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)

x **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)

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

(203) 968-3000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

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

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

Class	**Outstanding at 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 expressio 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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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.

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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, 2010	2009	Nine Months Ended September 30, 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.

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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

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.

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XEROX CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in millions)	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 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)

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.

XEROX CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Note 1 Basis of Presentation

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

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

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

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

Note 2 Significant Accounting Policies

Revenue Recognition

As a result of our 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 ASU s discussed above, these ASUs generally entail technical corrections to existing guidance or affect guidance related to specialized industries or entities and therefore have minimal, if any, impact on the Company.

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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.

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, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 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

Pension liabilities		39
Other long-term liabilities		247
Net Assets Acquired	$	6,512

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)

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 Ended September 30,		Nine Months 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.

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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 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.

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 Ended September 30,		Nine Months Ended September 30,	
	2010	2009	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 Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 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)

Balance September 30, 2010	$ 107	$ 24	$	$ 131

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

Reconciliation to the Condensed Consolidated Statements of Cash Flows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Charges against reserve	$ (70)	$ (65)	$ (153)	$ (231)
Asset impairment	1		5	
Effects of foreign currency and other non-cash items	15	(1)		
Cash Payments for Restructurings	$ (54)	$ (66)	$ (148)	$ (231)

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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:

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.

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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:

Currency Hedged (Buy/Sell)	Gross Notional Value	Fair Value Asset (Liability)[1]
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.

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

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

		Nine Months Ended September 30,		Ended September 30,	
		2010	2009	2010	2009
Interest rate contracts	Interest expense	$ 113	$ (6)	$ (113)	$ 6

Derivatives in Cash Flow Hedging Relationships	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) Three Months Ended September 30,	
	2010	2009		2010	2009
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 Hedging Relationships	Derivative Gain (Loss) Recognized in OCI (Effective Portion) Nine Months Ended September 30, 2010	2009	Location of Derivative Gain (Loss) Reclassified from AOCI into Income (Effective Portion)	Gain (Loss) Reclassified from AOCI to Income (Effective Portion) Nine Months Ended September 30, 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 Ended September 30, 2010	2009	Nine Months Ended September 30, 2010	2009
Foreign exchange contracts forwards	Other expense Currency gains (losses), net	$ (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	

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.

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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:

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

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

(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.

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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.

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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, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 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

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 refiling. 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.

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

To understand the trends in the business, we believe that it is helpful to analyze the impact of changes in the translation of foreign currencies into U.S. dollars on revenue and expenses. We refer to this analysis as currency impact or the impact from currency. This includes translating the most recent financial results of operations using foreign currency of the earliest period presented. Currencies for our developing market countries (Latin America, Brazil, the Middle East, India, Eurasia and Central-Eastern Europe) are reflected at actual exchange rates for all periods presented, since these countries generally have volatile currency and inflationary environments, and our operations in these countries have historically implemented pricing actions to 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-forma[3] 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.

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Summary Results

Revenues

(in millions)	Three Months Ended September 30, 2010	2009	% Change	Pro-forma (3) % Change	% of Total Revenue 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, 2010	2009	% Change	Pro-forma (3) % Change	% of Total Revenue 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%

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-forma[3] 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 revenue[1] or flat on a pro-forma[3] 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-forma[3] 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-forma[3] 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 revenue[2], 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-forma[3] 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 revenue[1], or 1% on a pro-forma[3] 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-forma[3] 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-forma[3] 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 revenue[2], 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.