

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

Semi-Annual Director Fees

- (a) Securities issued on July 15, 2010: Registrant issued 60,968 Deferred stock units (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.
- (c) The DSUs were issued at a deemed purchase price of \$8.53 per DSU (aggregate price \$520,057), based upon the market value of our Common stock on July 15, 2010, in payment of the semi-annual Directors' fees 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.

Dividend Equivalent

- (a) Securities issued on July 31, 2010: Registrant issued 1,849 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.
- (c) The DSUs were issued at a deemed purchase price of \$8.125 per DSU (aggregate price \$15,023), 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.

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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.

Table of Contents**(b) Issuer Purchases of Equity Securities during the Quarter ended September 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 third 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 September 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 |
|------------------------|-------------------------------------|---|---|--|
| July 1 through 31 | 1,541,612 | \$ 7.97 | n/a | n/a |
| August 1 through 31 | 217 | \$ 9.62 | n/a | n/a |
| September 1 through 30 | | | n/a | n/a |
| Total | 1,541,829 | | 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.

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.
- 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.

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| | |
|---------|--|
| 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. |

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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: October 29, 2010

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EXHIBIT INDEX

| | |
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