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NCR - Q3 2016 NCR Corp Earnings Call

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OVERVIEW:

Co. reported 3Q16 non-GAAP EPS of \$0.87. Expects 2016 revenue to be \$6.47-6.50b and non-GAAP EPS to be \$2.97-3.02. Expects 4Q16 adjusted constant currency revenue growth to be 8-10% and 4Q16 non-GAAP EPS to be \$1.01-1.06.



CORPORATE PARTICIPANTS

Michael Nelson *NCR Corporation - VP of IR*

Bill Nuti *NCR Corporation - Chairman, CEO and President*

Mark Benjamin *NCR Corporation - President and COO*

Bob Fishman *NCR Corporation - EVP, CFO and CAO*

Paul Langenbahn *NCR Corporation - SVP and President of Hospitality*

Michael Bayer *NCR Corporation - SVP and President of NCR Retail*

Andy Heyman *NCR Corporation - SVP and President of Financial Services*

CONFERENCE CALL PARTICIPANTS

Paul Coster *JPMorgan - Analyst*

Matt Summerville *Alembic Global Advisors - Analyst*

Dan Natoli *Oppenheimer & Co. - Analyst*

PRESENTATION

Operator

Good afternoon. My name is Ben and I will be your conference operator today. At this time, I would like to welcome everyone to the NCR Corporation's Q3 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions)

I would now like to turn the call over to Michael Nelson, Vice President of Investor Relations. Sir, you may begin your conference.

Michael Nelson - NCR Corporation - VP of IR

Good afternoon, and thank you for joining our third-quarter 2016 earnings call. Joining me on the call today are Bill Nuti, Chairman and Chief Executive Officer; Mark Benjamin, President and Chief Operating Officer; Bob Fishman, Chief Financial Officer; and Paul Langenbahn, Senior Vice President and President, Hospitality.

Before I turn the call over to Bill, let me remind you that our presentation and discussions today include forward-looking statements. Forward-looking statements reflect our current expectations and beliefs, but they are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. These risks and uncertainties are described in our earnings release and our periodic filings with the SEC, including our Annual Report.

On today's call, we will also be discussing certain non-GAAP financial measures. These non-GAAP measures are described and reconciled to their most directly comparable GAAP measures in today's presentation materials and on the Investor Relations section of our website. A replay of this call will be available later today on our website, NCR.com.

With that, I would now like to turn the call over to Bill.



Bill Nuti - *NCR Corporation - Chairman, CEO and President*

Thanks to all of you for joining us today. I'll start with some brief opening remarks. Bob will take you through the numbers and our guidance, and Paul Langenbahn will provide some color around solution revenue, key metrics, and market drivers.

Overall, NCR had a terrific Q3. In the 11 years since I've joined NCR, I have never felt better and more confident about our business. We entered the quarter with strong momentum. And through solid execution, we turned that momentum into healthy revenue growth across all of our business segments. The major highlights for the quarter included a 7% increase in software revenue, including software license growth of 26% and, impressively, [cloud] growth of 6%.

Subsidies grew 6% and hardware revenue was higher by 16%. We are seeing the volume growth that we predicted in prior quarters, with the main drivers of growth being omnichannel software, channel transformation, and digital enablement solutions. As expected, we also experienced solid operating margin expansion as a result of software revenue growth and improving productivity.

We were also pleased to see the expansion of our services margins in the quarter. Taken together, these results speak to the benefits of the diversity of our business, both in terms of software, services and hardware, as well as our leadership position in the expanding omnichannel market. The reality of how consumers interact and transact their business today is something that we saw coming many years ago.

Today NCR offers complete end-to-end solutions that help our customers address rapidly-changing consumer expectations and behavior, while helping them to increase revenue and lower their costs. The value we deliver to our customers, regardless of size or industry, has never been stronger. We recently announced strategic wins like Papa Murphy's, Weber's Department Stores, (inaudible) Federal Credit Union and Kohl's supermarkets are clear examples of these offers gaining traction across multiple industries.

As a result, I am particularly pleased that our higher profit outcome, coupled with our ongoing commitment to building a stronger and more efficient NCR, helped drive strong free cash flow results in the quarter and we remain on track to achieve our full-year 2016 free cash flow goals.

Lastly, NCR strengthened its executive leadership bench through the addition of Mark Benjamin as President and Chief Operating Officer. Mark has a great track record of results, is a well-known leader in the industry, and has vast experience with recurring revenue models, including cloud-based services. I'm excited about the value he can bring to both NCR and our customers, as we continue to build operating momentum and a keen focus on execution remains our top priority.

Now I'll turn the call over to Mark for a few words. Mark?

Mark Benjamin - *NCR Corporation - President and COO*

Thank you, Bill, for the kind words. I am truly honored to join NCR, a company with an incredible record of success, innovation, and vision that began nearly 135 years ago. NCR has built a unique platform through foresight, strategic focus, and a deep understanding of the many ways technology and consumer behavior is fundamentally changing the nature of transactions.

As I learn more about today's NCR, I was equally impressed with NCR leadership team's drive and focus to win in our market, our strategic focus on omnichannel, and our unwavering focus on NCR's associates and customers. I strongly believe in the service profit chain, which is defined as there being a strong and direct relationship between employee satisfaction, the customer loyalty, and to the ultimate profitability of the Company.

Simply stated, an engaged workforce will define our success measured by our customers and our shareholders. I have only been here for a couple of weeks, but already have seen many examples of the value of our solution, products and people bring to customers across all of our end markets and around the world.

The omnichannel market is here and is maturing, and NCR has built a strong leadership position. I'm looking forward to working with the entire NCR team as we leverage our innovative omnichannel software, channel transformation, and digital enablement capabilities and offerings, and execute against our long-term growth strategy.

Now I'll turn the call over to Bob, and he'll take you through the details of our Q3 results and guidance. Bob?

Bob Fishman - *NCR Corporation - EVP, CFO and CAO*

Thank you, Mark. Slide 4 shows our financial highlights for Q3. Revenue was up 10% on an adjusted constant currency basis. As a reminder, this is after normalizing for FX and the sale of our IPS business earlier this year. FX had a negative impact of only \$5 million in the quarter, while the sale of IPS had a \$79 million negative impact or 6%.

We were very pleased with our revenue performance in the quarter, which again came in over the top end of our guidance range. This was driven by strong performance in all three of our segments -- software, services, and hardware. Our recurring revenue was up 4% in constant currency and comprises 42% of our total revenue.

Looking at margins, Q3 non-GAAP gross margin was 29.3%, which was up 20 basis points on a constant currency basis. The improved margin rate was due to strong software revenue growth and improved productivity, especially in the services business. Q3 non-GAAP EPS was \$0.87, above the top end of our guidance, and increased 14% year-over-year constant currency.

We were especially pleased with free cash flow of \$153 million in the quarter, which improved \$47 million year-over-year due to improved cash from operations, and gives us confidence in achieving the full-year guidance.

Slide 5 shows our Q3 operational results on an as-reported and constant currency basis. Revenue was up 4% as reported, and 10% on an adjusted constant currency basis. We are using an adjusted constant currency measure throughout these documents to show revenue growth on a constant currency basis, and to reflect the sale of the interactive printer solutions business in May of 2016.

This creates an apples-to-apples comparison when comparing to the prior year. The one remaining piece of the IPS business in Middle East/Africa did not close as expected on September 30. We will continue to explore alternatives. And, as a reminder, this is a relatively small business, with revenue of approximately \$30 million per year. For Q3 and our calculation for adjusted constant currency revenue growth, we excluded \$79 million for Q3 2015 IPS revenue, which is included in our hardware segment.

We have included footnotes on the various slides to show the adjustments that were made in all periods. On a constant currency basis, operating income grew 10% in the quarter as a result of gross margin rate expansion of 20 basis points and improved productivity driving lower expenses as a percentage of revenue. The income tax rate was higher than in the prior year, due to favorable audit settlements in Q3 of 2015.

Non-GAAP EPS was up 12% as reported and up 14% on a constant currency basis, reflecting our strong performance in the third quarter. The next slide shows our Q3 GAAP results. The reconciling items include acquisition-related amortization of intangibles, acquisition-related costs, and restructuring transformation costs. For a reconciliation of non-GAAP to GAAP results, please refer to the supplementary materials at the end of this presentation.

Slide 7 shows our segment results for the third quarter. Software revenue was up 7%. Services revenue was up 6%, and hardware revenue was up 16%. The growth in software revenue drove an increase in operating income in the quarter, as the software segment is our highest gross margin business at 51%, and represents the largest component of our operating income at 64% of our total operating income.

The services revenue growth also contributed to the operating income due to productivity improvements and operating leverage. The hardware growth is consistent with the improved backlog in ATMs and self-checkout coming into the second half of this year. Much of this hardware is being driven by our focus on software, as customers continue to look for a comprehensive end-to-end omnichannel solution.

As a reminder, strong growth in software and hardware signals an increase in recurring revenue in future periods due to the attach of software and hardware maintenance contracts. Paul will discuss our segment results in greater detail later on in the call.

The next slide shows our revenue by region. In Q3 we saw 15% adjusted constant currency revenue growth in the Americas region, driven by growth in all segments. The Europe/Middle East/Africa region had 6% adjusted constant currency growth, which was driven by growth in the services and hardware segments. The Asia-Pacific region was relatively flat compared to the prior year.

On slide 9, you can see free cash flow for the quarter, which increased 44% year-over-year. Free cash flow was \$153 million in Q3 2016, up \$47 million from the prior year. With the significant increase in revenue in the back half of the year versus the first half of the year, we had plans for free cash flow to be more backend-loaded in 2016 than the prior year.

Our Q3 performance was better than expected, and positions us well to achieve our full-year guidance. We remain confident in our 2016 free cash flow guidance of \$425 million to \$475 million or approximately 95% of non-GAAP net income.

Slide 10 shows our net debt to EBITDA metric with a net debt leverage ratio of 2.8 times for Q3 2016, which is a significant improvement from the 3.1 times at Q2 2016. NCR remains committed to a balanced capital allocation strategy. As a reminder, we completed a \$250 million share repurchase in the first half of the year. And in the second half, we will use free cash flow to reduce our net debt balance.

On slide 11, you will find Q4 2016 guidance. Revenue growth will be up 8% to 10% adjusted constant currency. Hardware and software growth will continue to be significant in the quarter, with services roughly flat due to one-time implementation revenue in the prior year. Our non-GAAP EPS is expected to be \$1.01 to \$1.06 for the quarter.

At this point, we do not expect any impact from foreign currency. Our non-GAAP EPS will be up 16% at the midpoint of the range. The tax rate this year is expected to be 22% compared to 25% last year. Additionally, for Q4 2016, we have assumed OIE of approximately \$50 million and a share count of 157 million compared to IEO \$51 million and a share count of 175 million in Q4 2015. We expect to exit the year with strong backlog and positions ourselves well for 2017.

Slide 12 includes our full-year 2016 guidance. We are raising our revenue guidance to \$6.47 billion to \$6.5 billion, up from previous guidance of \$6.325 billion to \$6.4 billion. Revenue is now expected to be up 5% to 6% adjusted constant currency, which includes 1% of FX headwind. We are also raising our non-GAAP EPS to \$2.97 to \$3.02, up from previous guidance of \$2.90 to \$3. The operating income flow-through on the higher revenue is partially offset by higher expenses in the fourth quarter of 2016.

The expense increase is primarily due to lower employee-related expenses in the prior-year fourth quarter. The FX and pension headwind are still expected to be \$0.13. After adjusting for these two items, non-GAAP EPS growth for the year is expected to be 13% to 15%. As mentioned earlier, our free cash flow guidance remains unchanged at \$425 million to \$475 million.

For the 2016 guidance, we have assumed OIE of \$205 million to \$210 million, an effective tax rate of 25%, and a share count of 157 million compared to OIE of \$196 million, an effective tax rate of 23%, and a share count of 172 million in 2015.

Slide 13 shows our revenue guidance by segment for the full-year. We have increased our revenue guidance in all segments based on the strong Q3 revenue and the momentum we are experiencing coming into the fourth quarter. You can see on slide 14 our revenue, operating income, EPS and free cash flow trending over the last three years.

Using the midpoint of our guidance range, the implied guidance for the fourth quarter is in line with previous years. Fourth-quarter revenue represents 27% of the full-year and operating income represents 31% of the full-year. Both of these are consistent with previous periods. While EPS is slightly higher at 35% versus 31% to 32%, this is explained by an improved tax rate in the fourth quarter as well as the benefit of the share repurchases earlier in the year.

We remain confident in the full-year tax rate of 25%. The implied free cash flow percentage in the fourth quarter is much better than the three-year average, which gives us confidence in achieving our full-year objective. It is higher than the prior year, due to the revenue ramp in the back half of this year compared to last year.

I'll now turn the call over to Paul to go through the segments in more detail.

Paul Langenbahn - *NCR Corporation - SVP and President of Hospitality*

Thanks, Bob, and good afternoon, everyone. I'll start on slide 15, which offers an overview of NCR's strategic offers within the omnichannel market. While the omnichannel market continues to evolve, our early mover advantage, strategic foresight, and deepening understanding of the underlying market forces, continues to position us for success.

Our conversations with customers today are increasingly dominated by omnichannel not being a thing of the future but, instead, a daily reality that impacts their ability to compete and win share against a backdrop of disruptive competition, shifting consumer demands, and digital empowerment. NCR today is a leader in three key areas of the omnichannel market -- omnichannel software, channel transformation, and digital enablement.

Touching on each one briefly, omnichannel software consists of platform software and application solutions that offer competitive advantages to businesses. Those include the seamless integration of physical and digital channels, coupled with the ability to merge critical enterprise data that delivers tangible and actionable insights for both consumers and employees.

Our solutions here span multiple end-use markets and include Retail One for Retail, Customer Experience Platform, or CXP for Financial Services, Aloha Enterprise and Hospitality, and NCR Silver for small business. The second key area is channel transformation, which aligns changing consumer interaction and transaction preferences with our customers' physical and digital channels. The benefits of our solutions include increased productivity and revenue growth through a modernized omnichannel experience for consumers.

Our portfolio is robust and addresses customers of all sizes and segments across the banking, retail, hospitality, entertainment, and small business segments. It includes solutions comprised of NCR software and built-for-purpose edge hardware devices that transform physical channels like retail banking transformation solutions, featuring interactive teller software technology for financial services; self-checkout solution, featuring Fast Lane software for retail; and customer self-service kiosks for restaurants, theaters, and other venues.

It also includes solutions that transform and integrate through our omnichannel platform; digital channels, vis-a-vis solutions like mobile banking, mobile ordering and payment, and digital commerce. The last major area is digital enablement. This is where our solutions address the undeniable digital movement shaping the markets we serve.

Companies view the digital world as a means to eliminate cost by reducing their reliance on physical locations and labor-intensive means. NCR Solutions and Financial Services include remote deposit, loyalty, fraud prevention, and digital transaction processing. Our solutions in retail and hospitality include supply chain management, loyalty, secure payments, fraud prevention, and real-time actionable insights, just to name a few.

In small business, NCR offers a suite of SaaS-based digital enablement applications that address inventory management, labor, and workforce scheduling, security and fraud, as well as loyalty and promotions. An example of how NCR provides solutions across the three key areas of the omnichannel market -- omnichannel software, channel transformation and digital enablement -- and helps our customers transform their business, can be demonstrated by looking at the NCR solutions deployed by the fast-growing and award-winning fast casual restaurant chain, Papa Murphy's.

Papa Murphy's is a franchisor and operator of the largest take-and-bake pizza chain in the United States. NCR became the foundation for Papa Murphy's omnichannel strategy as the company implemented a common NCR point-of-sale software platform across its more than 1,500 stores, and leveraged our cloud-based omnichannel API ecosystem.

The seamless integration of our point-of-sale and omnichannel platform has enabled the company to create more points of interest through online and mobile ordering; offer unique marketing messages based on their customers' needs and ordering behavior; generate increased sales; and drive true value into their brand. Another example can be demonstrated by looking at NCR OPTIC -- Outdoor Payment Terminal Interactive Customer experience -- a new outdoor payment terminal for the petroleum and convenience retail market that allows merchants a consistent consumer experience across all pumps.

OPTIC is now live with several customers, including Speedway and Rutters. The NCR OPTIC solution offers a robust consumer experience on an open software platform for petroleum and convenience retailers to take the next step in their omnichannel strategy. It streamlines deploying and managing at pump systems to help provide consistent and personalized shopping experiences for their customers across all fueling platforms.

Additionally, the omnichannel software platform allows companies to bring to market growth revenue drivers and enhance the shopper experience at the pump through media content management, food offerings, and seamless loyalty program integration. NCR's work with Papa Murphy's and our early wins with NCR Optic are just two examples of how our omnichannel software, channel transformation, and digital enablement solutions come together to help customers run their businesses more efficiently and deliver superior consumer experiences.

Our customers' futures center on delivering omnichannel and transformative experiences to consumers in a digitally-driven world, while also capturing critical productivity and broader cost efficiency gains on the back-end. NCR is well-positioned to help companies achieve those goals.

Now let's move on to slide 16 to discuss our software results. Software-related revenue accelerated to 7% growth year-over-year, driven by growth in software license and cloud revenue. Unattached software license revenue, a key metric, increased 26%. Attached license increased 24%, driven by higher ATM and self-checkout unit volume.

Software maintenance increased 7%, driven by software license growth in prior periods. Cloud revenue, which has been muted in prior periods, has now accelerated the 6% growth, driven by prior-period bookings across the financial services and hospitality industries. We also remain pleased with the momentum of new SaaS bookings in the quarter, as reflected by net ACV of \$15 million, which brought our year-to-date net ACV to \$54 million as compared to \$25 million in the prior year.

As a reminder, this is a key leading indicator of future cloud growth and bodes well for cloud revenue growth in the coming quarters. Professional services revenue was flat compared to last year, due to the timing of project rollouts, but we entered Q4 with a strong backlog. Software operating income was up \$11 million to \$146 million or 8% constant currency in the quarter, driven by higher revenue.

We secured a number of notable omnichannel wins in the quarter, including International Bank of Commerce, and we completed our rollout with Papa Murphy's. Digital enablement and channel transformation continue to drive cloud as evident in NCR silver subscription based growth of 86%, digital insight user base growth of 9%, and a 35% increase in NCR secure payments volume. We also saw continued growth in our mobile ordering platform, as the number of mobile sites grew 21% and transactions grew 190% year-over-year.

NCR also announced next-generation consulting services to advance our leadership and channel transformation for the financial services, retail and hospitality industries. The consulting services addressed the growth in digital transformation needs of NCR's customers.

Slide 17 shows our third-quarter services results. Services revenue increased 6% on constant currency basis, driven by strong growth in implementation services as well as hardware maintenance and managed services. Services operating income was up \$7 million to \$56 million, or 13% due to higher revenue, solid operating leverage, and improved productivity and efficiency, which we believe well-positions NCR for profitable growth in the quarters and years ahead.

From an end market perspective, services continues to benefit from our overall channel transformation success, and the implementation services and hardware maintenance opportunities our progress unlocks, including wins with Domino's Pizza and Santander. Our higher-margin managed services offerings continue to expand in adjacent services, such as software distribution, endpoint security, and cash management, while our investment in big data analytics, predictive monitoring, and customer onboarding, are allowing customer service cases to be resolved more efficiently.

Additionally, our IoT-based managed service solution enabled an approximate 25% reduction in the time it took to onboard recent CFIs.

Turning to slide 18, hardware had a strong quarter, with revenue up 16% on an adjusted constant currency basis, driven by continued momentum in channel transformation across financial services, retail and hospitality industries. ATM revenue was up 11%, driven by strong customer demand for our new products and acceptance of our newly introduced omnichannel-ready products.

The successful launch of the 80 Series, which drove much of the growth in the hardware business for Financial Services, is the first platform which enables omnichannel solutions by converging our ATM assisted service and interactive teller capabilities into one solution. Another key driver to hardware revenue growth was self-checkout revenue, which increased 86% due to global store transformation growth, which continues to gain momentum in the retail segment.

Self-checkout performance continues to be positively impacted by the convergence of shifting consumer transaction preferences along with global labor availability and cost trends. Point-of-sale revenue increased 2%, driven by strong acceptance of our new MPOS and EPOS products. Operating income was down \$2 million but up 10% on a constant currency basis.

Channel transformation drove strategic wins in the quarter, including Kohl's supermarkets and State Bank of India. Self-checkout order volumes remain strong, and we continue to maintain a healthy backlog, led by continued store transformation initiatives in the retail industry, both by existing customers and new customers globally.

We are experiencing significant momentum within self-checkout, which is generating considerable uptake in our software-driven automated solution. Store transformation initiatives are driving an increase in the number of stores, as well as an increase in the number of lanes within the stores that are deploying self-checkout solutions.

Lastly, our new point-of-sale hardware portfolio continues to ramp faster than expected, with wins such as Darden Restaurants showing strong demand for enterprise, point-of-sale hardware, with strong market demand also showing for both our EPOS and MPOS solutions.

With that, I'll turn it over to Bill for closing comments.

Bill Nuti - *NCR Corporation - Chairman, CEO and President*

Thank you, Paul. In summary, a solid Q3 places us in position to continue executing against our full-year goal and is off to a fast start in 2017. Our global leadership in omnichannel software, channel transformation, and digital enablement is differentiating NCR and winning us business every day.

That is clearly demonstrated by our Q3 results as well as strong backlog and business metrics. NCR stands at the forefront of helping customers both address major global trends and are reshaping how industries interact with consumers, as well as secure productivity gains and cost efficiencies that best position them to compete in their rapidly-changing worlds.

Moving forward, our goals are clear -- continue to drive improved execution; further grow our backlog volume and mix; advance our operating model innovation; and finish the year strong. We remain confident that our leading global omnichannel offering should drive long-term profitable growth for the business, and deliver enhanced value to our shareholders and customers.

Operator, we will now turn the call over to questions.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Matt Summerville, Alembic Global Advisors -- excuse me, Paul Coster from JPMorgan.

Paul Coster - JPMorgan - Analyst

Thanks very much for taking the question. I guess the first question is -- maybe I got lost in the details here, but what were the big takeaways in terms of backlog and orders this quarter? And how does that compare to, say, the same time last year?

Bob Fishman - NCR Corporation - EVP, CFO and CAO

Yes. Hey, Paul, we had a strong quarter in terms of orders. Orders grew high-single digits for us in the quarter. And then we go into the fourth quarter with backlog up low-double digits. So that's good news for us, Paul. And it positions us well for good growth in Q4 revenue. We gave guidance of 8% to 10% for Q4 revenue. So, again, very pleased with topline growth in the third quarter and continued guidance for Q4.

Bill Nuti - NCR Corporation - Chairman, CEO and President

And Paul, I'd only add that software growth and orders were strong, right? Would you say that?

Bob Fishman - NCR Corporation - EVP, CFO and CAO

Yes, software growth was up around 12%, Paul, and backlog for software is up roughly 10%.

Paul Coster - JPMorgan - Analyst

And of course that's recurring in nature, much of it?

Bob Fishman - NCR Corporation - EVP, CFO and CAO

Yes.

Paul Coster - JPMorgan - Analyst

Okay. And the other question I've got is, and I'm kind of playing devil's advocate here, isn't this kind of a bit of a flukish year? You've got your nearest competitor engaged in M&A. You've got the ramp in bank transformation, and it probably doesn't get much better than the rate of growth you're seeing there this year.

And you had this new product on the ATM side that -- for which there was pent-up demand. Can this really be replicated in 2017?

Bill Nuti - NCR Corporation - Chairman, CEO and President

Paul, look, I think this is the strongest momentum I've seen in my 11 years as CEO. In fact, the order growth in Q4 will probably be in excess of 40% year-over-year. And it's really well-balanced. It's across every industry, every market. And really, when you peel the onion back, it's about omnichannel growth. But maybe Andy or Michael or Paul, you have a perspective on that?



Michael Bayer - *NCR Corporation - SVP and President of NCR Retail*

It's Michael Bayer speaking

Andy Heyman - *NCR Corporation - SVP and President of Financial Services*

Well, I would say on the -- yes, go ahead. Go ahead, Michael.

Michael Bayer - *NCR Corporation - SVP and President of NCR Retail*

Thank you, Andy. Let me talk a bit about the momentum Bill was alluding to. Already in March, we talked about the channel transformation, which, for us in retail, is called store transformation, as an area of growth. The orders have grown since Q4 2015 throughout the whole year this year, and we are now seeing the same moving forward, as some of our customers are getting ready in preparing themselves for rollouts starting in February 2017.

It's about new markets. It's about new customers, but it's also about existing customers who are starting to build their own roadmap jointly with us, how to increase the density and how to change the experience of their consumers. So, to us, it's really a longer-term trend. It was -- this year, to us, was the starting point of all of the things coming together.

Andy, go ahead, please.

Andy Heyman - *NCR Corporation - SVP and President of Financial Services*

Thanks, Michael. The thing I would say directly to the question you asked, Paul, about pent-up demand, which -- I think one of the things you were referring to is the 80 Series launch, which has been highly successful for us -- in the 12 months leading up to the Q3 scaled launch that we've had, we were still out there winning share in total, albeit by small amounts, but still winning share.

So this has been quite additive for us, number one. And number two, based on the funnel that we're looking at, we do not see it at all as a one-time event.

Paul Coster - *JPMorgan - Analyst*

Thank you very much.

Bill Nuti - *NCR Corporation - Chairman, CEO and President*

Thank you, Paul.

Operator

Matt Summerville, Alembic Global Advisors.



Matt Summerville - *Alembic Global Advisors - Analyst*

A couple of questions. First, I wanted to talk about kind of the incremental operating margins you are seeing in the businesses in which you report. First was software. You have kind of a total operating margin in the low 30s; incremental is not all that much different. I guess you are seeing constant currency revenue growth of 7%.

What has to happen for those incremental margins to move meaningfully higher above kind of the segment average? I would assume there's some degree of scale that has to play into here. If you can help kind of bridge that gap, that would be helpful.

Bob Fishman - *NCR Corporation - EVP, CFO and CAO*

Yes. Matt, no doubt that that's a big opportunity for us. When we look at our gross margins within the software business, we think there's significant opportunity, primarily in the cloud business and software maintenance. Those were the major findings coming out of the work earlier this year with Alex Partners.

So when we look at our margins compared to our competitors, we are probably 1,000 basis points below where they are at. So, two big projects coming out of the work earlier this year that will start to benefit us next year, is around building the efficiency in those two spaces. Now no doubt that volume helps the cloud business.

So we were extremely pleased to see the cloud growth in the quarter, up 6%. The net ACV bookings are tracking well, which bodes well for future growth. So, layering on higher growth, improving the efficiency in cloud and software maintenance, that's the key to improving those operating margins.

Matt Summerville - *Alembic Global Advisors - Analyst*

And then as a follow-up, conversely, your incremental margins -- and I look more just at the operating income line, and services were actually pretty good at about 25%. Even if you adjust out for currency in the hardware side of things, and you don't have the IPS business anymore -- which I assume would not be all that much of a moneymaking business for you guys -- not a lot of leverage on the hardware side.

So talk about what's going well on services, and why, with the ATM business up double-digits, self-checkout up almost double year-over-year, there's just no operating leverage?

Bob Fishman - *NCR Corporation - EVP, CFO and CAO*

Yes. Services for us is an exciting opportunity. You can not only improve the customer experience but to expand the margins. So a lot of it has to do with the technology plays, the investments we've made. It's around remote and predictive -- it's around centralizing our call center. So those are all investments that we've made that we are going to continue to benefit from going into 2017.

So a lot of opportunity within the services margins. A lot of that was technology investments that we've made. Within hardware, it does come down to mix of the business. No doubt the self-checkout business helps the margin. But overall, as we ramp our new product introductions, you'll see that our hardware operating margin improve.

Bill Nuti - *NCR Corporation - Chairman, CEO and President*

And, Matt, the only other point I would make is that, remember for us, there is significant attach of high-margin revenue for every dollar of hardware we ship. So, now, we are looking out in 2017 and 2018, and for every dollar of hardware we ship now, there's about [\$2] of attach. Services attach, PS attach and software maintenance attach, as well is one-time implementation services attach. So, the good news about our hardware growth is that, long-term, it benefits our higher-margin recurring revenue streams.

Matt Summerville - *Alembic Global Advisors - Analyst*

Thank you, guys.

Operator

(Operator Instructions) Ian Zaffino, [NCR].

Dan Natoli - *Oppenheimer & Co. - Analyst*

It's Dan Natoli in for Ian. Just a quick question on the self-checkout. Given a lot of the weakness that you see in retail and other parts of the market, would you say were there certain sectors within retail or subsectors that were more driven to the self-checkout? Or is it pretty much across the board across all the retailers?

Bill Nuti - *NCR Corporation - Chairman, CEO and President*

Relatively broad-based. But Michael, go ahead

Michael Bayer - *NCR Corporation - SVP and President of NCR Retail*

Yes, as Bill said, it's broad-based. And it is not the self-checkout itself. It's really around the full self-checkout experience for your customer. It can be mobile, it can be mobile in conjunction with a self-checkout unit; in-aisle checkout, mobile check-outs for the employees, mobile point-of-sale -- we've seen all of these numbers growing.

So it is really a trend where the customer -- where our customers are taking the theme of channel transformation for their consumers serious. And it comes hand-in-hand then with the software supporting that all around omnichannel software items Paul Langenbahn talked about, like loyalty, like eReceipts, like WebConnect.

So the whole play, which we've talked about over the last three years, has much faster accelerated than we assumed. And we are building those roadmaps with our customers around the world.

Maybe one last point for me to mention, one of the accelerating factors is actually the availability of labor. So, if you think about the top 100, 200 cities around the world, the commute for the employees becomes longer and longer in terms of the affordability of living in the city. So all of a sudden you have a lack of labor, and so the lack of labor is addressed through automotivation, which was something which I would say was an add-on to our business cases and the way we position store transformation.

Dan Natoli - *Oppenheimer & Co. - Analyst*

Great. And just a follow-up. Do you see the self-checkout still maintaining those high double-digit year-over-year growth rates?

Michael Bayer - *NCR Corporation - SVP and President of NCR Retail*

We are seeing positive growth rates. I'm not so sure what the growth rate in essence will be, but we're not seeing a slowdown, as we are having three components driving this growth. We have new countries coming to play, due to the situation around labor availability in the top cities. We have new customers coming to play.



We see more and more DIY also around the globe are looking into self-checkout, as well as our petroleum convenience customers looking into our smaller form factors of self-checkout in the outside payment and interaction terminals. And then we have new countries coming to play. We are getting more and more reach in Russia, Southeast Asia, and Latin America. So, that kind of gives me a positive view on where we are going to take this.

Dan Natoli - *Oppenheimer & Co. - Analyst*

Great, thank you.

Operator

I'd now like to pass the call back to Bill Nuti for any closing remarks.

Bill Nuti - *NCR Corporation - Chairman, CEO and President*

Thank you all for being here today. We'll see you in February. Bye bye.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.

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