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PITNEY BOWES INC /DE/
Form 10-K405
March 14, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549-1004

FORM 10-K

X ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
--

SECURITIES EXCHANGE ACT OF 1934

For the year ended December 31, 2001

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 1-3579

PITNEY BOWES INC.

Incorporated pursuant to the Laws of the State of Delaware

Internal Revenue Service - Employer Identification No. 06-0495050

World Headquarters
Stamford, Connecticut 06926-0700
Telephone Number: (203) 356-5000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class -----	Name of each exchange on which registered -----
Common Stock (\$1 par value)	New York Stock Exchange
\$2.12 Convertible Cumulative Preference Stock (no par value)	New York Stock Exchange
Preference Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

4% Convertible Cumulative Preferred Stock (\$50 par value)

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, and (2) has been subject to such filing
requirements for the past 90 days.

Yes X No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405

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of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X

-

The aggregate market value of voting stock (common stock and \$2.12 convertible cumulative preference stock) held by non-affiliates of the registrant as of February 28, 2002 is \$10,132,705,235.

Number of shares of common stock, \$1 par value, outstanding as of February 28, 2002 is 241,924,200.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the 2002 Annual Meeting of Shareholders are incorporated by reference in Part III.

PITNEY BOWES INC.

PART I

Item 1. - Business.....	3
Item 2. - Properties.....	5
Item 3. - Legal proceedings.....	6
Item 4. - Submission of matters to a vote of security holders.....	6

PART II

Item 5. - Market for the registrant's common stock and related stockholder's matters.....	7
Item 6. - Selected financial data.....	8
Item 7. - Management's discussion and analysis of financial condition and results of operations.....	9
Item 7A. - Quantitative and qualitative disclosures about market risk.....	28
Item 8. - Financial statements and supplementary data.....	29
Item 9. - Changes in and disagreements with accountants on accounting and financial disclosure.....	64

PART III

Item 10. - Directors and executive officers of the registrant.....	64
Item 11. - Executive compensation.....	64
Item 12. - Security ownership of certain beneficial owners and management.....	64
Item 13. - Certain relationships and related transactions.....	64

PART IV

Item 14. - Exhibits, financial statement schedules and reports on Form 8-K...	64
Signatures.....	69

PITNEY BOWES INC.

PART I

ITEM 1 - BUSINESS

Our company was incorporated in the state of Delaware on April 23, 1920, as the

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Pitney Bowes Postage Meter Company. Today, we are a provider of leading-edge global, integrated mail and document management solutions for organizations of all sizes.

Pitney Bowes Inc. and its subsidiaries (which we refer to in this Form 10-K as us, we, our or the company) operate in three reportable segments: Global Mailing, Enterprise Solutions and Capital Services. We operate both inside and outside the United States. Our financial information concerning revenue, operating profit and identifiable assets, by reportable segment and geographic area, appears on pages 58 to 60 of this Form 10-K.

Business Segments

Global Mailing

Our Global Mailing segment includes worldwide revenues and related expenses from the rental of postage meters and the sale, rental and financing of mailing equipment, such as mail finishing and software-based mail creation equipment. We also include in this segment software-based shipping, transportation and logistics systems, related supplies and services, and postal payment solutions and supply chain solutions such as order management and fulfillment support. We sell, rent or finance our products. We sell our supplies and services. Some of our products are sold through dealers outside the United States.

Products in this segment include postage meters, mailing machines, address hygiene software, manifest systems, letter and parcel scales, mail openers, mailroom furniture, folders, paper handling, shipping equipment, software-based shipping and logistics systems and postal payment solutions.

Enterprise Solutions

Our Enterprise Solutions segment comprises two divisions - Pitney Bowes Management Services and Document Messaging Technologies. In this segment, we sell, rent or finance our products, while we sell supplies and services.

Pitney Bowes Management Services includes revenues and related expenses from facilities management contracts for advanced mailing, reprographic, document management and other high-value services. Our facilities management services are provided by our subsidiary, Pitney Bowes Management Services, Inc. (PBMS). PBMS offers a variety of business support services to our customers to manage copy, reprographic and mail centers, facsimile, electronic printing and imaging services, and records management. PBMS is a major provider of on- and off-site services which helps our customers manage, the creation, processing, storage, retrieval, distribution and tracking of documents and messages in both paper and digital form.

Document Messaging Technologies includes revenues and related expenses from the sale, service and financing of high speed, software-enabled production mail systems, sortation equipment, incoming mail systems, electronic statement, billing and payment solutions, and mailing software.

We include our internal financial services operations in both the Global Mailing and Enterprise Solutions segments. The internal financial services operations provide lease financing for the company's products in the U.S., Canada, the United Kingdom, Germany, France, Norway, Ireland, Australia, Austria, Spain, Italy, Switzerland and Sweden. Our financial services operations financed approximately 33 percent of our consolidated sales in 2001, 37 percent in 2000, and 37 percent in 1999 and approximately 79 percent of our leasable sales in 2001, 76 percent in 2000, and 73 percent in 1999.

Capital Services

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Our Capital Services segment comprises primarily asset and fee-based income generated by financing or arranging transactions of critical large-ticket customer assets. We also include in this segment revenue and related expenses associated with the strategic financing of equipment for postal authorities around the world.

Some of the products which we directly finance or arrange financing for are commercial and non-commercial aircraft, real estate, over-the-road trucks and trailers, locomotives, railcars, rail and bus facilities, office equipment and high-technology equipment such as data processing and communications equipment.

3

Spin-off of Imagistics International Inc.

On December 3, 2001, we completed the spin off of our office systems business to our stockholders as an independent, publicly-traded company operating under the name of Imagistics International Inc. We believe that the spin-off of the office systems business allows us to focus on our global strategy of delivering leading-edge mail and document management solutions.

Support Services

We maintain extensive field service organizations in the U.S. and some other countries to provide support services to customers who have rented, leased or purchased equipment. These support services, which are usually in the form of annual maintenance contracts, accounted for approximately 13 percent of revenues in 2001 and 2000 and 12 percent in 1999.

Marketing

Our products and services are marketed through an extensive network of offices in the U.S. and through a number of our subsidiaries and independent distributors and dealers in many countries throughout the world. We also use direct marketing, outbound telemarketing, and the Internet. We sell to a variety of business, governmental, institutional and other organizations. We believe we have a broad base of customers, and we are not dependent upon any one customer or type of customer for a significant part of our business. The company does not have significant backlog or seasonality relating to its businesses.

Operations Outside the United States

Our manufacturing operations outside the U.S. are in the United Kingdom, France and Germany.

Competition

Historically we have been a leading supplier of products and services in our business segments, particularly postage meters and mailing machines. Our meter base and our continued ability to place meters in key markets is a significant contributor to our current and future revenue and profitability. However, all of our segments face strong competition from a number of companies. In particular, we face competition in many countries for new placements from several postage meter and mailing machine suppliers, and our mailing systems products face competition from products and services offered as alternative means of message communications. PBMS, a major provider of business support services to the corporate, financial services, and professional services markets, competes against national, regional and local firms specializing in facilities management. We believe that our long experience and reputation for

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product quality, and our sales and support service organizations are important factors in influencing customer choices with respect to our products and services.

The financing business is highly competitive with aggressive rate competition. Leasing companies, commercial finance companies, commercial banks and other financial institutions compete, in varying degrees, in the several markets in which our finance operations do business. Our competitors range from very large, diversified financial institutions to many small, specialized firms. In view of the market fragmentation and absence of any dominant competitors, we believe that it is not possible to provide a meaningful description of our finance operations' competitive position in these markets.

Research and Development/Patents

We have research and development programs that are directed toward developing new products and service methods. Our expenditures on research and development totaled \$133.1 million, \$120.5 million, and \$108.9 million in 2001, 2000, and 1999, respectively.

As a result of our research and development efforts, we have been awarded a number of patents with respect to several of our existing and planned products. However, we believe our businesses are not materially dependent on any one patent or any group of related patents. We also believe our businesses are not materially dependent on any one license or any group of related licenses.

4

Material Supplies

We believe we have adequate sources for most parts and materials for our products that we manufacture. However, these products rely to an increasing extent on microelectronic components, and temporary shortages of these components have occurred from time to time due to the demands by many users of such components. However, we do not expect these temporary shortages to have a material adverse impact on our business.

Regulatory Matters

We are subject to the U.S. Postal Service's regulations and those of foreign postal authorities, related to product specifications and business practices. From time to time, we will work with these governing bodies to help in the enhancement and growth of mail and the mail channel. See Legal and Regulatory matters in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Form 10-K.

Employee Relations

At December 31, 2001, we employed 26,698 persons in the U.S. and 6,026 persons outside the U.S. We believe that employee relations are satisfactory. The majority of our employees are not represented by any labor union. Our management follows the policy of keeping employees informed of decisions, and encourages and implements employee suggestions whenever practicable.

ITEM 2 - PROPERTIES

Our World Headquarters and certain other office and manufacturing facilities are located in Stamford, Connecticut. We have additional office facilities located in Shelton, Connecticut. We maintain research and development operations at a corporate engineering and technology center in Shelton,

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Connecticut. A sales and service training center is located near Atlanta, Georgia. We believe that our current manufacturing, administrative and sales office properties are adequate for the needs of all of our operations.

Global Mailing

Global Mailing products are manufactured in a number of plants principally in Connecticut, as well as in Harlow, England; Friedberg, Germany; Lyon, France and St. Denis, France. Most of these facilities are owned by the company. At December 31, 2001, there were 134 sales, support services, and finance offices, substantially all of which are leased, located throughout the U.S. and in a number of other countries.

Enterprise Solutions

Our Document Messaging Technologies business is headquartered in Danbury, Connecticut. We lease five facilities located throughout the U.S. Our management services business is headquartered in Stamford, Connecticut and leases 37 facilities located throughout the U.S. and facilities in Canada, England, Belgium, Denmark, France, Germany, Norway, Netherlands and Sweden.

Our headquarters of the financing operations within the U.S. are located in Shelton, Connecticut. Offices of the financing operations outside the U.S. are maintained in Mississauga, Ontario, Canada; London, England; Heppenheim, Germany; Paris, France; Oslo, Norway; Dublin, Ireland; French's Forest, Australia; Vienna, Austria; Effretikon, Switzerland; Milan, Italy; Barcelona, Spain; and Stockholm, Sweden.

Capital Services

Our wholly-owned subsidiary, Pitney Bowes Credit Corporation (PBCC), leases an executive and administrative office in Shelton, Connecticut, which is owned by Pitney Bowes Inc. There are nine leased regional and district sales offices located throughout the U.S.

5

ITEM 3 - LEGAL PROCEEDINGS

In the course of normal business, we are occasionally party to lawsuits. These may involve litigation by or against us relating to, among other things:

- .. contractual rights under vendor, insurance or other contracts
- .. intellectual property or patent rights
- .. equipment, service or payment disputes with customers
- .. disputes with employees

We are currently a plaintiff or a defendant in a number of lawsuits, none of which should have, in the opinion of management and legal counsel, a material adverse effect on our financial position, results of operations or cash flows. See Legal and Regulatory matters in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and the Legal Settlements section under Special Items of this Form 10-K.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We did not submit any matters to a vote of our shareholders during the three months ended December 31, 2001.

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Executive Officers of the Registrant

Name	Age	Title
Michael J. Critelli	53	Chairman and Chief Executive Officer
Brian M. Baxendale	59	Executive Vice President and Group President, Pitney Bowes Document Messaging Technologies
Gregory E. Buoncontri	54	Senior Vice President and Chief Information Officer
Karen M. Garrison	53	Executive Vice President and Group President, Pitney Bowes Business Services
Arlen F. Henock	45	Vice President - Finance
Luis A. Jimenez	57	Senior Vice President and Chief Strategy Officer
Matthew S. Kissner	47	Executive Vice President, Group President and Chief Development Officer
Murray D. Martin	54	Executive Vice President and Group President, Global Mailing Systems
John N. D. Moody	57	Executive Vice President - Office of the Chairman
Sara E. Moss	55	Senior Vice President and General Counsel
Bruce P. Nolop	51	Executive Vice President and Chief Financial Officer
Johnna G. Torsone	51	Senior Vice President and Chief Human Resources Officer

There is no family relationship among the above officers, all of which have served in various corporate, division or subsidiary positions with the company for at least the past five years except G.E. Buoncontri, L.A. Jimenez and B.P. Nolop.

Mr. Buoncontri was formerly the Vice President, Information Technology and Chief Information Officer of Novartis Pharmaceuticals Corp. (merger of Sandoz and Ciba Geigy). Prior to the merger, he also served as the Vice President, Information Systems and Chief Information Officer for Sandoz Pharmaceuticals Company. Mr. Buoncontri also served as Vice President, Information Management Services and Chief Information Officer of Asea Brown Boveri, Inc.

6

Mr. Jimenez joined the company from Arthur D. Little, an international management consulting company, with over 25 years of experience. Mr. Jimenez was appointed worldwide practice leader for postal organizations in 1990, Corporate Vice President in 1991, and served most recently on the firm's global board for telecommunications and media and as Manager of the Latin American practice.

Mr. Nolop joined the company from Wasserstein Perella & Co., an investment bank and one of Pitney Bowes' financial advisors, where he had served as managing

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director since 1993. Prior to joining Wasserstein Perella & Co., Mr. Nolop held senior positions with Goldman Sachs & Co., Kimberly-Clark Corporation and Morgan Stanley & Co.

PART II

ITEM 5 - MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDERS' MATTERS

Pitney Bowes common stock is traded under the symbol "PBI". The principal market it is listed on is the New York Stock Exchange. The stock is also traded on the Chicago, Philadelphia, Boston, Pacific and Cincinnati stock exchanges. At December 31, 2001, the company had 27,849 common stockholders of record.

Stock Information

Dividends per common share

Quarter	2001	2000
	-----	-----
First	\$.29	\$.285
Second	.29	.285
Third	.29	.285
Fourth	.29	.285
	-----	-----
Total	\$1.16	\$1.14
	=====	=====

Quarterly price ranges of common stock

Quarter	2001	
	High	Low
	-----	-----
First	38.40	32.00
Second	42.41	32.73
Third	44.70	37.65
Fourth	42.44	33.91

Quarter	2000	
	High	Low
	-----	-----
First	54.13	41.00
Second	47.00	35.63
Third	40.44	33.75
Fourth	39.38	24.00

7

ITEM 6 - SELECTED FINANCIAL DATA

The following tables summarize selected financial data for the company, and should be read in conjunction with the more detailed financial statements and related notes thereto included under Item 8 of this Form 10-K.

Summary of Selected Financial Data

(Dollars in thousands, except per share data)

Years ended December 31

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	2001	2000	1999	
Total revenue	\$4,122,474	\$ 3,880,868	\$ 3,811,576	\$ 3,499,000
Cost and expenses	3,356,090	3,078,020	2,987,634	2,840,000
Income from continuing operations before income taxes	766,384	802,848	823,942	658,000
Provision for income taxes	252,064	239,723	260,952	215,000
Income from continuing operations	514,320	563,125	562,990	443,000
Discontinued operations	(25,977)	64,104	73,222	13,000
Cumulative effect of accounting change	-	(4,683)	-	-
Net income	\$ 488,343	\$ 622,546	\$ 636,212	\$ 571,000
Basic earnings per share:				
Continuing operations	\$2.09	\$2.20	\$2.11	
Discontinued operations	(.11)	.25	.27	
Cumulative effect of accounting change	-	(.02)	-	
Net income	\$1.99	\$2.43	\$2.38	
Diluted earnings per share:				
Continuing operations	\$2.08	\$2.18	\$2.07	
Discontinued operations	(.10)	.25	.27	
Cumulative effect of accounting change	-	(.02)	-	
Net income	\$1.97	\$2.41	\$2.34	
Total cash dividends on common, preference and preferred stock	\$285,164	\$292,736	\$272,866	\$240,000
Cash dividends per share of common stock	\$1.16	\$1.14	\$1.02	
Average common and potential common shares outstanding	247,615,560	258,602,218	272,006,143	279,650,000
Cash from operating activities	\$1,035,887	\$872,244	\$981,086	\$770,000
Free cash flow	\$779,683	\$603,667	\$676,188	\$470,000
Balance sheet at December 31				
Total assets	\$8,318,471	\$7,901,266	\$8,222,672	\$7,660,000
Long-term debt	\$2,419,150	\$1,881,947	\$1,997,856	\$1,710,000
Capital lease obligations	\$3,103	\$4,660	\$6,372	\$0
Stockholders' equity	\$891,355	\$1,284,975	\$1,625,610	\$1,640,000
Book value per common share	\$3.68	\$5.16	\$6.13	
Ratios				
Profit margin-continuing operations:				
Pretax earnings	18.6%	20.7%	21.6%	
After-tax earnings	12.5%	14.5%	14.8%	
Return on stockholders' equity before accounting changes	54.8%	48.8%	39.1%	
Debt to total capital	79.7%	71.1%	67.2%	
EBIT to interest	5.2x	5.2x	5.8x	
EBITDA to interest	6.5x	6.5x	7.3x	
Other				
Common stockholders of record	27,849	32,231	32,754	

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Total employees	32,724	28,542	27,267
-----------------	--------	--------	--------

Note: The sum of the earnings per share amounts may not equal the totals due to rounding.

Earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation and amortization (EBITDA), are not presented as an alternative measure of operating results or cash flow from operations, as determined in accordance with generally accepted accounting principles, but is presented because we believe it is a widely accepted indicator of our ability to incur and service debt. EBIT and EBITDA do not give effect to cash used for debt service requirements and capital expenditures and thus do not reflect funds available for reinvestment, dividends or other discretionary uses. In addition, EBIT and EBITDA as presented in this summary schedule may not be comparable to similarly titled measures reported by other companies.

8

ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We continue to build on the core activities that support our strong competitive position in integrated mail and document management solutions.

We operate in three reportable segments: Global Mailing, Enterprise Solutions and Capital Services.

Our Global Mailing segment includes worldwide revenues and related expenses from the rental of postage meters and the sale, rental and financing of mailing equipment, including mail finishing and software-based mail creation equipment. We also include in this segment software-based shipping, transportation and logistics systems, related supplies and services, postal payment solutions and supply chain solutions such as order management and fulfillment support.

Our Enterprise Solutions comprises Pitney Bowes Management Services (PBMS) and Document Messaging Technologies (DMT). PBMS includes revenues and related expenses from facilities management contracts for advanced mailing, reprographic, document management and other high-value services. DMT includes revenues and related expenses from the sale, service and financing of high speed, software-enabled production mail systems, sortation equipment, incoming mail systems, electronic statement, billing and payment solutions, and mailing software.

Our Capital Services segment comprises primarily large-ticket financing and fee-based programs covering a broad range of products and other financial services. We also include in this segment the strategic financing of equipment for postal authorities around the world that were previously included in the Global Mailing segment.

During 2001, we completed several acquisitions that increased our presence in both domestic and international markets and that we believe will better position the company for long-term growth and enhanced shareholder value. These acquisitions included the following:

- . Secap SA, a mailing systems company based in France.
- . Danka Services International (DSI), a provider of on- and off-site

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document management services.

- . Bell & Howell's International Mail and Messaging Technologies (MMT) business in Europe, Africa, the Middle East and Asia.

On December 3, 2001, we completed the spin off of our office systems business to stockholders as an independent, publicly-traded company under the name of Imagistics International Inc.(IGI). On December 3, 2001, we paid a special stock dividend of IGI common stock to our common shareholders. Through this special dividend, we distributed 100% of the shares of IGI stock to common shareholders of the company. Each eligible common stockholder of record of the company on November 19, 2001 received 0.08 shares of IGI stock for each share of Pitney Bowes stock. The historical carrying amount of the IGI net assets distributed to our shareholders on the spin-off date has been recorded as a stock dividend of \$311.7 million. We have segregated the operating results of IGI and reported them as discontinued operations in the Consolidated Statements of Income. In connection with the spin-off, we recorded a loss of approximately \$26.0 million (net of taxes of \$12.2 million) for the year ended December 31, 2001. See Note 12 to the consolidated financial statements.

On January 14, 2000, we sold our mortgage servicing business, Atlantic Mortgage & Investment Corporation (AMIC), a wholly-owned subsidiary of the company, to ABN AMRO North America. We received approximately \$484 million in cash at closing. Accordingly, we segregated and reported as discontinued operations operating results of AMIC in our Consolidated Statements of Income. In connection with the sale, we recorded a loss of approximately \$27.6 million (net of taxes of \$18.4 million) for the year ended December 31, 1999. The transaction is subject to post-closing adjustments. See Note 12 to the consolidated financial statements.

9

Special Items

The following table summarizes the impact of special items on our diluted earnings per share from continuing operations during 2001, 2000 and 1999:

	2001	2000	1999
	-----	-----	-----
Reported earnings per share	\$2.08	\$2.18	\$2.07
Meter transition	.68	-	-
Restructuring charges	.30	.04	-
Legal settlements, net	(.81)	-	(.11)
State tax benefits	-	(.05)	-
	-----	-----	-----
Earnings per share excluding special items	\$2.25	\$2.17	\$1.96
	=====	=====	=====

Meter transition

In 2001, we adopted a formal plan to transition to the next generation of networked mailing technology. The information capture and exchange made possible by advanced technology turns the postage meter into an "intelligent" terminal that networks the mailer to postal and carrier information and systems. This two-way information architecture, in turn, enables convenient access to and delivery of value-added services such as tracking, delivery confirmation and rate information. The adoption of this plan was facilitated by our expanded access to technology and our ability to move to networked products combined with our expectations that the U.S. and postal services around the

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world will continue to encourage the migration of mailing systems to networked digital technologies. In connection with this plan, we recorded non-cash pretax charges of \$268.3 million for the year ended December 31, 2001, related to assets associated with our non-networked mailing technology. We have segregated these charges in the Consolidated Statement of Income for the year ended December 31, 2001. In November 2001, postal regulations were issued, consistent with our meter transition plan, defining the meter migration process and timing. See Regulatory Matters.

Restructuring charges

In 2001, we adopted a formal restructuring plan to implement a common, streamlined business infrastructure across the corporation as a result of our decisions to spin off our office systems business and align our mailing business on a global basis, as well as cost saving opportunities resulting from strategic acquisitions and partnerships, and additional benefits attained from the consolidation of our information technology organization and enterprise-wide resource planning initiatives. In connection with this plan, we recorded pretax restructuring charges of \$149.3 million in 2001, of which \$116.1 million was related to continuing operations and the remaining \$33.2 million was related to discontinued operations. We have segregated the restructuring charges related to continuing operations in the Consolidated Statement of Income for the year ended December 31, 2001. The restructuring charges related to discontinued operations are included in discontinued operations in the Consolidated Statement of Income for the year ended December 31, 2001.

In 2000, we recorded a pretax charge of approximately \$19 million related to the consolidation of information technology staff and infrastructure. We have segregated this charge in the Consolidated Statement of Income for the year ended December 31, 2000.

Legal settlements, net

In 2001, the company and Hewlett-Packard announced that they had reached an agreement resolving a lawsuit filed by us in 1995. The lawsuit arose out of a dispute over print technology patents. Under the terms of the agreement, the companies resolved all pending patent litigation without admission of infringement and we received \$400 million in cash and ten year supply and technology agreements. We recorded the cash payment, net of legal fees and related expenses of \$37.8 million, as other income in the Consolidated Statement of Income for the year ended December 31, 2001.

In 2001, we recorded a pretax charge of approximately \$24 million associated with the settlement of a lawsuit related to lease upgrade pricing in the early to mid-1990s. The settlement is subject to court approval. The \$24 million charge relates to the following settlement costs: award certificates to be provided to members of the class for purchase of office products through the Pitney Bowes supply line and the cost of legal fees and related expenses of \$8.3 million. We included this charge in other income in the Consolidated Statement of Income for the year ended December 31, 2001.

In 1999, the U.S. Postal Service (USPS) and the company announced that they had reached an agreement resolving a lawsuit filed by the company in 1997. The lawsuit arose out of a dispute over a 1978 Statement of Understanding authorizing the company to offer Postage by Phone/R/, our proprietary version of the Computerized Meter Resetting System. Under the terms of the agreement, we received \$51.8 million, representing a portion of the financial benefit that

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the USPS obtained as a result of the revised regulations. We recorded this payment, net of related legal expenses of \$2.2 million, as other income in the Consolidated Statement of Income for the year ended December 31, 1999.

State tax benefits

In 2000, we recorded a one-time tax benefit of \$12 million related primarily to state tax law changes.

Critical Accounting Policies

We have identified the policies below as critical to our business operations and to the understanding of our results of operations. We discuss the impact and any associated risks on our results of operations related to these policies throughout Management's Discussion and Analysis of Financial Conditions and Results of Operations. For a detailed discussion on the application of these and other accounting policies, see Note 1 to the consolidated financial statements.

The preparation of our financial statements in conformity with generally accepted accounting principles requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates include, but are not limited to customer cancellations and product returns, bad debts, inventories, investments, useful lives of long-lived assets, intangible assets, income taxes, financing operations, warranty obligations, restructuring, pensions and other postretirement benefits, and contingencies and litigation. Our actual results could differ from those estimates.

Revenue recognition

We derive our revenues from the following sources: (1) sales; (2) rentals and financing; and (3) support services.

Sales and management services revenue

We recognize sales revenue when the risks of ownership have been transferred to the buyer, which is generally when shipped. Our sales revenue from customized equipment and software, including software-enabled mail creation equipment and shipping products, is generally recognized when installed. We recognize our sales revenue from sales type leases at the inception of the lease. We recognize revenue from our sales of management services over the term of the contract.

Rental revenue

We rent equipment to our customers, primarily postage meters, mailing equipment and shipping systems under short-term rental agreements, generally for periods of three months to three years. We invoice in advance the charges for equipment rental. We defer the billed revenue and include it in advance billings and record as income over the rental period on a straight-line basis.

Financing revenue

We provide lease financing of our products in the U.S. through our wholly-owned subsidiary, Pitney Bowes Credit Corporation (PBCC) and of its products outside the U.S. through several wholly-owned subsidiaries under both sales-type leases and direct financing leases.

When a sales-type lease is consummated, we record the gross finance receivable,

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unearned income and the estimated residual value of the leased equipment. Unearned income represents the excess of the gross receivable plus the estimated residual value over the sales price of the equipment. We recognize unearned income as earned using the interest method over the term of the transaction. This earned income is included in rentals and financing revenue in the Consolidated Statements of Income.

When a direct finance lease is consummated, we record the gross finance receivable, unearned income and the estimated residual value of the leased equipment. Unearned income represents the excess of the gross receivable plus the estimated residual value over the cost of the equipment. We recognize unearned income as earned using the interest method over the term of the transaction. This earned income is included in rentals and financing revenue in the Consolidated Statements of Income. We account for initial direct costs incurred in consummating a transaction as part of the investment in the lease and appropriately amortized using the interest method over the term of the lease.

11

From time to time, we sell selected finance assets. We follow Statement of Financial Accounting Standards (FAS) No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," when accounting for our sale of finance assets. We recognize all assets obtained or liabilities incurred in consideration as proceeds of the sale and any gain or loss on the sale is recognized in earnings.

Our investment in leveraged leases consists of rentals receivable net of principal and interest on the related nonrecourse debt, estimated residual value of the leased property and unearned income. We recognize the unearned income as leveraged lease revenue in income from investments over the lease term. See Leveraged Leases.

Support services revenue

We provide support services to our customers primarily through extended maintenance contracts. We recognize support services revenue primarily over the term of the service contract or as services are rendered.

Allowance for credit losses and doubtful accounts

General

We estimate our accounts receivable risks and provide allowances for doubtful accounts and credit losses. We establish the allowance for credit losses through charges to the provision for credit losses. We believe that our credit risk for accounts receivable is limited because of the large number of our customers and the relatively small account balances for most of our customers. Also, our customers are dispersed across different businesses and geographic areas. We believe that our allowance for credit losses and doubtful accounts is sufficient.

We evaluate the adequacy of the allowance for credit losses on a periodic basis. Our evaluation includes historical loss experience, the nature and volume of our portfolios, adverse situations that may affect a customer's ability to repay, estimated value of the underlying collateral (if any) and prevailing economic conditions. We make adjustments to our reserve if the evaluation of reserve requirements differs from the actual aggregate reserve. This evaluation is inherently subjective because our estimates may be revised as more information becomes available.

Our financial services businesses

Our financial services businesses establish credit approval limits based on the credit quality of the customer and the type of equipment financed. We charge finance receivables through the allowance for credit losses after collection efforts are exhausted and we deem the account uncollectible. Our financial services businesses base credit decisions primarily on a customer's financial strength and, particularly in our Capital Services programs, we may also consider collateral values. We believe that our concentration of credit risk for finance receivables from sales type leases is limited because of our large number of customers, small account balances and customer geographic and industry diversification.

Our general policy for finance receivables contractually past due for over 90 to 120 days is to discontinue revenue recognition. We resume revenue recognition when payments reduce the account to 60 days or less past due. In our Capital Services programs, we discontinue revenue recognition as soon as it is apparent that the obligor will not be making payments in accordance with lease terms, such as in the event of bankruptcy. Otherwise, we discontinue revenue recognition when accounts are over 90 days past due.

12

Accounting for income taxes

When we prepare our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. We record this amount as a provision for our taxes in accordance with the accounting rules (FAS No. 109, Accounting for Income Taxes). This process requires us to make the following assessments:

- . we estimate our actual current tax liability in each jurisdiction
- . we estimate our temporary differences resulting from differing treatment of items, such as lease revenue and related depreciation, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which we include within our Consolidated Balance Sheet
- . we then assess the likelihood that our deferred tax assets will be recovered from future taxable income and if we believe that recovery is not likely, we establish a valuation allowance.

At any time, our provision for taxes could be impacted by changes in tax law and interpretations by governments or courts.

Fixed assets and depreciation

We state property, plant and equipment at cost. We depreciate property, plant and equipment principally using the straight-line method over estimated useful lives: machinery and equipment principally three to 15 years and buildings up to 50 years. We capitalize major improvements which add to productive capacity or extend the life of an asset and we charge to expense as incurred repairs and maintenance. We depreciate rental equipment on the straight-line method over appropriate periods, principally three to ten years. Changes in regulatory provisions or technology may impact the useful lives of these assets. We depreciate other depreciable assets using either the straight-line method or accelerated methods. We amortize properties leased under capital leases on a straight-line basis over the primary lease terms.

We capitalize certain costs of internally developed software. These costs

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include purchased materials and services, payroll and payroll related costs and interest costs. We amortize internally developed software on a straight-line basis over the estimated useful life which is, principally three to ten years.

From time to time, we assess the carrying value of our long-lived and intangible assets. Our assessment involves comparing the carrying value of the asset on our Consolidated Balance Sheet to the cash flows we expect to generate in the future by that asset. We forecast the cash flows based on our assessment of our business. If the expected cash flows are less than the asset's carrying value, we record an impairment charge on that asset.

We believe that we have no impairment to our assets as of December 31, 2001. However, future events and circumstances, some of which are described below, may result in an impairment charge:

- . changes in postal regulations governing the types of meters allowable for use. However, recent regulations were issued in November 2001, and therefore we do not expect new regulations for the foreseeable future
- . new technological developments that provide significantly enhanced benefits over current digital technology
- . significant negative economic or industry trends
- . changes in our business strategy that alter the expected usage of the related assets
- . significant increase or decrease in our cost of capital
- . future terrorist or other actions that significantly impact the volume of mail
- . future economic results that are below our expectations used in the current assessments.

Results of Continuing Operations 2001 Compared to 2000

In 2001, our revenue increased 6%, income from continuing operations decreased 9% and diluted earnings per share from continuing operations decreased 5% to \$2.08 compared with \$2.18 for 2000. Excluding special items in both periods, income from continuing operations decreased 1% and diluted earnings per share from continuing operations increased 3% to \$2.25 compared with \$2.17 for 2000. Excluding the acquisitions of Secap SA, DSI, and MMT, our revenue increased 1%. These acquisitions did not materially impact earnings either on a per share or an aggregate basis.

13

Revenue

The following table shows revenue in 2001 and 2000 by segment:

(Dollars in millions)	2001	2000	% change
Global Mailing	\$2,847	\$2,831	1%
Enterprise Solutions	1,083	862	26%
Total Messaging Solutions	3,930	3,693	6%
Capital Services	192	188	2%
	\$4,122	\$3,881	6%
	=====	=====	=====

Total Messaging Solutions revenue grew 6% over the prior year. The revenue increase came from growth in the Global Mailing and Enterprise Solutions

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segments of 1% and 26%, respectively, over 2000. Approximately 75% of our total revenue in 2001 is recurring revenue, which we believe is a continuing good indicator of potential repeat business.

Excluding the acquisitions of Secap SA and MMT, Global Mailing revenues decreased 2%. Global Mailing revenue growth, particularly in the U.S. was adversely impacted by moderating customer orders and upgrades due to the slow economic environment, especially for shipping and system related products. Within the Global Mailing segment, international mailing revenues grew at a strong pace, fueled by revenues from the recent acquisitions of Secap SA and MMT plus continued strong demand for mailing products in Europe. However, revenue was also adversely impacted by weaker performance in the U.K. and Canada, as both countries were affected by slowing economic activity and a lull in those countries' meter migration programs.

Enterprise Solutions revenue growth was driven by a 34% increase at PBMS as a result of higher volume in the core business and the acquisition of DSI. Excluding the acquisition of DSI, Enterprise Solutions revenue grew 11%. DMT revenues increased 5% over the prior year; however performance continues to be impacted by a worldwide slow down in capital spending, which has caused many of our customers to delay purchases of higher-margin customized inserting systems.

Capital Services revenue increased 2% primarily due to higher revenue associated with the strategic financing of equipment for posts around the world.

Operating profit

The following table shows operating profit in 2001 and 2000:

(Dollars in millions)	2001	2000	% change
	-----	-----	-----
Global Mailing	\$ 860	\$844	2%
Enterprise Solutions	77	73	6%
	-----	-----	-----
Total Messaging Solutions	937	917	2%
Capital Services	73	65	11%
	-----	-----	-----
	\$1,010	\$982	3%
	=====	=====	=====

Operating profit grew 3% over the prior year, which reflected contributions from the acquisitions, as well as our continuing emphasis on reducing costs and controlling operating expenses. Operating profit grew 2% in the Global Mailing segment and 6% in the Enterprise Solutions segment.

The operating profit growth in the Global Mailing segment came from improved profit margins at Pitney Bowes Small Business Solutions (SBS). Operating profit growth was moderated by the events of September 11, 2001 and the continued slowdown of the economy. This was particularly true for higher volume mail creation and shipping products. The acquisitions of Secap SA and MMT did not materially impact Global Mailing operating profit.

The operating profit growth in our Enterprise Solutions segment came from double-digit operating profit growth at PBMS. Excluding the acquisitions of DSI, Enterprise Solutions operating profit decreased 11%. Enterprise Solutions' operating profit was negatively impacted by lower operating profit at DMT, due to higher expenses associated with the introduction and marketing of new products and lower placements of higher margin customized production mail equipment as a result of the slowdown in worldwide capital spending.

Operating profit increased 11% in the Capital Services segment due primarily to

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the higher revenue and the previously stated strategic shift to concentrate on fee-based income opportunities.

14

The following table shows revenue in 2001 and 2000 by source of revenue:

(Dollars in millions)	2001	2000	% change
Sales and management services	\$2,125	\$1,883	13%
Rentals and financing	1,461	1,505	(3%)
Support services	536	493	9%
	\$4,122	\$3,881	6%

Sales revenue increased 13% in 2001 due mainly to the acquisitions of Secap SA, DSI and MMT and double-digit sales revenue growth at PBMS. Excluding these acquisitions, sales grew 3%. Sales growth was moderated as a result of the contraction and downsizing of operations of some of our customers resulting in reduced demand for some of our higher value mailing products and outsourcing services. The negative impact of foreign currency reduced sales growth by slightly more than 1%. Increases in value-added services to both new and existing customers, as part of the company's strategy of pursuing profitable growth, stimulated revenue growth at PBMS. U.S. and U.K. Mailing Systems' sales decreased due to softness in the high-end shipping and mail creation product lines as the economy and slower customer decision-making process for the higher-value, more complex products adversely impacted growth. Sales revenue includes all revenues from PBMS which were \$821 million, \$612 million and \$576 million in 2001, 2000 and 1999, respectively. In total, Financial Services financed 33% and 37% of all sales in 2001 and 2000, respectively.

Rentals and financing revenue decreased 3% in 2001. Rentals revenue decreased 6% primarily due to the slowing economy and consolidation of facilities by some of our customers, which has resulted in fewer than usual upgrades to our larger systems meters. We continue to experience good placements of our stand-alone and new digital meters. At December 31, 2001, electronic meters represented approximately 50% of our U.S. meter base and digital meters represented approximately 50% of our U.S. meter base, up from 44% in 2000. We no longer place mechanical meters, which is in line with USPS guidelines. As previously mentioned, in 2001 we adopted a formal plan to transition to the next generation of networked mailing technology. See Regulatory and Legal Matters. We do not expect this transition to have a material adverse impact on rentals revenue.

Financing revenue increased 1% driven by higher revenue associated with the strategic financing of equipment for postal authorities around the world. Financing revenue growth was moderated by our strategy to reduce our asset-based financing in our Capital Services segment, through asset sales in 2001 and prior years.

Support services revenue increased 9% in 2001. Despite competitive pricing pressures, U.S. and International Mailing had increased support services revenue due to a larger population of extended maintenance contracts, higher chargeable service calls and billed labor hours in 2001 and the acquisition of MMT. DMT had double-digit growth in support services revenue due to an increased service contract base and on-site contracts. Ongoing support services revenue continues to be partially dependent on equipment sales levels.

Costs and Expenses

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The following table shows cost of sales as a percentage of sales revenue in 2001 and 2000:

(Dollars in millions)	2001 -----	2000 -----	% change -----
	\$1,271	\$1,074	18%
Percentage of sales revenue	59.8%	57.1%	

Cost of sales, as a percentage of sales revenue, increased primarily due to the acquisition of DSI and the increasing mix of lower margin core PBMS sales revenue. Cost of sales attributable to PBMS was \$660 million and \$495 million in 2001 and 2000, respectively. This rate was also negatively impacted by unfavorable product mix at our U.S. and international mailing businesses; in particular, our DMT customers delayed purchases of higher-margin customized inserting systems.

The following table shows cost of rentals and financing as a percentage of rentals and financing revenue in 2000 and 2001:

(Dollars in millions)	2001 -----	2000 -----	% change -----
	\$351	\$373	(6%)
Percentage of rentals and financing revenue	24.0%	24.8%	

15

Cost of rentals and financing, as a percentage of rentals and financing revenue, improved .8 percentage points. The cost of rentals ratio improved due to lower costs and related depreciation at U.S. Mailing and SBS, partially attributable to our meter transition plan. We expect that this ratio will be impacted in 2002 by the timing of our customers' transition to digital meters. The cost of financing ratio was slightly higher due to higher costs associated with new business initiatives.

Selling, service and administrative expenses

The following table shows selling, service and administrative expenses as a percentage of total revenue in 2001 and 2000:

(Dollars in millions)	2001 -----	2000 -----	% change -----
	\$1,370	\$1,299	5%
Percentage of total revenue	33.2%	33.5%	

Selling, service and administrative expenses were 33.2% of total revenue in 2001 compared with 33.5% in 2000. The improvement in this ratio resulted from continued emphasis on controlling our expenses. This was the seventh consecutive year of improvement in our selling, service and administrative expenses to revenue ratio, excluding special items. The ratio was favorably impacted by our successful Enterprise-Wide Resource Planning (ERP) initiative and by our restructuring initiatives. The improvement in this ratio was partially offset by costs associated with investments in acquisition and growth initiatives and the higher mix of support services revenue.

Research and development expenses

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The following table shows our research and development expenses in 2001 and 2000:

(Dollars in millions)	2001 -----	2000 -----	% change -----
	\$133	\$120	10%

Research and development expenses increased 10% in 2001 to \$133 million reflecting continued investment in developing new technologies and enhancing features for all our products. The 2001 increase represents expenditures for digital document delivery systems, new digital meters and mailing machines, personal computer metering technology, advanced inserting equipment, and new and advanced features for production mail equipment and high volume incoming mail sorting equipment. We expect similar levels of investment in research and development in 2002.

Net interest expense

The following table shows our net interest expense in 2001 and 2000:

(Dollars in millions)	2001 -----	2000 -----	% change -----
	\$184	\$192	(4%)

Net interest expense decreased due to lower average interest rates during 2001 compared to 2000 associated with borrowings to fund the company's investment in leasing and rental products, acquisitions and the stock repurchase program. Our variable and fixed rate debt mix, after adjusting for the effect of interest rate swaps, was 42% and 58%, respectively, at December 31, 2001. Based on current borrowing levels, a 25 basis point change in interest rates would impact annual interest expense by approximately \$3 million to \$4 million.

Effective tax rate

The following table shows the effective tax rate in 2001 and 2000:

2001 -----	2000 -----
32.9%	29.9%

Excluding the impact of special items in 2001, the effective tax rate was 31.6% in 2001 compared to 31.4% in 2000, reflecting continued tax benefits from leasing and financing activities. The tax rate is favorably impacted by investment in leasing and international expansion. The company's provision for taxes could be impacted by tax law changes and interpretations by governments or courts.

Income from continuing operations decreased 9% and diluted earnings per share from continuing operations decreased 5% in 2001. Excluding special items in both periods, income from continuing operations decreased 1% and diluted earnings per share from continuing operations increased 3% in 2001. The increase in diluted earnings per share outperformed the decrease in income from continuing operations due to the company's share repurchase program, under which 7.8 million shares, approximately 3% of the average common and potential common shares outstanding at the end of 2000, were repurchased in 2001. Excluding special items in both periods, income from continuing operations as a percentage of revenue decreased to 13.5% in 2001 from 14.5% in 2000 due primarily to the higher mix of lower-margin revenues.

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Results of Continuing Operations 2000 Compared to 1999

In 2000, our revenue increased 2%, operating profit grew 8%, income from continuing operations was flat and diluted earnings per share from continuing operations increased 5% to \$2.18 compared with \$2.07 for 1999. Excluding the impact of special items in both periods, our income from continuing operations grew 5% and diluted earnings per share from continuing operations increased 11% to \$2.17 compared with \$1.96 for 1999.

Revenue

The following table shows revenue in 2000 and 1999 by segment:

(Dollars in millions)	2000	1999	% change
Global Mailing	\$2,831	\$2,799	1%
Enterprise Solutions	862	803	7%
Total Messaging Solutions	3,693	3,602	3%
Capital Services	188	210	(10%)
	\$3,881	\$3,812	2%

Total Messaging Solutions revenue grew 3% over the prior year. The revenue increase came from growth in the Global Mailing and Enterprise Solutions segments of 1% and 7%, respectively, over 1999. Approximately 74% of our total revenue in 2000 was recurring revenue.

Global Mailing revenue growth was negatively impacted by lower sales of mail creation and shipping logistics products in the second half of 2000. Global Mailing revenue was also negatively impacted by the weakening of foreign currencies, principally the British pound and Euro currencies.

Volume increases at PBMS and DMT were the principal reasons for the revenue growth in the Enterprise Solutions segment.

Capital Services revenue decreased 10% due to the company's previously stated strategy to concentrate on fee-based income opportunities. The impact of price changes was minimal.

Operating profit

The following table shows operating profit in 2000 and 1999 by segment:

(Dollars in millions)	2000	1999	% change
Global Mailing	\$844	\$790	7%
Enterprise Solutions	73	52	42%
Total Messaging Solutions	917	842	9%
Capital Services	65	65	-
	\$982	\$907	8%

Operating profit grew 8% over the prior year, continuing to reflect our emphasis on reducing costs and controlling operating expenses. The company's successful ERP initiative also helped to enhance our operating capabilities. Another measure of our success in controlling costs and expenses in 2000 and 1999 was that growth in operating profit continued to outpace revenue growth.

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Operating profit grew 7% in the Global Mailing segment and 42% in the Enterprise Solutions segment. Total Messaging Solutions operating profit grew 9% over the prior year. Operating profit remained flat in the Capital Services segment.

The operating profit growth in the Global Mailing segment came from improved profit margins at SBS and International Mailing, as well as margin improvements at U.S. Mailing Systems and related financing. The operating profit growth in our Enterprise Solutions segment came from double-digit operating profit growth at PBMS and DMT.

17

The following table shows revenue in 2000 and 1999 by source of revenue:

(Dollars in millions)	2000	1999	% change
Sales and management services	\$1,883	\$1,863	1%
Rentals and financing	1,505	1,486	1%
Support services	493	463	6%
	\$3,881	\$3,812	2%

Sales revenue increased 1% in 2000 due mainly to high single-digit growth in our International Mailing, DMT and management services businesses. The negative impact of foreign currency reduced sales growth by slightly more than 1%. Increases in value-added services to both new and existing customers, as part of the company's strategy of pursuing profitable growth, stimulated revenue growth in our management services business. DMT's sales growth was driven by strong demand for sophisticated, high speed production mail equipment to process complex, unique marketing and billing statements. U.S. Mailing systems' sales decreased due to softness in the high-end shipping and mail creation product lines as the slowing economy and slower customer decision-making process for the higher-value, more complex products adversely impacted growth. In total, Financial Services financed 37% of all sales in 2000 and 1999.

Rentals and financing revenue increased 1% in 2000. Rentals revenue grew 2% driven by growth in the U.S. and international mailing markets due to the continuing shift to electronic and digital meters, including increased placements of the digital desktop Personal Post/TM/ meter, available through various distribution channels such as telemarketing, the Internet and selected retail outlets specializing in business supplies. At December 31, 2000, electronic meters represented approximately 56% of our U.S. meter base and digital meters represented approximately 44% of our U.S. meter base, up from 40% in 1999. The company no longer places mechanical meters, which is in line with USPS guidelines.

Financing revenue was flat due to our strategy to reduce our asset-based financing, through asset sales in 2000 and prior years. Excluding Capital Services, financing revenue grew 7% driven by increased volume of leases of the company's products and by product offerings such as Purchase Power/R/, Postal Privilege/R/ and Reserve Account.

Support services revenue increased 6% in 2000. Despite competitive pricing pressures, U.S. and International Mailing had increased support services revenue due to a larger population of extended maintenance contracts and higher chargeable service calls and billed labor hours in 2000. DMT had double-digit growth in support services revenue due to increased service contract base and on-site contracts.

Costs and Expenses

The following table shows cost of sales as a percentage of sales revenue in 2000 and 1999:

(Dollars in millions)	2000	1999	% change
	-----	-----	-----
	\$1,074	\$1,072	—
Percentage of sales revenue	57.1%	57.5%	

Cost of sales, as a percentage of sales revenue, improved for the fourth consecutive year. The improvement in this ratio was achieved principally due to lower product costs, significant productivity improvements in our manufacturing processes, increased sales of higher margin supplies in our mailing business and the impact of strategic sourcing initiatives in the U.S. and Europe. The improvement in this ratio was moderated by the increasing mix of lower margin PBMS sales revenue.

The following table shows cost of rentals and financing as a percentage of rentals and financing revenue:

(Dollars in millions)	2000	1999	% change
	-----	-----	-----
	\$373	\$396	(6%)
Percentage of rentals and financing revenue	24.8%	26.6%	

Cost of rentals and financing, as a percentage of rentals and financing revenue, improved 1.8 percentage points. The cost of rentals ratio improvement was due to lower costs at U.S. Mailing in 2000. The cost of financing ratio decreased due to lower operating costs, partially offset by increased costs associated with new business initiatives.

18

Selling, service and administrative expenses

The following table shows selling, service and administrative expenses as a percentage to total revenue in 2000 and 1999:

(Dollars in millions)	2000	1999	% change
	-----	-----	-----
	\$1,299	\$1,290	1%
Percentage of total revenue	33.5%	33.8%	

Selling, service and administrative expenses were 33.5% of total revenue in 2000 compared with 33.8% in 1999. The improvement in this ratio resulted from continued emphasis on controlling expense growth. This was the sixth consecutive year of improvement in our selling, service and administrative expenses to revenue ratio, excluding special items. The improvement in this ratio was moderated by the company's continued investment in the Internet, ERP and other new business initiatives.

Research and development expenses

The following table shows research and development expenses in 2000 and 1999:

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(Dollars in millions)	2000	1999	% change
	-----	-----	-----
	\$120	\$109	11%

Research and development expenses increased 11% in 2000 to \$120 million reflecting continued investment in developing new technologies and enhancing features for all our products. The 2000 increase represents expenditures for Internet-based bill presentment and metering, digital document delivery systems, new digital meters, personal computer metering technology, advanced inserting equipment, and new and advanced features for production mail equipment and high volume incoming mail sorting equipment.

Net interest expense

The following table shows net interest expense in 2000 and 1999:

(Dollars in millions)	2000	1999	% change
	-----	-----	-----
	\$192	\$171	13%

Net interest expense increased due to higher interest rates during 2000 compared to 1999 associated with borrowings to fund the company's investment in leasing and rental products, and the stock repurchase program. Our variable and fixed rate debt mix, after adjusting for the effect of interest rate swaps, was 48% and 52%, respectively, at December 31, 2000.

Effective tax rate

The following table shows the effective tax rate in 2000 and 1999:

2000	1999
-----	-----
29.9%	31.7%

Excluding the one-time tax benefit related primarily to recent state tax law changes, the effective tax rate was 31.4% in 2000, reflecting continued tax benefits from leasing and financing activities, lower state and local taxes, and lower taxes attributable to international sourced income.

Income from continuing operations was flat and diluted earnings per share from continuing operations increased 5% in 2000. Excluding special items in both periods, income from continuing operations and diluted earnings per share from continuing operations increased 5% and 11%, respectively, in 2000. The increase in diluted earnings per share outpaced the increase in income from continuing operations due to the company's share repurchase program, under which 17.2 million shares, approximately 6% of the average common and potential common shares outstanding at the end of 1999, were repurchased in 2000. Excluding special items in both periods, income from continuing operations as a percentage of revenue increased to 14.5% in 2000 from 14.0% in 1999, the seventh consecutive year of improvement in this ratio.

Restructuring Charges

In 2001, we adopted a formal restructuring plan to implement a common, streamlined business infrastructure across the corporation as a result of our decisions to spin off our office systems business and align our mailing business on a global basis, as well as cost saving opportunities resulting from

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strategic acquisitions and partnerships, and additional benefits attained from the consolidation of our IT organization and ERP initiatives. In connection with this plan, we recorded pretax restructuring charges of \$149.3 million in 2001, of which \$116.1 million was related to continuing operations and the remaining \$33.2 million was related to discontinued operations. The restructuring charges related to continuing operations have been segregated in the Consolidated Statements of Income for the year ended December 31, 2001. The restructuring charges related to discontinued operations have been reported in discontinued operations in the Consolidated Statement of Income for the year ended December 31, 2001. See Note 13 to the consolidated financial statements.

The restructuring charges related to continuing operations are comprised of:

(Dollars in millions)	December 31, 2001

Severance and benefit costs	\$ 74.3
Asset impairments	28.0
Other exit costs	13.8

	\$116.1
	=====

All restructuring charges, except for the asset impairments, will result in cash outflows. The severance and benefit costs relate to a reduction in workforce of approximately 1,200 employees worldwide which was initiated in 2001 and will be completed over the next six months. The workforce reductions relate to actions across several of our businesses resulting from infrastructure and process improvements and our continuing efforts to streamline operations, and include managerial, professional, clerical and technical roles. Approximately 80% of our workforce reductions are in the U.S. The majority of the international workforce reductions are in Europe. None of the reductions will impact our sales coverage. As of December 31, 2001, 692 employees were separated under these initiatives and approximately \$34 million of severance and benefit costs were paid. Asset impairments relate primarily to the disposal or abandonment of certain hardware and software applications, resulting from the alignment of our mailing business on a global basis and ERP initiatives. Other exit costs relate primarily to lease termination costs, non-cancelable lease payments, and other costs associated with business activities that have been exited and the consolidation of excess facilities.

The restructuring charges related to discontinued operations are comprised of:

(Dollars in millions)	December 31, 2001

Severance and benefit costs	\$ 1.9
Asset impairments	17.5
Other exit costs	13.8

	\$ 33.2
	=====

The severance and benefit costs relate to a reduction in workforce of approximately 25 employees. The asset impairments relate primarily to an impairment of residual values, in connection with leases of copier equipment, and the write-down of certain facsimile and copier equipment, resulting from the spin-off of our office systems business. Other exit costs relate primarily to incremental costs associated with cancellation and separation of facility occupancy leases that are shared between the company and IGI.

Accrued restructuring charges at December 31, 2001 consist of the following:

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(Dollars in millions)	Total restructuring charges	Cash payments	Non-cash charges	Ending balance
	-----	-----	-----	-----
Severance and benefit costs	\$ 76.2	\$34.5	\$ -	\$41.7
Asset impairments	45.5	-	45.5	-
Other exit costs	27.6	14.5	-	13.1
	-----	-----	-----	-----
	\$ 149.3	\$49.0	\$45.5	\$54.8
	=====	=====	=====	=====

We expect that the majority of the remaining cash outflows related to restructuring charges will take place over the next six months, funded primarily by cash provided by operating activities. The restructuring charges are expected to increase our operating efficiency and effectiveness in 2002 and beyond while enhancing growth, primarily as a result of reduced personnel-related expenses. We expect pretax savings in operating expenses of approximately \$50 million in 2002.

In 2000, we recorded a one-time pretax charge of approximately \$19 million related to the consolidation of information technology staff and infrastructure. This initiative was focused on creating an efficient global organization and technology platform to leverage the

20

benefits of our ERP and e-business initiatives. The majority of the initiatives and cash outflows relating to this consolidation, were completed by December 31, 2001.

We operate in very competitive industries and we are continually evaluating our cost structure. Economic or competitive events in the future may necessitate that the company formulate additional plans to reduce our existing cost structure.

Meter Transition

In 2001, we adopted a formal plan to transition to the next generation of networked mailing technology. The information capture and exchange made possible by advanced technology, turns the postage meter into an "intelligent" terminal that networks the mailer to postal and carrier information and systems. This two-way information architecture, in turn, enables convenient access to and delivery of value-added services such as tracking, delivery confirmation and rate information. The adoption of this plan was facilitated by our expanded access to technology and our ability to move to networked products combined with our expectations that the U.S. and postal services around the world will continue to encourage the migration of mailing systems to networked digital technologies. As a result of this plan, certain electronic meter rental assets and related equipment will not be placed back in service. In addition, certain leased equipment will either not be remarketed or will result in lower realization at end of lease as a result of the introduction of new technology. In connection with this plan, the company recorded non-cash pretax charges of \$268.3 million for the year ended December 31, 2001, related to assets associated with our non-networked mailing technology. In November 2001, postal regulations were issued, consistent with our meter transition plan, defining the meter migration process and timing. See Regulatory Matters.

The charges related to the meter transition plan are comprised of:

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	December 31, 2001
(Dollars in millions)	-----
Impairment of lease residual values	\$128.4
Impairment of meter rental assets	71.3
Inventory writedowns	27.6
Additional depreciation costs on meter rental assets	41.0

	\$268.3

Acquisitions

In October 2001, we acquired Secap SA, a company based in France, for approximately Euros 220 million in cash. Secap offers a range of mail processing and paper handling equipment, supplies and technology for low- to mid-volume mailers. Secap holds more than 30% of the postage meter market share in France.

In June 2001, we acquired DSI from Danka Business Systems PLC for \$290 million in cash. DSI provides on- and off-site document management services, including the management of central reprographic departments, the placement and maintenance of photocopiers, print-on-demand operations and document archiving and retrieval services.

In June 2001, we acquired the MMT business in Europe, Africa, the Middle East and Asia, for \$51 million in cash. MMT markets and services high-end mail processing, sorting and service-related products through a network of distributors and direct operations. We accounted for the acquisition under the purchase method and accordingly the operating results of MMT have been included in the company's consolidated financial statements since the date of acquisition.

The acquisitions of Secap SA, DSI and MMT did not materially impact income from continuing operations for the year ended December 31, 2001. See Note 15 to the consolidated financial statements.

21

Accounting Changes

In 1998, FAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," amended in 2000 by FAS No. 138, was issued. FAS No. 133 requires that an entity recognize all derivative instruments as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Changes in the fair value of those instruments will be reflected as gains or losses. The accounting for the gains or losses depends on the intended use of the derivative and the resulting designation. The company adopted the provisions of FAS No. 133 in the first quarter of 2001. The company uses derivatives to reduce the volatility in earnings and cash flows associated with the impact of interest rate changes and foreign currency fluctuations due to its investing and funding activities and its operations in different foreign currencies. Derivatives designated as cash flow hedges include primarily foreign exchange contracts and interest rate swaps related to variable-rate debt. Derivatives designated as fair value hedges include primarily interest rate swaps related to fixed-rate debt. The adoption of FAS No. 133 has resulted in an after-tax reduction to accumulated other comprehensive income of \$7.0 million, including a one-time cumulative effect of accounting change which reduced accumulated other comprehensive income by approximately \$9.2 million in the first quarter of 2001. The adoption of FAS

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No. 133 has also impacted assets and liabilities recorded on the Consolidated Balance Sheet. The adoption of FAS No. 133 did not materially impact results of operations for the year ended December 31, 2001.

In 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements," summarizing certain guidance in applying generally accepted accounting principles to revenue recognition in financial statements. The company adopted the provisions of SAB No. 101 in the fourth quarter of 2000, retroactive to January 1, 2000. The adoption of SAB No. 101 resulted in a one-time cumulative after-tax reduction in net income of \$4.7 million (net of taxes of approximately \$3.1 million) in the first quarter of 2000. The reduction to net income was primarily attributable to the deferral of sales recognition of software-enabled mail creation equipment and shipping products prior to installation. See Note 1 to the consolidated financial statements.

In 2000, FAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" was issued, replacing FAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." FAS No. 140 revises the standards for accounting for securitizations and other transfers of financial assets and collateral, as well as requiring certain additional disclosures. However, it carries over most of the provisions contained in FAS No. 125. FAS No. 140 is effective for transfers and servicing of financial assets and extinguishment of liabilities occurring after March 31, 2001. However, it was effective for the recognition and reclassification of collateral and for disclosures relating to those transactions for the year ended December 31, 2000. The adoption of this standard did not have a material impact on the company.

In July 2001, FAS No. 141, "Business Combinations" and FAS No. 142, "Goodwill and Other Intangible Assets" were issued requiring business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and refining the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles will be evaluated against this new criterion and may result in certain intangibles being included in goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. FAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and indefinite lived intangibles. Under a nonamortization approach, goodwill and indefinite lived intangibles will not be amortized into results of operations, but instead will be reviewed for impairment and charged against results of operations only in the periods in which the recorded value of goodwill and indefinite lived intangibles is more than its fair value. The company has adopted the provisions of each statement, which apply to business combinations completed after June 30, 2001. The adoption of these accounting standards did not materially impact results of operations for the year ended December 31, 2001. The provisions of each statement, which apply to goodwill and intangible assets acquired prior to June 30, 2001 will be adopted by the company on January 1, 2002. The adoption of these standards is expected to reduce the amortization of intangible assets commencing January 1, 2002. Goodwill will be reviewed for impairment on a periodic basis.

In August 2001, FAS No. 143, "Accounting for Asset Retirement Obligations" was issued, amending FAS No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies," and applies to all entities. FAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. FAS No. 143 is effective January 1, 2003 for the company. The company is currently evaluating the impact of this statement.

In August 2001, FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," was issued, replacing FAS No. 121, "Accounting for the

Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and portions of Accounting Principles Board (APB) Opinion 30, "Reporting the Results of Operations." FAS No. 144 provides a single accounting model for long-lived assets to be disposed of and changes the criteria that would have to be met to classify an asset as held-for-sale. FAS No. 144 retains the requirement of APB Opinion 30, to report discontinued operations separately from continuing operations and extends that reporting to separate components of an entity. FAS No. 144 is effective January 1, 2002 for the company. The company is currently evaluating the impact of this statement.

In September 2001, the Financial Accounting Standards Board's Emerging Issues Task Force (EITF) reached a consensus on Issue 01-10, "Accounting for the Impact of the Terrorist Attacks of September 11, 2001." EITF 01-10 provides guidance for accounting for the

22

effects of the events of September 11, 2001 in financial statements. The company believes it is in compliance with this consensus in all material respects.

Liquidity and Capital Resources

Our current ratio reflects our practice of using a balanced mix of debt maturities to fund finance assets. Our ratio of current assets to current liabilities declined to .83 to 1 at December 31, 2001 compared to .91 to 1 at December 31, 2000. The decrease in this ratio was primarily due to the prior year classification of IGI's net assets to be disposed of in the current assets section of the Consolidated Balance Sheet at December 31, 2000. Excluding IGI's net current assets to be disposed of, the ratio of current assets to current liabilities would have been .84 to 1 at December 31, 2000.

To manage interest rate risk, we use a balanced mix of debt maturities, variable and fixed rate debt and interest rate swap agreements.

Our cash and cash equivalents increased to \$231.6 million at December 31, 2001, from \$198.3 million at December 31, 2000. The increase resulted primarily from \$1.0 billion provided by operating activities, offset in part by \$839.5 million and \$162.9 million used in investing and financing activities, respectively. Net cash of \$1.0 billion provided by operating activities consisted primarily of net income adjusted for non cash items, and the increase in deferred taxes on income, partially offset by changes in working capital and our investment in internal finance receivables. Net cash used in working capital resulted primarily from decreases in accounts payable, related to our implementation of SAP. Net cash of \$839.5 million used in investing activities consisted primarily of acquisitions, investments in fixed assets and leveraged leases, partially offset by reserve account deposits. Net cash of \$162.9 million used in financing activities consisted primarily of stock repurchases and dividend paid to stockholders.

Excluding special items and discontinued operations in both periods, the ratio of EBIT to interest was 5.4x and 5.3x and the ratio of EBITDA to interest was 6.7x and 6.6x for the years ended December 31, 2001 and 2000, respectively. The ratio of total debt to total debt and stockholders' equity was 79.7% at December 31, 2001, versus 71.1% at December 31, 2000. Including the preferred stockholders' equity in a subsidiary company as debt, the ratio of total debt to total debt and stockholders' equity was 81.0% at December 31, 2001 compared to 73.0% at December 31, 2000. The increase in this ratio was driven primarily by the special dividend associated with the spin-off of IGI and debt related to acquisitions and the \$300 million repurchase of 7.8 million shares of common

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stock. The company's generation of \$780 million of free cash flow (defined as cash from operations less capital expenditures) partially offset the increase in this ratio. Excluding the cash flow impacts of the restructuring initiatives, HP settlement and discontinued operations, free cash flow was \$617 million in 2001.

On June 30, 2000 the company, through PBCC, sold its PitneyWorks/SM/ Business Rewards/SM/ Visa/R/ and Business Visa/R/ card operations, including credit card receivables of approximately \$322 million.

Financings and Capitalization

On February 20, 2002, the company completed an offering of Euros 250 million of senior unsecured notes. These notes bear interest at a floating rate of EURIBOR plus 20 basis points, set two Euro business days preceding the quarterly interest payment dates and mature in August 2003. The notes are listed on the Luxembourg Stock Exchange and have been designated as a hedge of Euro denominated assets held by the company. The proceeds from these notes will be used for general corporate purposes which may include repaying commercial paper, financing acquisitions and the repurchase of company stock.

In October 2001, Pitney Bowes Inc. filed a shelf registration statement with the SEC which permits the issuance of up to \$2 billion in debt securities, preferred stock and depositary shares, all of which remained available for issuance at December 31, 2001.

In April 2001, the company issued the remaining \$300 million of notes available under a prior shelf registration, permitting issuances of up to \$500 million in debt securities (including medium-term notes) with a minimum maturity of nine months. These unsecured notes bear annual interest at 5.875% and mature in May 2006. The proceeds were used for general corporate purposes, including the repayment of commercial paper, financing acquisitions and the repurchase of company stock.

PBCC has \$75 million of unissued debt securities available at December 31, 2001 from a shelf registration statement filed with the SEC in July 1998. As part of this shelf registration statement, in August 1999, PBCC established a medium-term note program for the issuance from time to time of up to \$500 million aggregate principal amount of Medium-Term Notes, Series D. In August 2001, PBCC issued \$350 million of unsecured fixed rate notes maturing in August 2008. These notes bear interest at an annual rate of 5.75% and pay interest semi-annually beginning February 15, 2002. The proceeds from these notes were used for general corporate purposes, including the repayment of commercial paper.

In July 2001, PBCC issued four non-recourse promissory notes totaling \$111.5 million in connection with four lease transactions. The promissory notes are all due in installments over 194 months at an interest rate of 7.24%. In September 2001, PBCC sold its interest in two of the lease transactions and transferred the obligation on two of the non-recourse promissory notes totaling \$55.3 million in principal balance. Two non-recourse promissory notes remain outstanding at December 31, 2001 with a total principal balance of \$54.9 million. These notes are serviced by the underlying lease transaction payments.

In December 2000, PBCC issued \$100 million of unsecured floating rate notes maturing in April 2002 and \$100 million of unsecured floating rate notes maturing June 2004, available under the medium-term note program. These notes bear interest at floating rates of LIBOR plus five basis points and 25 basis

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points, respectively, set as of the quarterly interest payment dates. The proceeds from these notes were used for general corporate purposes, including the repayment of commercial paper.

In March 2000, PBCC issued \$43.3 million of 7.515% Senior Notes maturing 2002 through 2012. The proceeds from these notes were used to pay down commercial paper.

In April 2000, PBCC issued a total of \$134 million of Series A and Series B Secured Floating Rate Senior Notes. The notes mature in 2003 and bear interest at 7.443%. The proceeds from these notes were used for general corporate purposes, including the repayment of short-term debt.

To help us better manage our international cash and investments, in June 1995 and April 1997, Pitney Bowes International Holdings, Inc., a subsidiary of the company, issued \$200 million and \$100 million, respectively, of variable term, voting preferred stock (par value \$.01) representing 25% of the combined voting power of all classes of its outstanding capital stock, to outside institutional investors in a private placement. The remaining 75% of the voting power is held directly or indirectly by Pitney Bowes Inc. The preferred stock is recorded on the Consolidated Balance Sheets as preferred stockholders' equity in a subsidiary company. We used the proceeds of these transactions to pay down short-term debt. We have an obligation to pay cumulative dividends on this preferred stock at rates that are set at auction. The auction periods are generally 49 days, although they may increase in the future. The weighted average dividend rate in 2001 and 2000 was 3.3% and 4.7%, respectively. Preferred dividends are reflected as minority interest in the Consolidated Statements of Income in selling, service and administrative expenses. In December 1998, the company sold 9.11% Cumulative Preferred Stock, mandatorily redeemable in 20 years, in a subsidiary company to an institutional investor for approximately \$10 million.

At December 31, 2001, the company, together with its financial services businesses, had unused lines of credit and revolving credit facilities of \$1.5 billion in the U.S. and \$24.3 million outside the U.S., largely supporting commercial paper debt.

We believe our financing needs for the next 12 months can be met with cash generated internally, money from existing credit agreements, debt issued under new and existing shelf registration statements and existing commercial and medium-term note programs. Information on debt maturities is presented in Note 5 to the consolidated financial statements.

Total financial services assets increased to \$6.5 billion at December 31, 2001, up 4.3% from \$6.2 billion in 2000. To fund finance assets, borrowings were \$3.5 billion in 2001 and \$3.3 billion in 2000. Approximately \$290 million and \$480 million in cash was generated from the sale of finance assets in 2001 and 2000, respectively. We used the money to pay down debt, repurchase shares and fund new business investments.

The following summarizes our contractual obligations at December 31, 2001, and the effect that such obligations are expected to have on our liquidity and cash flow in future periods:

(Dollars in millions)	Total	Less than 1 year	1-3 years	After
	-----	-----	-----	-----
Commercial paper borrowings	\$ 865	\$ 865	\$ -	
Long-term debt and current portion of long-term debt	2,624	205	1,333	

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Non-cancelable capital lease obligations	7	3	4
Non-cancelable operating lease obligations	223	67	132
	-----	-----	-----
	\$3,719	\$1,140	\$1,469
	=====	=====	=====

24

Leveraged Leases

Our investment in leveraged lease assets consists of the following:

	December 31, 2001
(Dollars in billions)	-----
Rental receivables	\$7.7
Residual value	.7
Principal and interest on nonrecourse loans	(6.2)
Unearned income	(.9)

Total leveraged leases	\$1.3
	=====

- . The \$1.3 billion is the amount that is on our Consolidated Balance Sheet.
- . Rental receivables represent total lease payments from our customers over the remaining term of the leveraged leases.
- . Residual value represents the value of the property anticipated at the end of the leveraged lease terms and is based on independent appraisals performed by nationally recognized appraisers. We regularly review the recorded residual values to ensure they are appropriate.
- . Principal and interest on nonrecourse loans represent amounts due to unrelated third parties from our customers over the remaining term of the leveraged leases. The nonrecourse loans are secured by the lessees' rental obligation and the leased property. If a lessee defaults and if the amounts realized from the sale of these assets are insufficient, we have no obligation to make any payments due on these nonrecourse loans to the unrelated third parties. Accordingly, we are required by generally accepted accounting principles to subtract the principal and interest over the remaining term of the nonrecourse loans from our rental receivables and residual value. At December 31, 2001, the principal balances on the nonrecourse loans totaled \$3.1 billion and the related interest payments over the remaining terms of the leases totaled \$3.1 billion.
- . Unearned income represents our future financing income that will be earned over the remaining term of the leases.

The \$1.3 billion investment in leveraged leases on our Consolidated Balance Sheet is diversified across the following types of assets:

- . \$332.1 million related to commercial real estate facilities, with original lease terms ranging from 15 to 25 years.
- . \$301.3 million for nine aircraft transactions with major commercial airlines, with original lease terms ranging from 22 to 25 years.
- . \$286.4 million related to locomotives and railcars, with original lease terms ranging from 19 to 47 years.

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- . \$166.6 million for postal equipment with international postal authorities, with original lease terms ranging from 16 to 24 years.
- . \$130.0 million for rail and bus facilities with original lease terms ranging from 32 to 44 years.
- . \$120.8 million for telecommunications equipment, with original lease terms ranging from 14 to 16 years.

We have been entering into leveraged lease transactions for 14 years and losses related to our leveraged lease portfolio have been minimal. We enter into these transactions selectively with highly creditworthy lessees to whom we lease equipment and other assets with consistently strong resale values. Our average transaction value is approximately \$28 million. Additionally, our investment in leveraged leases is diversified across 37 customers, 48 individual transactions and six major product types. As a result, we believe that our risk of a material loss in the current portfolio is minimal.

Off-Balance Sheet Items

Finance receivables sales

We have sold net finance receivables and in selective cases entered into guarantee contracts with varying amounts of recourse in privately placed transactions with unrelated third-party investors. The uncollected principal balance of receivables sold and guarantee contracts totaled \$181.2 million and \$262.1 million at December 31, 2001 and 2000, respectively. In accordance with generally accepted accounting principles, we do not record these amounts as liabilities on our Consolidated Balance Sheet.

Our maximum risk of loss on these net financing receivables and guarantee contracts arises from the possible non-performance of lessees to meet the terms of their contracts and from changes in the value of the underlying equipment. These contracts are secured by the underlying equipment value, and supported by the creditworthiness of our customers. At December 31, 2001, the underlying equipment value exceeded the sum of the uncollected principal balance of receivables sold and the guarantee contracts. As part of our review of our risk exposure, we believe we have made adequate provision for sold receivables and guarantee contracts which may not

25

be collectible. See Notes 18 and 20 to the consolidated financial statements. We do not depend on these types of transactions to fund our leasing investments. We selectively use these transactions when the overall economic impact on us is more favorable than debt.

Equity interest

During 1997, PBCC and GATX Corporation (GATX) formed PBG Capital Partners LLC (PBG) for the purpose of financing and managing certain leasing related assets existing at that time. We contributed assets to PBG and maintain a 50% interest. We account for our investment in PBG under the equity method. Our maximum exposure is our investment of \$166 million on our Consolidated Balance Sheet at December 31, 2001. PBG's total assets and liabilities at December 31, 2001 are \$536 million and \$290 million, respectively. In accordance with generally accepted accounting principles, we do not record these assets and liabilities on our Consolidated Balance Sheet.

State and local government financing

We have originated tax-exempt secured loans to state and local governments and

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have sold certificates of interest in these loans to third parties. Generally, we recognize revenue for the fees we receive upon the sale of these certificates. These transactions however, may require us to buy back certificates from the third parties if interest rates rise significantly. Our maximum risk of loss arises because we may be required to buy back certificates and resell them to other third parties at below our cost. We have structured these transactions so that even in a rising interest rate environment, our losses would be minimal. We have further minimized any risk of non-performance on the state and local government loans by obtaining credit guarantees of these loans from a highly-rated nationally recognized insurance company. Certificates outstanding at December 31, 2001 and 2000 were \$263.7 million and \$240.7 million, respectively. In accordance with generally accepted accounting principles, we do not record these certificates as assets or liabilities on our Consolidated Balance Sheet.

Capital Investment

During 2001, net investments in fixed assets included net additions of \$132 million to property, plant and equipment and \$124 million of rental equipment and related inventories, compared with \$122 million and \$147 million, respectively, in 2000. These additions included expenditures for normal plant and manufacturing equipment. In the case of rental equipment, the additions included the production of postage meters and the purchase of facsimile and copier equipment related to the discontinued operations of IGI. Excluding IGI, net investments in fixed assets during 2001 included net additions of \$119 million to property, plant and equipment and \$68 million to rental equipment and related inventories, compared with \$118 million and \$71 million during 2000, respectively.

The company expects net investments in fixed assets in 2002, relating to continuing operations, to be flat to slightly higher than the prior year. These investments will also be impacted by the timing of our customer's transition to digital meters. At December 31, 2001, commitments for the acquisition of property, plant and equipment reflected plant and manufacturing equipment improvements as well as rental equipment for new and replacement programs.

Legal and Regulatory Matters

Legal

In the course of normal business, we are occasionally party to lawsuits. These may involve litigation by or against the company relating to, among other things:

- .. contractual rights under vendor, insurance or other contracts
- .. intellectual property or patent rights
- .. equipment, service or payment disputes with customers
- .. disputes with employees

We are currently a plaintiff or a defendant in a number of lawsuits, none of which should have, in the opinion of management and legal counsel, a material adverse effect on the company's financial position or results of operations. See Legal settlements, net in Special Items.

USPS meter transition

In 2000, the USPS issued a proposed schedule for the phaseout of manually reset electronic meters in the U.S. as follows:

- .. As of February 1, 2000, new placements of manually reset electronic meters are no longer permitted.
- .. Current users of manually reset electronic meters can continue to use these meters for the term of their current rental and lease agreements. Leases or rentals that expired in 2000 could be extended to December 31, 2001.

On November 15, 2001, the USPS issued a final rule as follows:

- .. New placements of non-digital meters without the "timeout" feature that enables the meters to be automatically disabled, if not reset within a specified time period are no longer permitted after December 31, 2002. These meters must be off the market by December 31, 2006.
- .. New placements of non-digital meters with a "timeout" feature are no longer permitted after June 2004. These meters must be off the market by December 31, 2008.

We have submitted comments to the USPS's proposed schedules described above. We adopted a formal meter transition plan in the second quarter of 2001, to transition to the next generation of networked mailing technology. See Note 14 to the consolidated financial statements.

USPS Information Based Indicia Program (IBIP)

In May 1995, the USPS publicly announced its concept of its IBIP for future postage evidencing devices. As initially stated by the USPS, the purpose of the program was to develop a new standard for future digital postage evidencing devices which would significantly enhance postal revenue security and support expanded USPS value-added services to mailers. The program would consist of the development of four separate specifications: (i) the Indicium specification; (ii) a Postal Security Device specification; (iii) a Host specification; and (iv) a Vendor Infrastructure specification. During the period from May 1995 through December 31, 2001, we submitted extensive comments to a series of proposed IBIP specifications issued by the USPS, including comments on the IBI Performance Criteria.

Other regulatory matters

In June 1999, we were served with a Civil Investigative Demand (CID) from the U.S. Justice Department's Antitrust Division. A CID is a tool used by the Antitrust Division for gathering information and documents. The company believes that the Justice Department may have been reviewing the company's efforts to protect its intellectual property rights. We believed we have complied fully with the antitrust laws and cooperated fully with the department's investigation. In February 2002, the Justice Department advised us that it has decided to close this investigation with no further action.

Effects of Inflation and Foreign Exchange

Inflation, although moderate in recent years, continues to affect worldwide economies and the way companies operate. It increases labor costs and operating expenses, and raises costs associated with replacement of fixed assets such as rental equipment. Despite these growing costs and the USPS meter migration initiatives, we have generally been able to maintain profit margins through productivity and efficiency improvements, continual review of both manufacturing capacity and operating expense levels, and, to an extent, price increases.

Although not affecting income, deferred translation losses amounted to \$9

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million, \$46 million and \$5 million in 2001, 2000 and 1999, respectively. These translation losses resulted principally from the weakening Canadian dollar, British pound and Euro currencies.

The results of our international operations are subject to currency fluctuations. We enter into foreign exchange contracts primarily to minimize our risk of loss from such fluctuations. Exchange rates can impact settlement of our intercompany receivables and payables that result from transfers of finished goods inventories between our affiliates in different countries, and intercompany loans.

At December 31, 2001, we had approximately \$601 million of foreign exchange contracts outstanding, most of which mature in 2002, to buy or sell various currencies. Risks arise from the possible non-performance by counterparties in meeting the terms of their contracts and from movements in securities values, interest and/or exchange rates. However, we do not anticipate non-performance by the counterparties as they are composed of a number of major international financial institutions. Maximum risk of loss on these contracts is limited to the amount of the difference between the spot rate at the date of the contract delivery and the contracted rate.

27

Dividend Policy

Our Board of Directors has a policy to pay a cash dividend on common stock each quarter when feasible. In setting dividend payments, our board considers the dividend rate in relation to the company's recent and projected earnings and our capital investment opportunities and requirements. We have paid a dividend each year since 1934.

Forward-Looking Statements

We want to caution readers that any forward-looking statements with the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 in this Form 10-K, other reports or press releases or made by our management involve risks and uncertainties which may change based on various important factors. These forward-looking statements are those which talk about the company's or management's current expectations as to the future and include, but are not limited to, statements about the amounts, timing and results of possible restructuring charges and future earnings. Words such as "estimate," "project," "plan," "believe," "expect," "anticipate," "intend," and similar expressions may identify such forward-looking statements. Some of the factors which could cause future financial performance to differ materially from the expectations as expressed in any forward-looking statement made by or on our behalf include:

- .. changes in international or national political or economic conditions
- .. changes in postal regulations
- .. timely development and acceptance of new products
- .. success in gaining product approval in new markets where regulatory approval is required
- .. successful entry into new markets
- .. mailers' utilization of alternative means of communication or competitors' products
- .. the company's success at managing customer credit risk
- .. changes in interest rates
- .. foreign currency fluctuations
- .. timing and execution of the restructuring plan
- .. regulatory approvals and satisfaction of other conditions to consummation

of any acquisitions
.. impact on mail volume resulting from current concerns over the use of the
mail for transmitting harmful biological agents

ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to the impact of interest rate changes and foreign currency fluctuations due to our investing and funding activities and our operations in different foreign currencies.

Our objective in managing our exposure to interest rate changes is to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. To achieve our objectives, we use a balanced mix of debt maturities and variable and fixed rate debt together with interest rate swaps.

Our objective in managing our exposure to foreign currency fluctuations is to reduce the volatility in earnings and cash flows associated with the effect of foreign exchange rate changes on transactions that are denominated in foreign currencies. Accordingly, we enter into various contracts, which change in value as foreign exchange rates change, to protect the value of external and intercompany transactions.

The principal currencies hedged are the British pound, Canadian dollar and Euro currencies.

We employ established policies and procedures governing the use of financial instruments to manage our exposure to such risks. We do not enter into foreign currency or interest rate transactions for speculative purposes. The gains and losses on these contracts offset changes in the value of the related exposures.

We utilize a "Value-at-Risk" (VaR) model to determine the maximum potential loss in fair value from changes in market conditions. The VaR model utilizes a "variance/co-variance" approach and assumes normal market conditions, a 95% confidence level and a one-day holding period. The model includes all of our debt and all interest rate and foreign exchange derivative contracts. The model excludes anticipated transactions, firm commitments, and receivables and accounts payable denominated in foreign currencies, which certain of these instruments are intended to hedge.

The VaR model is a risk analysis tool and does not purport to represent actual losses in fair value that will be incurred by us, nor does it consider the potential effect of favorable changes in market factors.

During 2001, our maximum potential one-day loss in fair value of our exposure to foreign exchange rates and interest rates, using the variance/co-variance technique described above, was not material.

28

ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Consolidated Statements of Income
(Dollars in thousands, except per share data)

Years ended December 31		
2001	2000	1999

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Revenue from:			
Sales and management services	\$2,125,745	\$1,882,501	\$1,862,753
Rentals and financing	1,460,915	1,505,101	1,485,599
Support services	535,814	493,266	463,224
Total revenue	4,122,474	3,880,868	3,811,576
Costs and expenses:			
Cost of sales and management services	1,271,445	1,074,177	1,071,782
Cost of rentals and financing	350,870	373,232	395,667
Cost of meter transition - impairment	227,300	-	-
Cost of meter transition - additional depreciation	41,000	-	-
Selling, service and administrative	1,370,152	1,299,081	1,290,180
Research and development	133,105	120,486	108,900
Other income	(338,097)	-	(49,574)
Interest expense	193,076	200,957	175,699
Interest income	(8,903)	(8,580)	(5,020)
Restructuring charges	116,142	18,667	-
Total costs and expenses	3,356,090	3,078,020	2,987,634
Income from continuing operations before income taxes	766,384	802,848	823,942
Provision for income taxes	252,064	239,723	260,952
Income from continuing operations	514,320	563,125	562,990
Income from discontinued operations, net of income tax	-	64,104	97,140
Loss on disposal of discontinued operations, net of income tax	(25,977)	-	(23,918)
Cumulative effect of accounting change	-	(4,683)	-
Net income	\$ 488,343	\$ 622,546	\$ 636,212
Basic earnings per share:			
Income from continuing operations	\$2.09	\$2.20	\$2.11
Discontinued operations	(.11)	.25	.27
Cumulative effect of accounting change	-	(.02)	-
Net income	\$1.99	\$2.43	\$2.38
Diluted earnings per share:			
Income from continuing operations	\$2.08	\$2.18	\$2.07
Discontinued operations	(.10)	.25	.27
Cumulative effect of accounting change	-	(.02)	-
Net income	\$1.97	\$2.41	\$2.34

Note: The sum of the earnings per share amounts may not equal the totals above due to rounding.

See notes, pages 33 through 62

Consolidated Balance Sheets

(Dollars in thousands, except share data)