Capita Transcript– 5th March 2020

Jon Lewis:
Well, good morning, everyone. I'd like to offer a warm welcome to people here in the room at Capita's head office in London and also to everyone watching via the webcast. Thank you for your interest in Capita and in our 2019 full year results. Some housekeeping: in the highly unlikely event that we have a fire alarm going off, I ask that you follow those who work with Capita to the staircases down at the far end of the lifts, the elevators, please.

Okay. Before I start, naturally, I have to draw your attention to the legal text on this slide. So, we have made good progress in 2019, even if we've not had it all our own way. I'm in no doubt that Capita is in a much stronger position today than it was, though we have much more work to do. And we have certainly laid the foundations for growth in 2020, something I'll come back to in a minute.

And we've done that by improving dramatically our employee engagement. We've repaired customer service levels and client confidence in us. We now are effectively pivoting to markets with higher growth potential. We're channelling investment to software products and in-demand transformational capabilities. And we've launched our consulting business. I will cover all of these in more detail in my broader section later on in the presentation.

We had to work hard through some tough markets. But 2019 headlines are as expected with profit in line with guidance we gave a year ago. Two years ago, we set out targets for 2020, including a goal of 200 million in free cash flow and double-digit margins. Naturally, I, and the leadership team are disappointed. We are updating guidance on this today.

The whole leadership team are resolved to deliver the transformation plan, while doing the right thing for the long-term health of the business. This is reflected in our new guidance for 2020. We now expect to grow revenue for the first time in five years, and to deliver at least 160 million in free cash flow. My confidence in the long-term of this business remains the same. And I am convinced that our plan remains one that is right: to create a more focused, more sustainable, more predictable business, generating and growing free cash flow.

Now, this next slide is familiar to many of you and serves as a quick reminder of the overall transformation plan, which is underpinned by three imperatives: to simplify, to strengthen, to succeed. We're focusing our business on those markets with attractive margins and strong long-term secular growth trends, where we have distinctive capabilities as a consulting, digit-enabled services, and software business. And we have made good progress against all three of these imperatives, which is presented on the next slide.

This presents an update on the key transformational workstreams. And it is a slide, of course, we've shared with you before. The lighter dots represent where we are now, and the darker dots are the progress we expect to make in 2020. As we enter the third year of our multiyear transformation, we can look back on significant progress across a range of issues that needed fixing. And I'll give a lot more details on these later on.

There is more to do. But we have made the necessary progress, such that my top priority, and the leadership's top priority this year, is to deliver organic growth. And that will be the delivery of growth in this business, of course, for the first time in five years. Now, let me hand over to Patrick to go through 2019 in detail. Patrick.

Patrick Butcher:
Thank you, Jon. And good morning to you all. I'm delighted to be with you after just over one year in post. 2019 was the second year in Capita's multiyear transformation and a lot has been achieved. There are many signs of progress on our journey towards becoming a simpler, stronger, more successful company, generating free cash flow in a sustainable and predictable manner. However, as these results show, progress has been harder and more expensive than we had hoped, partly because we have chosen to invest for the long-term, and partly because some of the challenges could not have been fully scoped in early 2018.

There is a lot to cover, so I'll start with an overall summary. Revenue and profits are in line with expectations, with cost reductions offsetting investments, lost revenue, and lower margins on some contract renewals. Some of the benefits of the transformation work, such as profit improvements on the three challenging contracts, are reflected in the results. While our core growth businesses have largely shown growth in the second half, that growth has been, however, slower than we had hoped.

As in 2018, the results have benefited from some one-off items, as is to be expected in a complex group in transition. The cost and cash management controls, and programs implemented over the last two years give us a better base and will continue to provide positive returns in 2020. Interest is reduced following a deleveraging in 2018.

The balance sheet was significantly strengthened in 2018. But the headline net debt leverage ratio is at the top end of our range, as a result of lower conversion of EBITDA to cash and more investment being required to fix contracts and lay the foundations for growth. The group has the liquidity it needs to continue the transformation journey. We expect this liquidity to further improve following the introduction of new funds to replace the current debt that matures over the next 18 months.

And as part of our drive for simplification, we decided, recently, to seek to dispose of a number of core -- non-core businesses, the proceeds from which will be recycled to strengthen the group. However, as we said at the half-year, securing returns on our investments in the form of positive revenue growth and free cash flow generation are the priorities for 2020.

So, turning to revenue. As expected, revenue reduced year-on-year by around 4 percent. This slide details the key drivers of this movement, many of which have been communicated previously.

Firstly, the one-off gains of 48 million in 2018 on the termination of the Prudential and Marsh contracts. And then, 105 million of flow-through from contracts lost in 2018, such as Prudential, Marsh, and the defense infrastructure organization. And then, a further 109 million of contract losses in 2019, including, as we have discussed, in local governments and then spread across

other divisions.

Delays in local authorities taking back work meant that the impact of these losses were lower than expected in 2019. But the majority of these have now come to an end. This should, of course, be set against strong retention rates on contract renewals, such as over 80 percent in customer management.

Scope and volume changed revenue has decreased, due to high competition in market pressures and technology solutions, and lower volumes in our life and pension contracts, and real estate and infrastructure business. Our transactional business has declined a little bit, particularly in special services. Contract wins of 107 million is made up of 67 from the annualized impact of wins in the prior year, such as Transport for London, Zurich, and the financial services compensation scheme, and 40 million of new contract wins in 2019.

There is call center and back-off office contracts, and product sales, and software. This, however, was not as much as expected, particularly in the second half of the year, which explains the emphasis we put on the importance of revenue growth in 2020. Finally, as happened in 2018, there were a number of one-offs arising from termination payments and deferred income releases associated with contract terminations and changes.

We've talked previously about two business, the closed book life and pensions contracts and multiyear/multiservice local authority contracts, as being structurally-challenged or in runoff. This is a more granular version of a slide that we have shown before. The light blue relates to the two business areas mentioned as structurally-challenged, and the dark blue is the rest of Capita. The data is presented on an adjusted half-year basis.

And this clearly highlights two important points. Firstly, as previously reported, the vast majority -- some 85 percent of the revenue decline over the period -- is concentrated in just those two areas. And, secondly, the remainder of the group, taken as a whole, has seen revenue stabilized and, in the second half, a modest return to growth in most divisions.

In 2020, we expect further declines in the structurally-challenged business to be more than offset by revenue growth in the rest of Capita, which should result in modest growth for the group, as a whole, over the year. The next slide shows the data for the dark blue box analyzed by division. So, this is not our total revenue, just that that isn't structurally-challenged. And this slide shows that after excluding the structurally-challenged runoff businesses, all divisions, except government services -- for reasons explained on the slide -- grew in the second half. You will also notice that we've renamed IT and Networks as Technology Solutions.

Turning to a familiar topic, which is our cost out program, this has been one of the most financially successful aspects of our transformation, so far. Capita had been run, prior to 2018, as a collection of autonomous business units with limited collaboration or central direction. A disciplined, highly-structured program, with weekly challenge meetings across the business, has delivered cumulative savings of 200 million, including an expected flow-through of 40 million into 2020.

Some examples of that are the consolidation of 26 service desks in Software into one. We've closed another 32 properties and reduced our overall property footprint, saving 7.7 million in 2019; integration of business units in Technology Solutions, saving 8 million; and Smarter Travel using technology, saving 1.8 million. In addition to these year-on-year savings, there have been end-year and one-off benefits. And as we leverage investments, for example, of over 10 million that we have made in robotic process automation and our existing offshore capabilities, there is more to come.

However, as the following slide shows, there is more to the results than just revenue growth and cost-out initiatives. This slide breaks out the revenue and cost impacts on profits. The margin from contract wins and the benefits from improved performance on three challenging contracts, which have been highlighted separately, are offset by the combined impact of contract losses and scope and volume reductions described earlier.

From a cost perspective, the cost savings have been offset by cost inflation, mainly inflationary pay increases focused on lower-paid colleagues, and investments in strengthening functions, such as growth. A range of other group-wide actions, such as a lower bonus accrual, resulted in the final profit-before-tax number, which is in line with the range that I communicated at the start of the year. While I appreciate that this slide is busy, it does highlight the number of moving parts in a business that is not yet as simple as we would like.

Looked at from a divisional perspective, margins across the divisions grew from 11 to 12.2 percent, driven by cost-out initiatives and supported in some divisions, such as Government Services and Specialty Services, by the one-off benefits referred to earlier. This was offset by an increase in Group Costs, resulting in a small overall decline in margins. The increase in Group Costs reflects investments in technology, growth, and our new consulting business, which are targeted at the delivery of future revenue growth.

Investments have also been made in other functions to strengthen governance and controls. We now, for example, have much improved controls over the risks accepted in new contracts, which will result in a more stable and predictable business, which Jon will talk about later. These investments provide the resource and control we need to support the business, as it grows. In 2020, we will, as part of the cost reduction work, look for further overhead efficiencies in some of the large functions included in Group Costs.

As you know, we adjust profits to take account of items that we believe are not reflective of current trading. In 2018, the net effect of these items was less than 10 million. However, in 2019, it has been higher, which is why we exclude these items from adjusted results. There was a reduction in the amortization impairments of acquired and intangibles because, firstly, the previously acquired intangibles run down each year. And, secondly, we haven't made material acquisitions in recent years. And, finally, in 2018, there was a one-off write-down of some 62 million.

Restructuring increased as the transformation program expanded in the year. The impact of business exits was reflected; the end-year trading losses of those business is 17 million and write-offs of 52 million associated with two businesses being exited at year-end. And, of course,

IFRS 16 was adopted in the year, but its impact is excluded to aid comparison with 2018.

As expected, capital expenditure increased in 2019, in line with the transformation objectives, as the investment in property and IT infrastructure continue. 2019 also saw a ramp-up in expenditure on technology and growth. Looking forward, the level of capital expenditure will fall materially, as the mix of work changes. For example, as clients move out of on-premise and data center solutions to cloud-based architecture, Capex reduce and Opex spend with cloud providers increases.

Turning to cash flow, the first component of total cash flow is adjusted free cash flow, which is one of the key metrics established at the time of the rights issue in 2018. On this slide, we have analyzed working capital to separate out the effective contract-driven movements, such as deferred income, accrued income, and contract fulfillments assets. This, plus EBITDA, gives cash from trading operations, which I think is a more helpful way to think about these movements, rather than describing them as working capital outflows, and provides a more stable and consistent view of the operation cash flows being generated by the business.

This change has allowed us to focus in on the management of real working capital. We remain committed to paying all suppliers in line with the prompt payment code. However, through improving and standardizing processes and controls, we are looking to improve our performance in our management of debtors and creditors in 2020.

As described earlier, Capex has increased. The tax line shows the impact of the tax refund received in 2018, following the implementation of IFRS 15, and, finally, in 2018, the impact of the 110 million to clear the receivables financing. However, that's not the whole cash flow story.

As in 2018, there are a range of other cash flows that impact net debt. We continue to pay down our pension deficits in line with the plan agreed in 2018. This, combined with the cash flow associated with the restructuring spend earlier, contributes it to an increase in net debt of around 330 million. Other cash flows include the payment of dividends to joint venture partners.

At the time of the rights issue, we expected to invest 720 million over three years. Over the last two years, through a mix of operating costs, restructuring, and capital expenditure, we've invested some 650 million, spread across the three categories identified. The table at the bottom of the slide shows that an increasing proportion of the investment is in operating costs and restructuring.

The restructuring spend will continue into 2020, although it's a lower level. And as I have said earlier, Capex will also reduce in 2020, as the business mix changes. Overall, this will result in investment nearer 800 million, excluding the impact of 2020 Opex investment. We will also make the final payments in the agreed three-year deficit reduction plan on our pension scheme.

A few words on headline net debt. Last year, the business had £640 million worth of cash. 200 million of this was used to pay down debt that matured in 2019. The business cash outflow was 330 million, was a bit higher than expected, reflecting movements already described, resulting in headline net debt being at the top of the guidance range. But, as we have said, while we remain

focused on cost and cash management, it is taking longer than we had thought and requiring more investment.

The chart at the bottom left shows that our net debt is lower over the last two years and much more stable as we manage period ends differently. For 2020, we expect headline net debt to increase modestly, and, going forward, to then decline as we reach the end of the restructuring changes and complete the final payments in the three-year pension deficit reduction plan.

A few words on outlook. In the light of the investment that has been made in building platforms for growth, we expect that revenue growth in our core businesses will translate into modest organic revenue growth for the group, as a whole, in 2020. Contractual working capital outflows will reduce by more than 120 million, as a result of known contract movements. And our plan to focus on the management of debtors and creditors will generate further benefits.

Capital expenditure, as discussed earlier, will reduce significantly in 2020. And so, adjusted free cash flow is expected to be at least 160 million. As a result of planned restructuring in the last of three agreed payments towards our pension deficit, net debt will rise modestly. All of these items are before taking account of the impact of potential disposals and the impact of IFRS 16. I will now hand you back to Jon.

Jon Lewis:
Thank you, Patrick. As I said in my opening remarks, we have made significant progress over the last two years. And we are clearly in much better shape than we were in early 2018 and we have now set the foundations for growth. In this section of my presentation, I will provide more details of this progress, starting with an update on our initial focus on fixing what we inherited.

We have done a lot of the heavy lifting on this and, thereby, have substantially de-risked our overall transformation plan. This creates the stable platform we need as a precursor to delivering long-term, sustainable revenue growth and growth in free cash flow. As it is my top priority this year, the second part of my day will then go on to talk in more detail about how we plan to achieve this. Next slide.

As a services company, we are only as good as the ability of our colleagues on any day to delight our client's customers. And I would like to take this opportunity to thank all of our colleagues for their hard work in 2019, which was another demanding year. We aspire to become a truly progressive, purpose-led, responsible business. And our blueprint sets out four principles shown on this graphic in support of our purpose, which, you will remember, is we create better outcomes. This defines our desire to serve society and to drive value for all of our stakeholders.

Our purpose-led responsible business blueprint has progressive elements beyond those you would find in a typical ESG strategy. And this has unquestionably helped us attract talent and change perceptions of Capita in the last two years. One important government stakeholder told us -- and I quote -- "Capita's commitment to be at the forefront of social responsibility is recognized and welcomed by government" -- quote.

We need to invest in our people if we are to delight our clients. And we, therefore, took the

decision to guarantee the real living wage for our U.K staff, effective the 1st of April this year. This improves the salaries of circa 6,000 people, 6,000 of our colleagues here at Capita. Together, with improved parental pay and life insurance packages, we estimate the cost in 2020 will be circa 10 million, more than we planned when we put our transformation plan together in 2018.

However, the long-term benefit will be seen in further improvements in employee engagement -- something I'll come back to -- lower levels of voluntary departures, and, therefore, lower recruitment costs, and reduced cost of poor quality. Two datapoints support this progress. I'm delighted that we have seen a 14-point improvement in this year's net -- employee net promoter score. And 72 percent of our colleagues are now proud to work for Capita, which is a huge improvement in the just over 50 percent who would make that statement two years ago. The benefits of having an engaged and motivated team of colleagues can be seen, also, in the marked increase in voluntary attrition over that same period, and an improved customer net promoter score, something I will also come back to.

For the first time in many years in Q3, our third-party defined reputational measure amongst external stakeholders became positive. I want to emphasize that this is not about corporate ego but is an important proxy for the improved operation performance that underpins Capita's transformation progress, to date. And we are now much better perceived by broader, particularly influential stakeholders. In summary, this is a key foundational element to our much-improved license to operate, a theme that will run through the rest of my presentation. Next slide.

In 2018, many of you will remember we established the contract review committee to make sure that there is a consistent form of governance over any contract and scope of work we sign up to. Major improvements have been made to ensure that we de-risk the scopes of work we commit to, going forward. We have now embedded a more disciplined approach to what we choose to bid and the risks and financial returns we seek from those bids.

For example, much more detailed contract execution plans are defined prior to bid to flush out potential problems, rather than simply focusing on PBT. Cash returns over the lifetime of the contract also pay a significant part. This means we decided not to bid on a number of contract opportunities in 2019. This included highway's agency contract, where the opportunity cost was too high; and an enforcement services contract, where the scope, terms and pricing opportunity did not match the risk profile we are willing to accept. Strategy also plays a key role here, of course.

The executive committee also -- now also regularly reviews early-stage operational performance on contracts to ensure that implementation is going to plan. There is also a tie-in here to investment we have made in our skilled program managers and in the evolved proprietary program management tool we have been using the last 18 months. And we have now also put in place a continuous process for feeding lessons learned back into the bidding process.

We can already see the benefits of this far more disciplined approach. Contracts signed since 2018 have experienced far fewer operational issues than the Legacy portfolio we inherited. And I'm pleased to say that the average net margin on contracts signed since 2018 exceeds 10 percent.

The CRC, then, is another core building block of our transformation that makes Capita a higher quality, lower risk business now and in the future.

Now, failing to deliver on our commitments to too many clients, including some very high-profile contracts -- on some very high-profile contracts has been a drain on our resources for many years. Many of you are very familiar with these. And we have spoken regularly of fixing three key contracts. We remain on-track to break even on each of these this year. And we are perhaps, more importantly, now embedding many of the lessons we've learned across our entire contract portfolio.

I've worked in other industries where cost of poor quality, COPQ, metrics are well-established, ultimately forming part of the routine performance management and pay for managers. We've created a new policy and methodology tool to begin to do the same at Capita. And you will expect me to update you -- you can expect me to update you on this regularly.

In 2019, I'm pleased to report that we saw a marked improvement in contract delivery performance. We are now hitting 92 percent of our key performance indicators on our entire portfolio of contracts. And while not directly comparable, we have also seen a 70 percent decline in the penalty payments to clients, as you can see from the graph on the right. We are doing a far better job today than we were two years ago of delivering against our client commitments. This has come at an additional short-term cost, as we rebuild our clients' trust in our ability to deliver, a fundamental and necessary precursor to us growing the business.

Now, the benefits of an ever more client-centric approach and the investment to fixing poorly-performing contracts can be seen in our improving client net promoter score, which is in positive territory for all of our divisions for the first time. This was a major contributing factor to the reduction in revenue attrition in 2019. I'm particularly proud of the swing of 35 points in one year in our government services division; no small achievement.

And the improvements speaks to a strong -- to strong key stakeholder management, investments we have made to improve our service delivery, and alignment of our values and sense of purpose with what government, in particular, now expects of its strategic suppliers. This is an essential element of our ability to win future government work. And it is another indicator -- sorry -- another indicator of client satisfaction is our contract renewal rates, also showing a healthy improvement end-year. Excluding People Solutions, we -- where we've more work to do -- the renewal rate in 2019 was 91 percent.

Now, our recruitment contract with the British Army, a contract to digitize and improve the process of recruitment, has also made very significant progress. This contract is, in fact, a great example of the impact the investment we have talked about can have. In 2017, five years into this contract, the contract was failing and the relationship between ourselves, and the Army, and the MOD was broken. In fact, recruitment into the Army was a national issue.

In 2018, we successfully reset the partnership with the Army, at very senior levels, and both parties agreed to invest in the execution of the scope of work. In 2019, we have delivered dramatically better performance for the client and are currently within a few recruits of the

regular soldier recruitment target of 9404, or 9404, for the 12 months ending March 2020. I am very confident that we'll get there in the next three weeks, which will be the first time we have hit the target since the contract began. We have also improved other aspects of this contract as part of our broader digital transformation on that engagement. For instance, our candidate conversion rate is now one in eight, materially better than other complex public-sector programs, such as the police.

Now, in 2019, we continue to review our business portfolio in line with our ambition to simplify Capita and focus on becoming a consulting, digitally-enabled services, and software technology business. To date, the portfolio simplification is focused on our Specialist Services division. This was put together, you'll remember, in 2018, and included several standalone businesses that did not naturally fit with our overall growth platforms and that would be, therefore, managed for value.

We have concluded that a number of these assets, including our government [unintelligible] would benefit from closer alignment with our core growth platforms. The regulated businesses, life and pensions, and mortgage services, and the Irish-based customer services business are moving to customer management, where they will benefit from shared best practice. Some of the other businesses in Specialist Services are likely to benefit from the focus of new owners and we are progressing disposal options, as we speak. Clearly not appropriate to give any more details, at this stage, as you will understand. But we will keep you updated, as and when we can. As Patrick has mentioned, the benefits of this simplification will be used to strengthen the core business.

Now, the second part of my presentation focuses on our plan to deliver revenue growth. Since 2018, we've learned a great deal about Capita. Looking back, we now realize we underestimated the amount of effort it would take to fix all the issues we inherited. However, this is, today, offset by our increasing confidence in our ability to grow revenue.

At the half-year results in August, we talked about the role emerging growth opportunities would play in our overall transformation. It is well-known that Capita hasn't grown organically for many years. And, yet, the markets we serve are benefitting from long-term secular growth trajectories. And there are two questions I ask myself and my team. One would be: why haven't we been growing? The second would be: and why do we believe we can grow in 2020?

Taking these in turn, why haven't we been growing? First, we have been far too reliant, historically, on simply responding to tenders. And then, essentially, winning on price alone, rather than using our deep expertise to truly understand clients' needs, and collaborate on solution design, and sharing in more of the value created.

Second, we were particularly good at winning one-off contracts. But that reduced our ability to reuse components successfully and didn't always mean we cherished our client relationships as we should have. Thirdly, instead of investing in innovation or products, we prioritized diversification through acquisition. And, finally, we had to deal with the extra pressure from the slowdown in contracting as a result of austerity and political uncertainty here in the U.K.

And why are we -- why am I now confident in our ability to grow this year? Well, firstly, the market opportunity is large-growing and the client need clear, although this is assuming no major market dislocation associated with Coronavirus. Conventional analysis on Capita usually focuses on the relatively low growth government outsourcing or private-sector BPO markets, where we have, of course, significant presence and ongoing opportunities. But that does not capture all of the more dynamic consulting, digitally-enabled services, or software markets, which we are also exposed to.

I'm sure you're -- you are familiar with how advances in AI, robotics, IOT 5G cloud, and cyber are throwing up opportunities and some threats to businesses and governments. Either way, they are looking to us, as well as others, for help. Our clients have told us they want us to be far more proactive than we have been, historically, not reactive to tenders. They want us to offer them more transformational services and to innovate and lead them through the next phase of their business changed.

In PWC's global CEO survey last year, 81 percent of CEOs agreed that technological progress -- read, "digital transformation" -- will fundamentally change their organizations. This comes together in a U.K. digital transformation market estimated to be worth £36 billion annually, and growing at 12 percent per annum, with the U.K. being right at the forefront of this dynamic trend. Using, very importantly, our practitioner mindset, developed from being responsible for executing today many of the business processes that need digital transforming, we have already began to build a track record applying these solutions to our clients.

But there is more we can do. The graphic on the right of this slide captures how our business model has evolved to address this. Consulting is the front end. Working with clients to design solutions, which are implemented in the change or transform phase, which then moves into the operational process or deliver phase.

The plan to deliver growth, as we flagged at the half-year, has four distinct parts to it. First, we have refreshed the Capita brand, by which I don't just mean the new imagery. We have engaged with our clients and conducted an advertising campaign to help people understand what Capita now stands for: a modern, purpose-led, innovative, differentiated business.

Next, and for the first time at Capita, we have defined all of the products and services we sell. And our first cut of the data showed we had more than 180. From this long list, we were able to identify clusters of capabilities and products that best aligned to our clients' needs, which are scalable, unreputable, and these now inform our investment decisions.

Third, we have addressed our lack of sales proactivity by promoting a consultative sales, process-launched Capita Consulting -- I'll come back to that -- and restructured sales incentives. Finally, we have recognized parts of our account management approach. We've adopted a single instance of CRM, Salesforce across Capita, and we are rolling out dedicated expert client partners, who are responsible for understanding their clients' needs and bringing all the relevant parts of Capita to them. Let me know go into each of these in a bit more detail.

At the beginning of 2019, we commissioned a comprehensive third-party study into what our

clients thought of us and wanted from us. This gave us clear insight that our clients thought that Capita was a strong and resilient brand in the B2B and B2G spaces, in stark contrast to how we've often portrayed in the media in the more familiar B2C space. As the chart on this slide shows, and perhaps this comes as a surprise to some of you, the Capita brands whole -- the Capita brand holds its own in the international, tech-enabled, professional services peer group. And we are significantly ahead of traditional outsources.

Our clients trust us to know their sector and their business needs, inside-out, often better than they do themselves, and to be able to deliver complex transformation projects. And in the market today, we are displacing more established incumbents, as you can see from some of this year's wins against the so-called top three on this slide.

More than half of our investments in the past two years have been in our software products, where we have leveraged the benefits of the 1,200 people who now work at our digital development center in Pune in India. They're focused on optimizing product management, driving standardization, and reducing development lifecycles.

We used to have a slow waterfall or monolithic development process that was subscale, fragmented, and can take anything up to 18 months to deliver new product. We now have an agile 13-week target development cycle that has dramatically increased our ability to deliver innovative client solutions more quickly. In 2019, we delivered cloud-enabled versions of SIMS, Retain, and our ONE platforms, as well as SaaS software as a service-enabling core enterprise products to enter new markets, particularly mid-tier markets such as our Flow products solution for the Utility "challenger brands."

We're expanding our core platforms to increase our client offerings. For example, our SIMS education ecosystem now offers new applications, such as SIMS Pay and SIMS Finance, as well as new analytics' dashboards, such as curriculum-led financial planning. We are also exploring new adjacent opportunities, such as Literacy360 into the reading assessment space. Returns from these investments made over the last couple of years underpin our target to grow software revenues by mid to high single digits in 2020.

Now, as mentioned a few moments ago, during 2019, we went through a major exercise to define our market offerings. And we now have a much better sense of which of our products and services our clients need the most. We have identified six foundational or transformational capabilities, which capture a significant proportion of the opportunity in our addressable market.

And we are not newcomers to this party. We already do a lot of work in these areas. But we were rarely joined up. So, historically, investment was inefficient, and uncoordinated, and we lacked scale. And where we were -- and we were unable to capitalize on growing market demand, as we might. As a first step, we have now pointed leads to each of the six capabilities. They are responsible for coordinating Capita's capabilities in the space and implementing superior go-to-market or commercialization approaches to develop and win new work.

You can expect regular updates from me on how we are progressing across all six. And I will kick off with more details in a moment on automation and IOT, the internet of things. But before

I do that, a very brief introduction to the other four. Customer experience is about designing processes and adopting a range of digital technologies to deliver a seamless service for the end-user: our clients' customer. It is a measure of how intuitive and relevant the customer journey is, as well as how reliable and cost-effectively it can be delivered for our client.

We are combining existing resources with additional hires and investment in technology, such as Dragonfly, with our intimate knowledge of clients' operations and needs, to enhance our customer experience offerings. The Dragonfly team are here today, along with many of our investments in technologies startups through Capita's Scaling Partners. Please do go and talk to them and see a demo of their -- I have to say -- rather cool products after the formal presentation has finished.

Data and insight, at its core, is about using information to make better decisions. The possibilities here are growing every day, of course. An interesting example of this is our work with law enforcement agencies using a range of sources, including social media, to speed up their ability to identify potential or real emergencies.

Using the cloud brings quicker, cheaper, scalable, and more agile services to clients. We're working with a major media company here in London to advise them on their cloud migration strategy. More than -- and more than 20 percent of the pipeline of opportunities in our technology solutions division today speaks to cloud-enablement. Cybersecurity is particularly relevant in our long-standing client base across the government, utilities, and financial services, for whom we have a strong track record of delivering networks, and technology infrastructure. Cyber is a natural extension of this capability.

Let me now turn to automation and IOT. Well-designed and correctly implemented automation drives efficiencies, greater reliability, accuracy, and speed. And Capita's experience working on automation projects goes back many years. For example, we have been running several hundred bots for O2 since very early-on on that contract term.

We've now coordinated our previously separate teams and ramped up this capacity over the last two years, initially to apply automation internally to existing and new contracts. As the U.K.'s largest outsourcer, we are ideally -- the -- we are an ideal testbed for such technology, something we have absolutely leveraged. Today, Capita is one of the largest -- has one of the largest dedicated robotic process automation teams in the U.K. And, now, the priority is to take this experience, and know how we have gained, to market.

I think it's too early to know how far automation will go. The ONS, for example, has predicted that 1.5 million roles in this country could be automated, in the future. But whether this is right or not, we are now superbly positioned to take advantage of this.

A good case study in our application of RPA is to the peak period, GPN -- GP pension submissions in our NHS PCSE contract, which has delivered major improvements to all stakeholders. We have halved the time it takes for submissions to be processed. We've significantly improved accuracy. And, perhaps more importantly, we have freed up advisors to spend more time helping doctors with more complex challenges.

Now, in IOT, Capita is already a leader in designing and managing a number of very large and structurally-complex contracts. This, again, is a natural evolution of our work in networks and infrastructure contracts, such as the Scottish-wide area network, and the work we've done for Transport for London around congestion charging, and the ultra-low emission zone solution.

We help our clients to gather and unlock large amounts of data in secure and reliable way to make customer experience better and create efficiency in their operations. Capita's subsidiary, the Data Communications Company, or DCC, was set up to support government policy to design and rollout smart meters in the U.K. energy system. The scale of the DCC network is already impressive. It sent more than 500 million encrypted messages in 2019, alone. So far, it has connected 4 million second-generation meters and is migrating more than 14 million first-generation meters onto the network.

In time, the network will connect 30 million homes and businesses across the U.K., some 99 percent of all premises. It will then, at that point, be the largest IOT solution in the country, designed, implemented, and run by Capita. As a secure network, its data and connectivity applications have significant potential as an IOT platform for the long-term, bringing with it potential for many further opportunities. In an evermore connected world, our IOT expertise will, increasingly, be valued.

Now, one of the most significant events of 2019, for me, was the launch of Capita Consulting. It's a new brand reflecting a more practitioner approach. But we're not starting from scratch. Capita has owned a number of small consultancies for some time. But they were subscale and not designed or particularly effective at driving pull-through revenue for the rest of the business. They also tended to focus on internal to Capita versus external client opportunities.

In the second half of 2019, we brought these businesses together. This included our data science teams at Barrach'd and our customer experience -- customer digital experience teams at Orange Bus. And we have now brought a further 30 client partners and industry experts together with that, sourcing from both our existing talent pool and new hires from the big four and digital service providers. I have been particularly encouraged by the caliber of talent we have been able to attract to our consulting business. We have now over 40 partner-level individuals running that business.

A strong consulting frontend in which we proactively work with clients early-on in the sales process to cocreate solutions will reduce, over time, our reliance on the timing and tenders of -- timing of client tenders. It also leverages one of our core assets: our position as the U.K.'s largest outsourcer. Put simply, we know more about our clients' business processes and their technology needs than almost anyone else. Who better, then, to trust to safely design and deliver a change to a current business process than the entity who does that work for you today? This practitioner-led model is a major differentiator in the market when clients compare us to our digital transformation peers. We understand them in ways others don't.

In 2020, from a base of 12 million in revenue, we expect to grow this business to closer to 50 million. More importantly, we are targeting the rest of Capita to benefit in the region of around

250 million of total pull-through contracts. That's TCV. We will not see all of the benefit of that revenue in 2020.

Now, we can't talk about all of the clients for whom we've already engaged with through our consulting business. But I'm very pleased with the traction we are gaining in the market today, as indicated by the logos on this slide. We launched this in December. I'm very pleased with the velocity at which opportunities are developing.

Now, experience with TFL neatly summarizes everything we have talked about today and what happens when we deliver on one scope of work and, in so doing, create a platform for additional Capita offerings. Indeed, our business with TFL is a microcosm of what we wish to achieve across many of Capita's clients and evidences the rationale for our strategy. We have transformed our position with TFL from performing badly a few years ago, on one contract in one division, to delighting the client across four divisions today.

Daily, for TFL, customer management provides front-office, multichannel services to over 5,000 of the customers. Capita software's Pay360 platform collects over 16,000 payments. Capita's technology solution manages the infrastructure to capture 1.4 million vehicle movements, and 13,000 physical documents, and managed by Capita Specialist Services.

And the result for our client is that TFL has delivered a 35 percent reduction in nitrous NO2 emissions in the first six months, the equivalent of around 200 tons. And as of March 14th, Capita technology services will have completed the infrastructure or the implementation of mobile telephony, the mobile telephony infrastructure for the Jubilee line. Over the past two years, our TFL revenues have almost quadrupled, with a healthy pipeline of new opportunities to go after. Again, it is a microcosm of what we wish to achieve across many of our larger clients and evidences the rationale for our strategy.

As a reminder, we have improved employee engagement, repaired customer service levels, and confidence in us, pivoted towards growth markets, channeled investment to software products and in-demand transformational capabilities, and launched Capita Consulting. Put simply, we have already done a lot of the heavy lifting, which has substantially de-risked the transformation since 2018. Now, the priority is to deliver growth. The prize that remains the same: to deliver sustainable and growing cash flows for the long-term. Thank you for your attention. And Patrick and I will be very happy to take questions.

Rob Plant:
Thanks. It's Rob Plant from Panmure Gordon. You've clearly set out that in consulting, and digital, and IT, you're not keeping up with the market. I just wonder if you ever worried, are your business good enough? I just -- I'm concerned that Capita's too small, you're too diverse, your balance sheet is fairly stretched to compete against big international IT and tech firms, and you're just going to keep losing market share.

Jon Lewis:
Look, as I indicated on the material we shared, we compete with many of those same entities

today. We are able to win against them. I think what differentiates us is our deep domain expertise. I was at pains to point out our practitioner understanding and experience in that section. We are the U.K.'s largest outsourcer. We are managing back office processes for more entities, more FTSE companies, and sections of government than anyone else.

And one thing I learned many years ago, in the application of technology, is that it is an understanding of those business processes, and your ability to leverage your understanding of those business processes, to effectively and successfully implement technology platforms that is, if you like, the secret sauce. I did that for 10 years in software in the States when I worked in oil and gas. That practitioner understanding is what differentiates us and why we believe we can be an effective competition in this space. And those are growing opportunities for us today.

Paul Sullivan:
Great, thank you. It's Paul Sullivan from Barclays. Just a few on costs. The positive P&L contributions this year, what was the expectation when you set targets at the beginning of 2019? And what do you envisage the movements in 2020? And then, just following on from that, the 41 million of one-off costs positives, that seems very high, a little bit of sort of colour there. Can you provide some color on the group central costs for 2020? And then, when you think about sort of the bigger picture, your 10 percent margin target for 2020 that you set originally, that does feel like it was plucked out of thin air. Could you give us any comment because it seems to have been dropped?

Jon Lewis:
I'll let Patrick talk about the initial financial questions. Then, I'll come back to the margin comment.

Patrick Butcher:
Okay. So, the key slide on costs is the 105 million that is in the year-to-year bridge from '18 to '19, where you can see on the page that we are -- it's page 11 -- we're expecting 40 million of that to flow through into 2020. We've got costs and cost programs that will deliver, yeah, further savings into 2020.

As I, you know, described earlier, as we look into 2020, we've got some revenue headwinds on a local government's work, which left towards the very end of 2019. So, that's a headwind in. And I've talked about lower margins on contract renewals while we're still hitting, as Jon said, and through our governance process, double-digit margins, cash margins over the life for those contracts. You know, Capita has a mix of high margin and low margin activities. In the second half, we had a number of quite high margin contracts that we renewed. So, we'll continue the focus into 2020.

On the group costs and support services, it's difficult to overstate what wasn't here a couple of years ago. And so, we've had to make a lot of investments in what you would regard as -- in a large business like this -- basic controls.

So, the commercial controls, we've talked about implementing the new sales system that Jon talked about. We're implementing a new HR system. We've made investments in financial

systems and controls, you know, strengthened the legal department, strengthened HR. So, that's driving that. Plus, obviously, investment in the consulting division and all of the managers and the growth activity that Jon has talked about. And so, that, you know, that sort of level of investment is going to continue into 2020.

Jon Lewis:
So, Paul, you know me well enough to know that I would not have plucked a number out of the sky. A great deal of diligence went into modeling the commitments being made -- we made for 2020. At that point in time, we didn't appreciate the amount of investment, the sheer amount of investment we would have to make in the business. We didn't appreciate the degree to which we would see the level of revenue attrition we have.

And we also didn't appreciate the switch between Capex and Opex. We are spending less on Capex because of the nature of the business today. We are spending more on Opex, all of which, of course, impacts margin. And that is why we have come off that number.

We are two years into a multiyear transformation. As an investor in the business -- and I am a substantial investor in the business -- I want to see that we are growing the top line and that we are growing cash generation. That, we believe -- those, we believe, are the two fundamental measures that really determine success in executing the transformation. And that is why we are focusing on those two metrics. Suhasini had a question here.

Suhasini:
Good morning. Suhasini from Goldman Sachs. A couple from me, please. You mentioned that you had originally planned for 720 million of investment restructuring and transformation costs. And that's moving to 800 million, excluding additional Opex investments in 2020. Can you give a little bit of a breakdown on this additional 80 million spend and maybe quantify the Opex spend for 2020, please?

Jon Lewis:
I'm going to let you do that.

Patrick Butcher:
So, the Opex spend is going to be at about the same. If you look on slide 18, you can see that in FY19 we're culling out 76.9 million of operating costs as investment; that, we'll broadly continue into 2020. In terms of the restructuring spend in 2020, it is more of the same. There's no fundamental change. We've got more to do to continue restructuring the central functions that -- about half of it will go on cost to achieve the savings that we're looking to get in 2020. We still -- while we've made really good progress on a number of our contracts, we've got a number of businesses where we're still reorganizing and restructuring them. And that requires additional resource, as they go through that transition.

A good example of that would be our pensions administration business, where it's absolutely core to Capita in the long-term. It's, you know, price of business processing. But what we've typically done is as we've taken on -- this is in our People Solutions division -- as we've taken on contracts, we've sort of designed the process for each contract.

So, we've got, literally, hundreds of contracts, all of them working individually. And so, there's a big investment, which we call Project Fortify, which is to, you know, restructure, redesign the processes, standardize where we can. It’s a great opportunity to implement robotic process automation. So, there's a -- yeah, that's just an example.

Suhasini:
The other one is on your revenue growth for 2020. I think, for software, you mentioned that you expect to grow mid to high single digits. Can you give some color on some of the other divisions, please?

Jon Lewis:
Yeah. I think the first thing I would say about growth is that we have spent the last two years putting in place improved offerings, understanding the markets we wish to focus upon. We spent the second half of last year investing in what we call our client value propositions. And those are specific to each of the divisions. We have dramatically improved the competency of our salespeople, the quality of sales insight. The market insight we have is far superior through what we're doing with Salesforce than we've had, historically.

We've upped the competency and capability of our sales individuals. And, of course, we have Capita Consulting, which, as we talked about in the presentation, we believe will create pull-through opportunities. Each of the growth platforms, therefore, we anticipate delivering modest revenue growth in 2020.

Tom Sykes:
Morning. Tom Sykes from Deutsche Bank. I wondered if you could just help us bridge to the 160 million of -- or, at least 160 million of free cash flow. Obviously, particularly, the kind of combined deferred income, A.I., et cetera, working capital, and Capex. Because if you're having quite a significant swing in working capital, how can you convince us that the rest of the group is actually generating much cash in order to get to that 160 --

Jon Lewis:
Okay. So, the best slide to look at, as I answer this question, is slide 16, which is the adjusted free cash flow. As I mentioned in -- when I -- in my remarks, the movements in deferred income -- so, for example, if you get to the end of the contracts, or you terminate or restructure a contract early, you then release the deferred income on the balance sheet. That shows up as revenue and profit, and then, shows up in the working capital statement as an outflow. And that, to me, isn't the best way to look at it. So, we -- so, what I've done is put together the contractual working capital movements. So, deferred income, contract fulfillment assets, and accrued income. And then, if you take that with EBITDA, you get this metric that I'm calling cash from trading operations. And I think that's a better measure of the extent to which the operating business is generating cash flow.

And so, we expect, as we move into 2020, that that one -- that our conversion of EBITDA to cash is going to go from, roughly, 42 percent, as it is here, to about 72 percent next year. Because we can see, upfront, what's going to happen to deferred -- to those balances because

they're on long-term contracts. So, that contractual working capital of modest -- two to eight -- is going to be significantly lower. We're calling out about 120 million lower. That, then, gives you more cash from operations.

Then, if you go down to Capex, we described the change of our business model. We've done quite a lot of investments in IT, infrastructure, property. So, Capex will come down to below 100 million for next year. And then, as I mentioned, now that we've got a much clearer view on our sort of real working capital, the traditional debtors and creditors that you're all familiar with, we've set up a specific program to focus on that. And that will result in the -- some real working capital being an inflow. And then, the combination of those numbers gets you to the 160.

Tom Sykes:
Sorry. What's, approximately, the level of working capital inflow you would expect if you hit consensus?

Jon Lewis:
It's going to be 30 to 40 million.

Tom Sykes:
30 to 40? Okay. And then, if you don't dispose of any companies, what's the rough leverage that you would expect to get to, if you're at 160 million? Because --

Jon Lewis:
So, we -- if you do the math, we're guiding that net debt is going to go up. And we're guiding that cash from trading operations is going to go up. But a chunk of that is working capital. So, EBITDA is going to come down. So, net debt is going to rise. We're comfortable that, over the median term, the right metric is, you know, in pre-IFRS language because, of course, it will change, is between one and two times. But it will be above two for 2020.

Tom Sykes:
And in terms of this year's EBITDA, what's the level of non-cash backed profit that you're --

Jon Lewis:
-- it's that 42 percent to 72 percent.

Tom Sykes:
Right, okay. And then, finally for me, just when you look at some of the larger businesses in the group; so, software, in particular, SIMS, Axelos, how are you -- and the high margin, as you said, the social housing software, as well -- what's the budget for them? So, SIMS and social housing, are you expecting those to actually grow that region?

Jon Lewis:
So, Tom, we're not going to reveal budget by product family. But --

Tom Sykes:

You haven't discussed the ---- the proper movements by -- -- division. They're in the appendix rather than in your presentation. So, we're just trying to get some granularity --

Jon Lewis:
-- what we did say, of course, is that the lion's share of our Capex investment has gone into the software business over the course of the last three years.

Tom Sykes:
All right. So, the ROI on that business has come down, isn't that -- I mean, that's --

Jon Lewis:
Well, that is another business where we have had to -- we had to take 29 separate software businesses that weren't integrating, which weren't innovating at the pace they needed to innovate. We've invested in product management. We've invested in the development center in Pune to improve the output from that division. And we're starting to see that now, in terms of order book.

And if you look at what happened to the order book in software in 2019 increased. In fact, book to bill ratio was 106 percent. We didn't see that reflected in the revenue because a lot of that is migrating to SaaS. We're seeing that revenue realized over a longer period of time. But if you are to ask, "Are we starting to see the impact and benefits of the three years" -- some of this predates this leadership team -- "three years of work that's being done to integrate, rationalize, streamline, and focus on those core markets where we believe we have long-term growth opportunities," yes, we're starting to see the benefits of that.

Tom Sykes:
Sorry. Just final follow-up on that. It's just on the shift to cloud and the changes that that does do to your revenue recognition and the profitability. Is that going to have a significant effect, at all, on the operating profits, as you would see them? I mean, how much of SIMS, for instance, is cloud-based, or is it still largely installed?

So, it's going to incremental sales.

Patrick Butcher:
Okay. If you take the conversation to the group level, there are -- there is a change in mix, which is less Capex, more Opex. But once you've kind of gone through the change, you get back to where we want to be. In software, specifically, why do the margins come down in 2019? There was some increased costs we incurred as we sought to go into the U.S. market. We've reduced that. We've, you know, market entry. There's a bit of change there. And then, there was some specific change revenue that you normally get every year, as government rebases benefits. And then, we make the changes. And then, we charge local authorities for the changes. And that's very high margin work that wasn't there.

And then, as we've talked about, we're transitioning to this digital delivery center. And so, that means you're building up capability in India. And there's a little bit of double-running cost. And that will start to come out. So, we would see software margins normalizing at around where they

were last year.

Tom Sykes:
Okay. Thank you very much.

Jon Lewis:
In that case, thanks very much, everyone, for your interest in Capita. Good morning.