CAPITA

Capita plc
Half-Year Results 2018 Q&A

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Q&A

Suhasini Varanasi (Goldman Sachs): Six, seven months back when we met you did mention that the UK MOD was probably not the best place for Capita to be. Since then you have probably participated and won quite a lot of contracts. Can you talk about how the relationship with the UK government has changed and what makes you more optimistic here? Thank you.

Jon Lewis (CEO, Capita plc): Firstly, let me deal with the MOD. I think the DIO contract which we extricated ourselves from in 2017 was not necessarily a contract that we were best suited to deliver against. I am not sure we made that statement about the Defence Fire and Rescue contract. If you look at the contracts we engage with, with Central Government what they all have in common is a focus on people smarts, productivity efficiency and the use of technology. The Defence Fire and Rescue contract is no different. That technology manifests itself in the form of the equipment we are sourcing largely from the US to deliver the service but also the software technology that Capita is using to execute on the service. That includes our resource allocation software as well as our control works blue-light software which we sell to third parties as well. It is in line and is of the margin performance 6-8% that we recognise we can derive from delivering contracts to Central Government.

To your broader question about Central Government I am encouraged by what I am hearing from the Cabinet Office. I think as painful as events of the latter part of last year and the early part of this were for other players in the space that has caused not just the Cabinet Office, the civil service, but politicians to take a much closer look at the efficacy of government procurement, the transfer of risk, the terms and conditions. We should be doing much more, as I mentioned at the Public Accounts Committee a month or so ago, to co-create, to collaborate and to innovate. Government procurement in its current form is quite frankly too restrictive. In terms of our ability to innovate, to create value I would also suggest that the transfer of risk is unreasonable. Those are factors which are being embraced and understood by Central Government today. We are proactively involved in discussions through a number of vehicles in helping shape Central Government thinking around strategic sourcing and I am encouraged by some of the decisions that are being made.

Julian Cater (Numis): The first is in respect of the problem contracts, I wondered if you could say what the year-on-year profits delta was from the three contracts that you drew out there.

The second question is in terms of the Contract Review Committee, Jon that you now chair, how rapidly are you seeing changes in the behaviour of people within the organisation bringing potential contracts to you and the rest of the committee?

My third question is in respect of your comments on local government. Can you remind us within the Government Services division what proportion of that is local government? When you talk about an expectation of a 4% CAGR is that 7% in Central Government and -2% in local government or how do you see that developing please?

Jon Lewis: Let me start with the last one first. About 17% of our revenue today is from local government. It is a subset of that which is in the local government BPO space. We do not anticipate the local government BPO business to grow going forward. That is not a model that local government feels is appropriate going forward. Our opportunity is to deliver more of the scalable solutions, as I mentioned, that we are very successfully delivering to a number of councils across the UK today. We have some of those solutions today in the form of revs and benefits. We have other solutions that we are developing. I would also emphasise that we have a very healthy software business with local government which is not declining.

In terms of your first question I am afraid we are not going to go to that level of granularity. I would simply say that I am pleased with the pace at which we are improving the operational performance of those three problematic contracts that we covered today. Indeed I would say that progress on those is probably progressing a little better than I would have anticipated at the beginning of the year.

Julian Cater: Second question was more a cultural point in terms of the Contract Review Committee you chair.

Jon Lewis: I would say yes. Capita has had a culture historically where things were optional. This is no longer optional. If people are going to bid they have to come to the Divisional Contract Review Committee firstly, and if it is of a certain value or has certain financial risk or reputational risk criteria it comes to the Group-level Contract Review Committee. The papers are distributed well in advance of the meeting. They are gone through in some detail. Each contract we review over a period of roughly an hour and I think it is fair to say, with the support of the commercial function in the organisation, which own the process, all the way down through the hierarchy, people are getting it. This is the way we are now going to assess, very early on in a tender process or when we actually submit the bid, whether this is something we want to be doing or not based on the risk profile, based on our strategy etc.

Kean Marden (Jefferies): First of all Nick, I wonder if you can give us a bit more detail on the £52m of other working capital that you mentioned in your slides? I guess it is conceptually why, if you have got negative organic revenue growth, it is still absorbing cash in the working capital line.

Secondly, could you give us a bit of background please on the £6.8m put option cancellation that is in the notes and whether there is a mechanism maybe to change the formula for the other put options that the company has?

Thirdly, from an analyst perspective, your guidance excludes a number of factors but we would need to include them, particularly when we are putting cash flow statements together. Could you help us think about maybe the initial losses on the DFRMO contact that potentially could be generated this year and next year? Also the cancellation fee that you mentioned regarding the Prudential contract as well. Thanks.

Nick Greatorex (CFO, Capita plc): The £52m working capital movement was made up principally of three things. The unwind of the receivables financing facility obviously had a partial contribution to that. We had some suppliers in the first-half who tightened some of their payment terms, not surprisingly, as a result of some of the events that we went through. We are expecting by the full-year that that will have reversed again. Then we also had some rent payments that were held over from the end of last year which we have normalised. There was a fourth item as well. We had one large customer that historically had paid us quite significantly in advance and we have reduced the amount of that advanced payment. There is a combination of things in there.

Your second question around the put option I am afraid people far brighter than me do the calculation around how we discount that but what I do know is as the date comes closer to fruition the discount rate and the discount calculation changes. I think that is probably what you are seeing but we might want to follow up later on that one.

DFRMO loss we will not be specific on that at this stage, not least because of the position the contract is in at the moment. Your last question on Prudential, there will be an accelerated unwind of the deferred income on the Prudential contract which will be released in the second-half. As I said earlier, we are not including that within our guidance. One of the things that we will have to quantify is any asset write-downs that will offset that. For example, if we are carrying any CFAs or tangible assets in relation to that contract they will also offset that number. We will disclose that in full in the second-half but, as I said, it is not included within our guidance. If there is a positive contribution it will mean profits will be in excess of that guidance.

Kean Marden: Is that cash or bookkeeping?

Nick Greatorex: There will be some cash on termination but the deferred income, no, it is purely an accounting adjustment.

Tom Sykes (Deutsche Bank): Morning everybody. Firstly the SIMS roll-out seems to be taking a little bit longer than expected. Can you give us an update on profitability.

Jon Lewis: I think your question was on the profitability of SIMS. Was that correct?

Tom Sykes: That is right.

Jon Lewis: We do not break down our financials at that level of granularity. What I will say about SIMS is it is a very successful product. We have 80% of market share in the UK. We are now starting to get traction in one or two selected international markets. We are expanding the modules for the SIMS product. We announced and rolled out the Finance Module in the first half year. Frankly it is one of the jewels in what is a very strong portfolio software asset. A very successful product, but I am afraid we are not going to break down the profits on that business specifically.

Tom Sykes: If that is the case, what is happening to the rest of the software businesses and where is profitability declining there please?

Then on the cost savings, could you say whether that is a £30m impact in the half-year or is that a run rate by the end of the half-year?

Maybe finally a view on revenue attrition that you expect for H2 please.

Nick Greatorex: To go back on your SIMS question, on the adoption of IFRS 15 the recognition of revenue on the SIMS product became more akin to a SAS-based platform. As we moved to the cloud with SIMS the likelihood is there will not be a significant impact. That is one of the advantages of that early adoption, meaning that it is a much smoother effect on revenue as SIMS moves to the cloud. There has been some profit decline in some of the software businesses. Historically we enjoyed some quite significant profits on sale of licences which under the new accounting are now spread into the future. That business is getting used to the new accounting standard and the effect that that has on its sales strategy and one of the reasons why we have been pushing those products into the US.

Jon Lewis: The cost savings, yes, it is impacting the first-half results and Nick, I am not sure whether the other part of the question was run rate for the remainder of the year. Yes, it will be, yes?

Nick Greatorex: For revenue attrition in H2.

Jon Lewis: Yes. The cost savings.

Nick Greatorex: Yes, we have talked about £70m for the full-year.

Jon Lewis: Okay. On revenue attrition Tom we have not given guidance on revenue attrition. I do not plan to do that today. What we have committed to doing since I have come on board is delivering organic revenue growth by 2020 and we are on track to do that.

Nick Greatorex: What we can say Tom is that consensus has us down about 3.5% for the full-year.

Thomas Beevers (Stockviews): I had a question on the £49.1m of contracts and restructuring charges. I understand that 70% of that relates to the cost out programme from what you have said. I am trying to square that with the guidance of £40m cost to achieve that you still have in your guidance for 2018. Perhaps you could help me to understand that.

Jon Lewis: About one third of that £49m is associated with professional services fees that we incurred in the definition of the strategy, the cost-out work and the operating model activity we are doing. There is also some professional service fees there associated with our preparation for the rights issue. The other two-thirds is directly associated with costs that relate to taking cost out of the business and the transformation overall. Nick, is there anything you would add to that?

Nick Greatorex: No, I think to reiterate that we expect to spend around about £40m taking £70m out of the business. There are some other programmes that were ongoing as we entered the year so we have spent money on things like the Smarter Faster Finance programme as well, which is delivering some good results for us.

Thomas Beevers: Just so I understand that, two-thirds of that £49m would relate to the cost to achieve which equates to about £33m. Does that mean it is very heavily weighted to the first-half versus the second-half?

Nick Greatorex: Approximately £33m also includes some costs that we have incurred in relation to other programmes that were already underway. The cost to deliver the £70m we think will be about £40m, although we have spent a lot of that money in the first-half which will then have a full run rate effect in the second-half.

Thomas Beevers: A second question on Specialist Services. You have said not to expect any additional disposals for the time being, which is fair enough. Are you still actively pursuing disposals however for parts of that business?

Jon Lewis: No, we are not. We have shut down any further disposals for the time being. That is not to say that we might not revisit that in the future but right now I am delighted with the proceeds we received from the businesses we have already sold. Those that remain in Capita Specialist Services, as I have said, are very cash-generative by and large. They are growing. We have one or two we need to fix. This is not the right time to sell those. We want to maximise the value from them and to do that we shall not be selling them at this point in time.

Thanks very much everyone for attending today and your interest in Capita. Thank you.

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