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Speaker Key:

JL	Jonathan Lewis
NG	Nick Greatorex
TR	Toby Reeks
PS	Paul Sullivan
KG	Karl Green
RM	Rory McKenzie
MD	Michael Donnelly
CO	Coordinator

OP Good morning, ladies and gentlemen, and welcome to the Capita plc conference call. My name is Dave and I'll be your coordinator for today's conference. For the duration of the call your lines will be on listen-only, however, at the end of the presentation, there will an opportunity to ask questions. If, at any time, you need assistance, please press *0 on your telephone keypad and you'll be connected an operator. I'm now handing you over to Jon Lewis to begin today's conference. Thank you.

JL Thank you, Dave, and good morning everyone, and thank you for joining our call today. I'm Jonathan Lewis and I started, formally, as the Chief Executive of Capita on 1st December. I'm also conscious that many of you may not know me, so I'd like to start by way of a brief introduction.

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I spent most of my career, some 20 years, in fact, at a large American company called Halliburton that was a B2B execution-focused enterprise, including ten years in that business as the head of the Landmark Technology Division, a business that had many parallels with Capita. I also led the turnaround of two of Halliburton's major business turnarounds, and my last public CEO role was as CEO of Amec Foster Wheeler, a company I joined in June of 2016. Capita, therefore, is my fourth turnaround.

I'm excited by the opportunity to lead Capita, but I'm also conscious that the short-term outlook for the business is weaker and that there is much work to be done. While today's announcement includes some tough messages, it also outlines the first steps on the road to recovery as we take key steps to strengthen the balance sheet, commence a broad transformation programme for the benefit of both

stakeholders, and also set a prudent plan for 2018. I'd like to cover this in more detail before I, then, handover to Nick to run through the numbers and the outlook.

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I have initiated a broad transformation programme to drive the change that needs to take place to improve the performance of Capita over the medium to the long term. There are five workstreams, all led by the central one which is, of course, strategy. This will inform our portfolio of business, our operating model, and it will determine capital allocation decisions as we put together a multi-year growth plan for the business.

Early findings include that Capita has many strengths which we can build on such as our very strong market positions in the UK, our long-term relationship with blue-chip customers, excellence around a number of key technologies, all of which will be leveraged to take advantage of the secular growth in digital solutions. Of course, we also have a very strong, talented and committed workforce.

However, Capita also has a number of weaknesses that we need to address. It is far too complex, it has placed too great an emphasis upon short-term performance, it has underinvested in infrastructure, it has over-relied upon acquisitions for growth, and has, today, limited financial flexibility, constraining our ability to invest in the future for long-term benefit.

We are now addressing these challenges head on in order to strengthen the medium-term growth prospects for the business. We have identified significant multi-year opportunities to reduce costs and improve operational efficiency. These include reductions in general and administrative expenses which are higher than our peers. We have an opportunity to centralise procurement to deliver further cost savings. We are standardising more processes, and we need to make greater use of offshoring in automation. In short, Capita needs to apply to itself what it sells to its clients.

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I will provide more detail on these cost savings during the course of the year. Over the medium term we intend to use some of the benefit from any further efficiency savings to improve our competitiveness and our capability. In summary, and I reiterate, I believe there is a significant cost opportunity at Capita, across SG&A, Procurement, Operations and Property.

We have also redeployed our previously centralised business development capability to our operating divisions, bringing these resources closer to the markets we serve. This reduces complexity and increases accountability in relation to bidding, implementation and management of contracts, as we seek to improve sales performance. I want our divisional leadership to have clear and unambiguous accountability for the overall performance of their respective businesses.

I intend to simplify Capita and increase the focus of our resources on a smaller number of markets that are likely to deliver the best prospects for the group, particularly ones where we have the potential and the capability to create value.

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Today, we are too broad and unfocused and have a portfolio of businesses that has not been driven by a multi-year underlying strategy. We have identified a small number of quality businesses that do not fit within our core skills, for which there will be better owners, and a process to maximise value for these will commence very shortly.

We also need to ensure that we have a prudent and sustainable capital basis to support our customers and our operations and an ability to increase investment in the business to deliver on our long-term strategy. Capita's transformation programme, therefore, includes an assessment of the appropriate financial leverage for the group over the medium term. Whilst the outcome of the programme has yet be finalised, the board's preliminary view is that the appropriate leverage for Capita, over the medium term, should be between one and two times net debt to EBITDA, and that the group should target an investment grade credit rating.

Given the short-term outlook and level of indebtedness, the board has decided upon a number of important actions. Firstly, we're pursuing self-help options including the aforementioned cost actions and non-core disposals. Secondly, the board is not recommending the payment of a final dividend. Dividends will resume when we are generating sustainable free cash flow. And, thirdly, the board is planning to raise equity by way of a rights issue during the course of the year. The precise quantum, up to 700 million, will be determined by the strategic review and be informed the strategic review, and the company has entered into a standby underwriting agreement for up to 700 million with Citi and Goldman Sachs, in the interim. Let me now handover to Nick to talk through the trading and the outlook.

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NG Thank you, Jon. As we stated in December, trading in the second half of 2017 was in line with our expectations. We have now completed the budgeting process for 2018, from which we have set a prudent plan. We are taking a long-term approach. We have decided to invest in people, sales and our transformation programme for the long-term benefit of the group.

Following our December trading update, when we highlighted a higher level of attrition than expected, we have continued to experience delays in decision-making and weakness in new sales. Our divisional plans indicate that there are likely to be significant and negative impacts on profits in 2018 from three main factors. Firstly, contract and volume attrition, primarily in our Private Sector and IT Services divisions. Secondly, the dropping out of one-off items, including contract and supplier-related profits, such as the DIO, which were reported in our Public

Services and IT Services divisions in 2017. And, finally, increases in some cost items, including depreciation and adoption of the General Data Protection Regulation.

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We do not expect to offset the above headwinds through the full-year benefit of last year's cost actions and new business. A more fundamental approach to cost competitiveness is required. As a result, we expect the group's underlying pre-tax profits, before significant new contracts and restructuring costs, to be between £270 million and £300 million in the full year to December 2018.

Turning to leverage, we expect net debt at the 2017 year-end, excluding bonds and guarantees, to be in the region of £1.15 billion and leverage to be around 2.25 times. This is after the receipt of proceeds from the disposal of our Capita Asset Services businesses, partial normalisation of seasonal cash management, and the reduction of deferred income in the second half of the year. We expect our receivables financing balance to be £110 million at 31st December 2017.

Looking forward, we expect a free cash outflow this year due to a number of known non-underlying payments and working capital items. We expect around £215 million spend in relation to known commitments, including £66 million cash costs on the Connaught settlement, around £50 million in relation to the separation of Capita Asset Services, including a pension contribution, contingent considerations, historic litigation and restructuring costs. In addition, we expect £130 million cash outflow from the final normalisation of seasonal cash management and a further £130 million cash outflow on continued reduction in deferred income, reflecting the ongoing low level of new business.

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Finally, I should also like to remind everyone that we are undertaking a triennial review of the pension scheme. Our current expectation is that the actuarial deficit after this review will be significantly below the last disclosed IAS 19 deficit of £381 million at 30th June 2017. In addition to our annual contribution, we are committed to a further contribution of £21 million in 2018 and we will seek to reduce the remaining deficit as a priority. And, now, I'd like to hand you back to Jon to summarise.

JL Nick, thanks very much. So, whilst the short-term outlook is challenging and there is much work to do on transformation, I believe the actions we are taking will provide a firm, prudent and necessary foundation upon which to improve the long-term performance of Capita. As we go through 2018, we will update the market more fully on our plans around cost, our planned disposals, our revised strategy, and the equity plans that that will inform.

We have the building blocks at Capita to create a great business, one that is more focused on a core set of markets that can deliver sustainable growth, one that is

less complex, more accountable and has operational discipline at its heart, one that generates sustainable free cash flow and a return for its shareholders. The new executive committee and I are determined to deliver just this. And, with that, Nick and I will be happy to take your questions.

00:12:00

CO Thank you. Ladies and gentlemen, if you'd like to ask a question, please press *1 on your telephone keypad and I'll be able to introduce your line. The first question is from Toby Reeks from Morgan Stanley. Please, go ahead.

TR Morning, guys. Could I ask a couple, please? I'll stay off the rights issue and stuff like that but, of the headwinds you flagged in 2018, if you add up all the areas that affected you, you get to quite a large proportion of revenue and I think some of those end markets are undergoing pretty big changes in terms of service delivery, so moving more to digital transformation, use of automation and stuff like that. How should we think about further attrition over the current years, because I'm assuming the competitive position is pretty weak at the moment? The market is changing is very quickly and how quickly do you think you can get to a position of actually being competitive again? And, then, the other question is you talk about multi-year transformation; can you give us an idea of how many years that will imply, please? Thank you.

JL Toby, thanks very much for the questions. This is Jon Lewis. Let me address the second first. This is a multi-year transformation, as we highlighted in the RNS and in our pre-prepared remarks. Look, I'm eight weeks into this, quite how long that transformation/turnaround is going to take, frankly, it would irresponsible of me to put a timeframe on this at this point in time; it's two-plus years. What I have been very encouraged by, however, is the appetite within the organisation to embrace the change that is necessary.

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As I travel across Capita and visit our various centres, I'm really impressed by the level of innovation and creativity we have. And, all of that, frankly, speaks to your first point, which is our ability to remain competitive, and I highlight that we are continuing to win contracts today so, by definition, we have competitive offerings across all of our segments in terms of those markets that we serve.

TR Are they in digital transformation areas, I think, is the point I'm trying to get to?

JL Yes. We're very active in the application of robotic process automation, both internally, to improve the efficiency of our own business, and externally, for clients, as well. We provide tremendous to customers around our use of data analytics, particularly as it relates to our customer management business, to help key customer, particularly in the private sector, derive a better understanding of their customers' spending patterns and habits with a view to ultimately helping them grow their business. So, Toby, digital solutions is one of the five key workstreams

within the transformation of this business and will be centre stage for us as we evolve this business over the course of the next several years.

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TR And, that's going to be an area you're going to invest a lot in I assume. Is that right?

JL Absolutely, we need to invest in that. Now, I want to be very upfront and say that some of that investment is going to have to address what I call the sins of the past. As we said in the RNS, as Capita tried to deliver on consensus, it has underinvested in the past in some areas of technology. We need to address that whilst, at the same time, investing in the future. And, it is for that reason that we've put a financial plan for 2018 together that provides an ability to do that.

TR Okay. Thanks, guys.

JL Thank you, Toby.

CO The next question is from Paul Sullivan from Barclays. Please, go ahead.

PS Yes, good morning everyone. Just to be clear, the guidance in 2018 doesn't include any additional step-up in investment as far as you're concerned. Could you just, maybe, walk us through, again, the component parts of the '18 change and put some figures around it; that's the first question. Secondly, around the disposals, it's probably too early, but can you give us a sense of the scale or scope of the disposals, maybe framing it in a range in terms of percentage of revenues and in terms of the contribution to profitability of some of the stuff you're looking at; what we should be thinking about there? And, then, the third point in terms of net cash flow, given the restructuring and investment, it sounds like we should, effectively, be writing off positive cash flow for '18, and possibly '19 too.

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JL Paul, I'll let Nick address the financial questions. What I did want to touch on was disposals. We have been, over the last several weeks, very thoughtful about how we think about disposals. First and foremost, they need to be non-core and we've named two of those to date, Constructionline and ParkingEye, which are not going to be core to the future of Capita. They also have a financial performance that ensures that they're not going to be diluted.

As we go through a review of the other disposals, obviously we're going to want to do that in such a way that it doesn't compound our net debt to EBITDA ratio, and we're confident that we can do that. We are not articulating, at this point, the quantum that we wish to realise through disposals. We are simply indicating, and I and the board feel very strongly, that we need to head towards investment grade credit rating and that means a net debt EBITDA of one to two and we will come to market, if you like, over the next several weeks and months with an indication of

what combination of equity and disposals gets us there, again, I emphasise, fundamentally informed by the long-term strategy for the business. Nick.

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NG Morning, Paul. Thanks for the question. With regard to the 2018 guidance, just to reiterate, we've taken a very different approach to our planning process this year. Historically, we've been very focused on in-year planning and Jon and I have been very keen to put together a robust plan that positions us well for the future. That plan includes investments in people, it includes investments in sales, which are badly needed. What it doesn't include, and the guidance we've given doesn't include, is the cost of the transformation of the group. We're still going through an assessment as to what we want to invest in that, in particular, with regard to the structural cost opportunities that we see in the business and which Jon said earlier are significant. So, our guidance is excluding any investment in that transformation and in any impact from new sales and IFRS 15.

You asked me about a walk. I'm not going to get into specific numbers on that walk on this call, but what I can repeat is that there are a number of known items, in particular, in relation to the DIO and the one-off benefits from Networks that we had last year, which clearly drop out in 2018. We've also got the attritional effect of some of the lower revenue in the private sector business and the IT services business that we talked about in December.

We've got increased depreciation that hits us next year as a result of some of the programmes that went live in the latter part of 2017, together with a significant investment in the GDPR regulation that hits a number of our businesses next year. And, we're making a significant investment in the people in our business, as well as an expectation that we'll begin to take cost out of the business. When you put all of those together, we've put together a prudent plan for 2018 which we've outline to you in the statement.

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With regard to cash flow, we do expect to be cash flow negative in '18 as some of those bills catch up with us. We've done a lot of work, as you know, to normalise the cash position in the business. A significant amount of that was achieved during 2017 off the back of the Asset Services disposal, but we do have an overhang that we want to sort out in 2018 to bring us to a normal position once and for all.

We also need to deal with some of those historic costs that I talked about earlier in the conversation. Once those are out of the way, it gives us a firm base on which to start to grow cash flow again. We haven't yet forecast out to '19 in detail because it depends very much on the impact of the transformation programme. What I can say is that we should return to cash generation on the basis of the cost reduction that we're planning and also the investment in sales which Jon is planning to reignite through that transformation programme.

PS Thank you. One quick follow-up. Back to the disposals, when you address the sins of the past and you put in the necessary investment, do you find that there are parts of the business that are now going to be operating at a very low margin that is unacceptable going forward, and how should we think about that?

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JL There are one or two businesses that fall into that category, Paul, but, more fundamentally, the issue is around focus and investment. We can't continue to focus in the incredibly broad array of disparate businesses that are part of the Capita portfolio today. The strategic review we're undertaking will cause Capita to shrink, cause Capita to focus on those areas where we can deliver long-term secular growth for our shareholders, and that focusing will enable us to be more distinctive, more differentiated through the investment in those areas, and that we're starting the process of delivering today with the P&L and balance sheet decisions that we are making. We are taking today, very prudent steps to position Capita for long-term success, as opposed to kicking the can down the road and believing the markets are just going to miraculously turn around.

PS Great. Thank you very much.

CO The next question is from Karl Green, from Credit Suisse. Please, go ahead, Karl.

KG Thank you very much. I've got a couple of questions. Good morning to both of you. The first question, Jon, just back on your comment there about Capita shrinking, which seems strategically desirable. To what extent are you going to be prepared to see the trading margin decline to ensure that you've got the central capabilities and costs to support the longer-term growth of the group? It's something that I think people are going to be reading across from Serco, who have obviously put a lot of investment into systems and people and capabilities and governance. And, you delivered an 11% margin in the first half of '17 on an IFRS 15 basis. Is it reasonable to expect that that margin comes down significantly beyond 2018 as the group shrinks; that's my first question.

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The second question – perhaps, one for Nick – is around the deferred income reduction you referenced in the second half of 2017. At the first stage, you had 1.7 billion of deferred income balances on the balance sheet. Can you just talk a little bit more about what drove those declines in the second half and how that's likely to pan out over 2018, please?

JL Karl, good morning and thanks for the question. Look, I'm not going to be drawn eight weeks in on what I think is going to happen to the margin. What I will say is, and reiterate, and some might argue I have a track record here, that there is a considerable, substantial cost opportunity at Capita. It has not been run as an integrated whole. It has been run as a portfolio of relatively independent businesses. There is, therefore, significant replication of cost and I would very

much hope that over the course of the next three years, we will see the benefit of those cost actions impacting the margin performance, of course.

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Now, is that going to happen in ’18? No. ’18 is year of investment. Indeed, there may be a need for some investment in ’19. But, over the medium-term, I am confident that we can create a more efficient, leaner, more focused business that will generate the types of margins that Capita has generated historically, would be my first comment. My second comment would be, we shouldn’t be compared to the Sercos, the G4Ss, the Interserves of this world. We’re not a blue-collar, low-margin outsourcing business. We’re a tech-enabled BPO and software business. That is the peer group with which we should be compared going forward. Nick.

NG Morning, Karl. Just to answer your question around deferred income. You’re right, the balance that we created in 2017 was driven by the adoption of IFRS 15, where we now have a significant rolling deferred income balance. At the moment, that predominantly represents profits that haven’t been booked on contracts and software licences where we’ve received the cash. As you know, the way that works is it unwinds over time, but it gets replaced as we sell new software licences or new large contracts where we receive cash ahead of booking revenue.

The experience at the moment is that because we’re not selling at the pace that we would like to, that deferred income balance is unwinding. The unwind in 2017, across the year, was about 50 million and that, particularly, hit us in the second half where we weren’t getting the sales throughput that we expected from a declining sales pipeline.

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Our forecasts for 2018 see about 130 million more of that balance unwind during the course of 2018. That, of course, would be offset if we achieve a greater level of sales in 2018 than we’re currently forecasting. That would come principally from either licence sales in the software business or from transformation contracts where we have significant upfront cash receipts from clients and recognise that benefits of that transformation over the life of the contract. An improved sales performance in 2018 would help to offset that decline but, importantly, it’s investment in sales that we’re making that will begin to reverse that in the longer term and it’s something that we’re very aware of.

KG Very clear. Thanks, Nick.

CO We have a question from Rory McKenzie, from UBS. Please, go ahead.

RM Hi, guys. A couple from me. Nick, can you just help us, firstly, on the revenue side of the equation for 2018? Obviously, you talk about attrition going up. Can you just help us understand where revenue goes to and, then, obviously, what that implies for margins? And, then, Jon, you did mention at the start of the call that, for the mid-term, you very much think you’ll be using your savings to improve

competitiveness. I know you don't want to be drawn yet on the mid-term outlook for margins but can you, maybe, start talking about the shape about how you think any progress might be made there? And, then, the last one, just on the pension, Nick. Can you give a bit more clarity around where you think that the deficit might sit? Any more detail there would be great. Thanks.

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NG Shall I take the first one?

JL Yes.

NG Okay. Hi, Rory. Morning. Thanks for the question. With regard to revenue, as Jon said, we don't want to get drawn on long-term margin predictions but our plans for 2018 see revenue broadly flat. That, of course, does assume that there's significant sales to replace some of the attrition that we're experiencing. If you look at the underlying attrition in the business for 2017, excluding the impact of the sales that we enjoyed during '16 which gave us a partial benefit in '17, we had underlying divisional attrition of close to 5%, and we see a significant level of attrition going into to 2018 at a divisional level with the shortfall in some of the opportunities in the major sales pipeline.

We're quite reliant on the conversion of one or two of the deals that have slipped, so we're still waiting for a decision on DFRP, we're still waiting for a firm decision on the BA opportunity. We are assuming that we're successful with regard to some of those larger deals and, therefore, assuming a relatively flat revenue profile, but, underneath that, there's attrition that needs to be offset by successful divisional conversation and also the conversion of some of those larger opportunities, so there is clearly risk in that number.

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With regard to the pension, we're going through the triennial valuation at the moment. We haven't yet had the formal results of that from our external advisers, but we have done some calculations of our own using our actuarial team and the forecast suggests that there will be a significantly lower deficit than that which we've announced under IAS 19 which is positive. And, as we said earlier, we expect to make a cash contribution to that as a result of the Capita Asset Services disposal. We've already committed to paying that £20 million this year and, clearly, we'll want to be in dialogue with the trustees in the second half of this year around the implications of that valuation and how we plan to address the remaining deficit as a priority. I don't want to be more specific on that, but we are reasonably confident, based upon our forecast, that the deficit will be lower than that which we previously announced under the accounting standard.

JL Rory, I think Nick actually answered the question you had for me around margins. It's too early, but clearly the focus is going to be, through the actions we've started and communicated today, one of focusing the business on those segments where

we can deliver secular long-term earnings growth. It's about earnings growth and the actions we've taken are foundational to that.

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RM Maybe just coming back on that margin point. Coming in from the outside, do you think the issue is, effectively, a declining gross margin in the industries you're exposed to or is it more an issue of the internal efficiency and the conversation of that into profits? As you approach this from the outside, which of those two things has been the bigger issue, do you think?

JL Well, Rory, it is, as I'm bound to say, a combination of both. Can I be explicit on the percentage that is due to end market competitive factors versus that which is due to inefficiency? No. What I would say, and it's a reiteration, really, there is significant opportunity for us to drive efficiency and productivity and leanness within this organisation.

RM Okay. I understand. Thank you very much.

JL Thank you, Rory. I think we've got time for one more.

CO We have a question from Michael Donnelly, from Panmure. Please, go ahead, Michael.

MD Good morning. Couple of quick ones. Can you confirm that you've got 469 million of UK Government contracts that expire this year? And, the second question is, Jon, you've told us that Capita is an underinvested business. My previous understanding was that Capita was, in fact, not an underinvested business. Can you tell us if the quantum of that underinvestment is more or less than a quarter of a billion pounds? Thank you.

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JL Mike, you're asking extraordinarily specific questions which, I'm afraid, at this stage in my tenure, I'm not going to address. I go back to what we've iterated in the RNS and what we've iterated in the questioning section. We need to invest. We need to invest in IT infrastructure. We need to invest in our people. We need to invest in our IT systems. We need to invest in the solutioning of new offerings. All of this is very tractable but, frankly, hasn't had, in many areas, the attention that it should have had the last several years.

I want a business that has systems that enable me to make informed judgements as to how I pull the levers to ensure we maximise our ability to grow. That's going to require investment. I want people with accountability and competencies that ensure we win appropriately high-margin contracts; that we execute on those well; and that we delight our customers as a result and win incremental business. This is all an area of investment and that is why we have rebased, obviously, our consensus for 2018.

Okay. I really appreciate everyone's participation in the call today. I want to end the call by reiterating what I said at the end of my prepared remarks. We have the building blocks at Capita to build a great business. That is why I came to this company. It will be one that's more focused, it'll be less complex, and it'll be focused on markets that can deliver sustainable growth.

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I want a business that's more accountable and with stronger operational discipline. We have had too many contracts that have had patchy delivery. And, I want us to deliver a business that creates sustainable free cash flow and return for our shareholders. And, I will reiterate what I said earlier on, which is that, as an executive committee, we are determined to deliver this. Thanks very much for your time today.

CO Ladies and gentlemen, thank you for joining today's conference. You may now replace your handsets. Thank you.