Capita's Half Year Results Call

Jon Lewis:
Good morning, everyone, and welcome to Capita's half-year 2021 financial results presentation. As usual, I draw your attention to the disclaimer on slide two.

So, we're pleased to report that we are making tangible progress on our transformation strategy and the priorities we set out at our full-year results in March. In 2021, we are targeting our first year-on-year organic growth for six years. For the Group as a whole, we maintained revenue in H1 with Q2 4.5 percent ahead of last year, and we have the order book and pipeline of opportunities to grow in the second half.

New contract wins drove year-on-year growth in Government Services, People Solutions, and Technology Solutions, these being offset by declines elsewhere, including the continued low levels of activity due to COVID in our travel and entertainment and enforcement business. The robust improvements in operating delivery we have seen over the last two years have also continued. These have combined to increase operating margins by 320 basis points year-on-year.

And we have generated £536 million from disposals year to date, including ESS and AXELOS, 75 percent of the targeted £700 million we communicated in March. Further disposals are now underway, and the remaining 25 percent of this disposal proceeds target will be delivered by the end of the first half of 2022, six months earlier than previously planned. We have extended our RCF out to August 2023 and have completed our triennial pension valuation. Liquidity remains strong and is more than sufficient to meet our debt repayment obligations in 2022.

Earlier this week, we transitioned to our new operating model. We now have two core divisions, Capita Experience and Capita Public Services, and an expanded non-core division, Capita Portfolio. The structure is both more client-focused, operationally efficient, and cost-effective and will support sustainable revenue growth and cash generation. We will cover off these points in more detail later in the presentation.

At this point, I would like to say thank you to all our 55,000 colleagues. The progress we have made has only been possible through their continued hard work, professionalism, and commitment. And I'm honored and proud to work alongside them. Let me now hand over to Tim Weller, our new CFO, who joined us in May, and who will take you through the first half financial performance.

Tim Weller:
Thanks, Jon. And good morning, everyone. It's great to be here. And if you recognize in Jon's introductory comments, this is a really good time to be joining Capita. The organizational simplicity and strategic logic as a new operational structure establishes a firm foundation as a business in flex to top-line growth. Jon and the team have made huge progress in efficiency delivery, which is evident in our bottom-line progression in the first half, with more to come in the future. And, finally, some very important steps have been taken in the last few weeks to

strengthen the balance sheet, which I'll go into in more detail in the next few slides.

All this puts us firmly on track to deliver on our plans for 2021 and to generate sustainable free cash flow in 2022 and beyond. Now turning to slide 5 for our financial highlights. As in previous presentations, we share our results on an adjusted basis which excludes the impact of businesses exited and the trading results of AXELOS, which has been shown as held-for-sale at the period end.

Despite the ongoing impact of COVID-19 adjusted revenue was maintained in line with the first half of last year with PBT and EBITDA improvement reflecting that revenue stability and ongoing efficiency delivery. Cash generative by operations reduced by 7 percent compared with the prior year, which, as previously disclosed, benefited from £77 million of advanced receipts arising as a result of the COVID pandemic. Free cash flow increased by 12 percent as the reduction in adjusted cash generated by operations was more than offset by lower capital expenditure, interest, and tax paid.

And we delivered a step reduction in net debt in half, visibly reflecting the initial ESS disposal proceeds partially offset by the expected one-off, catch-up, increase in pension deficit contributions.

Turning now to revenue in slide 6. The puts and takes that led to the in-line revenue performance are shown in the chart. The in-period revenue impact from contract losses halved year-on-year, reflecting our sustained focus on retention and service delivery.

The relatively small ongoing contract scope and volume reductions reflects 2020 pandemic-related work and other projects in customer management, which did not repeat in 2021. We've seen improvement in our transactional revenue, which in 2020 was particularly impacted by COVID-19 when the business experienced a negative impact of around £80 million. In this half, we saw the biggest recovery in Technology Solutions and People Solutions.

The first half benefited from a number of notable wins, including the commencement of the Royal Navy training contract and the Job Entry Targeted Support contract, which commenced in February, and these were combined with the annualised impact of the Defense Fire and Rescue contract and smaller wins within Customer Management and Software. To provide a view of revenue trends over the half, the slide shows a period-on-period progression in Q1 and Q2. As you can see, Q1 this year was down 4 percent on Q1 2020, which was largely unaffected by COVID-19, but Q2 saw an inflection to growth with revenues up 4.5 percent. We are particularly encouraged by the performance in this quarter, as it derives mainly from the major contract wins, I have just outlined rather than a bounce-back in our COVID-impacted business volumes.

Moving on to our profit before tax bridge, as shown on slide 7. There are a number of key drivers behind the substantial step up in profits in the first half. Firstly, to ensure a like-with-like starting point, we've adjusted for the 2020 one-offs totaling £12 million, which included contract asset impairments recognized in Customer Management and an increase in contract provisions. The margin effect of revenue losses, scope, and volume, transactional changes, and contract wins come to a net £4 million negative with the ramp-up mainly in Q2 from new wins not yet offsetting the impact of contract losses.

Our successful transformation program continued to deliver substantial savings in the first half of 2021 with a £79 million period on period benefit. In last year's interim results, we outlined the impact that the Group's holiday pay accrual had on the first half of 2020. The impact of this is significantly unwound in 2021, as colleagues stepped up the usage of holiday entitlement. Despite this, we would still expect the phasing of leave accrual recognition to result in a weighting operating profit to the second half.

The final block on the slide shows the period on period impact the reinstatement of the employee bonus scheme this year with £25 million accrued at 30 June, compared with the release of 2019's £15 million bonus accrual in the first half of 2020. Moving into the second half, we expect to see the reward for the hard work by the team on cost transformation over the last few years, with revenue growth and operating leverage driving the bottom line.

Turning now to slide 8, which reconciles our adjusted profit for tax measure with reported PBT. Business exits reflect the ESS & Irish Life and Pensions disposals; we generated £240 million disposal profit and classification of AXELOS as held-for-sale at 30 June. Restructuring costs of around £30 million were slightly lower than the comparative period, and we expect strategic restructuring costs to increase in the second half with the implementation of the Future Capita structure, which is effective from August. Overall, for the year, we're projecting restructuring costs of between £75 million and £90 million in what will be our last year of substantial below-the-line restructuring investment.

Litigation and claims include a £5 million insurance receipt in respect of the previously recognized claim and a small movement provision in respect of specific historical claims. In summary, the adjusting items added £216 million to our adjusted PBT, bringing the overall year-on-year increase to £290 million.

On slide 9, we provide the divisional revenue and operating profit performance under the organization structure which existed during the period. Today's announcement provides further detail on the financial performance and key achievements for each of the divisions operated in the first half.

On slide 10, we provide a proforma analysis of first-half revenues under the organization structure, which has just been put into effect. Later this year, we plan to provide full historical proforma financials under the new divisional structure. As today's announcement makes clear, our two new client-focused core divisions are at different stages in their transformation journeys and are facing into markets that are recovering at different rates. The U.K. Government market is strong, reflected in the 8.6 percent proforma growth shown in Capita Public Service, whereas the private sector is less strong, and Capita Experience saw a 7.5 percent revenue decline in the first half.

Nevertheless, as noted earlier, overall, we expect the Group to return to revenue growth this year, despite the ongoing impact of COVID-19, and we remain on track to deliver cost savings of £50 million in 2022 from the simplification inherent in the Group structure.

Turning now to the cash flow and net debt movements as summarized in slide 11. Operating cash flow conversion has fallen from 176 percent to 121 percent, reflecting the reversal of the working capital benefit in the prior year is COVID-19-related advanced receipts partially offset by advance payments from a couple of our major customers this year.

Whilst there has been the net cash flow benefit in the first half working capital movements, we currently expect a material working capital outflow in the second half reflecting the unwind of the advanced customer payments I've just mentioned across the balance of the year, together with the natural expansion in working capital as we transition to revenue growth. Overall, we are expecting operating cash flow conversion for the full year to be between 65 percent and 75 percent in 2021 before reverting to a more normalized 80 percent to 90 percent in to 2022 and beyond.

Capital investment fell period on period reflecting ongoing COVID-19 cash preservation measures and the completion in 2020 of the number of transformation projects. We expect a step up in capital spend in the second half to somewhere between £35 million and £45 million as we move into a growth phase. There were a number of other cash flows during the first half of 2021 which impacted the overall movement in net debt, the largest obviously being the proceeds received on the ESS disposal in February offset by the expected one-off additional pension contributions.

Additionally, we saw a small outflow in the first half from the reversal of the one-off VAT phasing benefit we received in 2020 and expect the bulk of the rest of the 2020 benefit to reverse in the second half. Overall net debt reduced by £183 million to £894 million at the end of June.

On slide 12, we itemize the material cash flow headwinds that the Group is currently exposed to and show an estimate of how these are expected to develop in the second half of the year and 2022. One of the largest outflows in 2021 will be the repayment of deferred VAT under the Government's COVID-19 support measures, which, as I've just noted, will largely be repaid by the end of the year.

As I explained earlier, there have been substantial catch-up pension deficit contributions in the first half. Following the agreement reached in June with the pension Trustees in respect of the triennial valuation, we expect to make a further regular deficit contribution of around £14 million in the second half, £30 million in each 2022 and 2023, and £15 million a year in 2024 to 2026. Notwithstanding the step-up in restructuring costs expected in the second half of the year as we implement the new organization structure, moving into 2022, we expect restructuring costs to be materially lower and are not planning to be calling restructuring costs out separately as adjusting items beyond the current financial year.

Overall, the material reduction in cash flow headwinds expected as we move into 2022 is one of the key factors which underpins the transition to sustainable free cash flow from that year onwards.

On slide 13, we set out the Group's liquidity position and summarize some of the key steps taken recently to strengthen the Group's balance sheet. As at 30 June, we had substantial liquidity with net cash of £242million and a wholly undrawn revolver. The current £452million revolving credit facility expires on 31 August 2022, and in June 2021, we entered into a new RCF for £300million covering the period from August 2022 to August 2023; with a further extension to 31 August 2024 contingent on a number of conditions as outlined in the half-year results announcement.

Last week, we received total proceeds of £227 million in respect of the AXELOS transaction and the contingent consideration from the ESS sale. In aggregate, we have now received around 75 percent of the £700million target for disposal proceeds that we set out in March, and, given the processes underway, we remain confident that the balance will be delivered across the remainder of 2021 and the first half of 2022. In July, we repaid £159 million of the U.S. private notes, leaving some £280 million of additional maturities between now and the end of 2022.

The Group's current strong liquidity position provides the financial resources to address the forthcoming maturities with headroom to spare even before the benefit of the expected further disposal proceeds, I've just talked about. We will therefore be taking a measured approach to any potential refinancing and expect to be able to take our time to implement a longer-term debt solution at the appropriate moment.

So finally, set out on slide 14 and returning to the comments I made at the start about this being a really good time to join Capita.

We've delivered an encouraging first-off financial performance with strong bottom-line progression in line with our expectations. The revenue trends we've seen in the first half and the new operational structure create a platform for revenue growth in the second half. As a result of the various moving parts in cash flows, we expect net debt to be broadly flat across the remainder of the year before the benefit of any further disposals. Given the material reduction we expect in cash flow headwinds beyond this year, we are on track for sustainable free cash flow in 2022. And all of this is underpinned by the substantial progress made recently in strengthening the balance sheet, with more to come from the ongoing disposal programme.

So, with that, I will hand back to Jon for the strategic update.

Jon Lewis:
Thanks, Tim. At the heart of our strategy is our commitment to being a purpose-led, responsible business, working to create a sustainable future for all our stakeholders. This represents our' license to operate in the markets we serve and, in particular, ensures we are strongly aligned to the Government's Social Value Act. Our purpose, creating better outcomes, has also been a key driver of the needed cultural change that was required within the organization.

From September, all U.K. government suppliers with contracts with annual values in excess of £5 million will have to commit to being Net-Zero by 2050 through a published "Carbon Reduction Plan." This is something we have been working on for well over a year and have well-defined plans to achieve three key milestones on our road to Net-Zero. We are committed to neutralizing our Scope 1 and Scope 2 operational emissions by 2025, will add Scope 3 business travel by 2030, and finally, by 2035, include our remaining Scope 3 emissions, taking us to net zero.

In February of this year, we achieved Science Based Targets Initiative accreditation, which independently ensures our targets are robust and credible. We have continued to focus on the safety and wellbeing of our people through the pandemic. And over 40,000 are currently working from home, and many will continue to do so as we adopt our New Ways of Working hybrid model. And as I have stated previously our purpose -- we create better outcomes, and what it stands for is a foundational element of Capita being a sustainably successful company.

As Tim stated, this set of results record the first tangible benefits from the investment in people, systems, products, and client service delivery made over the last three years. These feed into a virtuous circle of sustainable growth in revenue, margins, and cash. Our Client Net Promotor Score, at plus-32, tells you that our investment in client service delivery is recognized, something that is fundamental to renewing and growing our business with existing clients. And we have much stronger relationships with our clients today. Trust and engagement have improved, and we have clearer insights to their needs and the revenue opportunities these create.

Our new, much more client-centric operating model will further improve that focus, enabling our client partners to bring more of Capita to their respective accounts. The impact of winning work on better commercial terms that create value for Capita and its shareholders is also now much more visible. The improved discipline on bids over the last three years no longer serves to offset cash leakage on historic contracts but is now beginning to drive margin growth. And finally, we are executing strongly on our new contracts, delivering on bid margins, and creating further growth opportunities as a result. This is the virtuous circle we will continue to perpetuate to create sustainable revenue and margin growth.

Revenue and margin growth. I am pleased with the first half sales performance, previously, our priority had been to fix those contracts that had operational issues and unhappy clients. With that considerable effort and cost largely behind us, we are now able to bring more resources and energy to investing in our capabilities for long-term sustainable growth. And as Tim showed, we inflected to growth in Q2 ahead of any material COVID bounce-back from businesses, such as Travel and Events, and Enforcement.

We won just shy of £2.6 billion of new business in the first half, 70 percent more than we did over the same period last year. £925 million of this came from our Royal Navy training contract, but even excluding that, we still increased total contract value by 9 percent year on year. Our investment in the professionalization of our sales organizations, means we're also better at winning business. We had a 76 percent win rate in the first half, a 14-point increase on the prior year. And our strength in sales performance is further evidenced by our strong in-year revenue growth, up 13 percent on last.

And finally, we have further reduced revenue attrition associated with the loss of large scopes of work, such as that for local government last year, or Prudential and Marsh the year before. Our contract renewal rate remains high at 89 percent, itself an indicator of how well we are delivering for our clients today. These, collectively, are the building blocks from which we expect to grow revenue this year and into the future. As a result of the work we have won in the first half, the order book increased by a net £0.8 billion, more than £2 billion of pipeline opportunities moved onto the order book over that period. And in the last 12 months, we have increased our 2022 pipeline by over £2 billion.

Our sales data also shows that we are starting to realize the change in the mix of work associated with our consult, transform, deliver engagement model. We're winning more strategically valuable and higher-margin consulting and transformational work, engagements where we can monetize our depth of understanding of clients' needs and the solutions to them. This change in mix is one of the core pillars of our margin enhancement strategy, and in future, we will share the percentages of work won in each category. Examples in Capita Public would be our consulting and transformational work for Network Rail or our work for the Joint Information Systems Committee.

Capita Experience is continuing to expand scopes beyond traditional call center delivery to more transformational work, collaborating with clients to implement digital solutions that drive superior customer outcomes, while also, of course, reducing cost to serve. We're currently working with a major financial services client and a transport sector client on bids that offer transformational services, as well as just lower cost to deliver.

Our focus on the professionalization of our sales function is also generating insights on who our highest growth potential clients are and the types of solutions we are most likely to sell to them. 98 percent of the total contract value sold in the first half was with our top ten key clients, and importantly, £1.6 billion of that, more than 60 percent, was from solutions we had not previously sold to them. In other words, we're doing a better job of increasing our share of spend, and growing revenues from our top clients.

Over £2 billion of work was concentrated in 10 market offerings. These scalable, repeatable solutions include, complex transformation, as with the Department for Education; access to skills, as with NHS; digital connectivity, with Transport for London; and customer experience transformation and digital services for a major European telco, as well as Tesco Mobile. And those same 10 market offerings, which have demonstrable market competitiveness, form 70 percent of the weighted pipeline for the rest of this year.

Now, as determined as we are to grow the top line, we will only do so on pipeline opportunities that have the right risk and margin profile. Our well-established governance processes, including our contract review committees, ensure that we comprehend execution risk, and bid appropriate margins for the work in our pipeline. As a result, average bid margin is now 11 percent since the start of the transformation, reflecting this disciplined approach. And on renewals, our average margin uplift on recent significant renegotiations has been six percentage points higher than their historic performance. Our disciplined approach is further evidenced by the fact that we ultimately chose not to bid on almost £400 million of pipeline opportunities in the first half as we didn't consider the risk/reward profile to be appropriate.

The operational performance of our contract portfolio was again strong in the first half, with contract delivery KPIs up a further 1 percent on H1 2020. Our contract delivery performance is now consistently in line with industry benchmarks. However, we are a long way from being complacent, and we have a number of areas, for example in our Pensions Administration business, where we can better serve customers, and so do more efficiently. We're also delivering well on our major new contracts, in particular, Defense Fire and Rescue for the MoD and training for the Royal Navy, with operational and financial KPIs in line with expectations.

Delivering against the original bid plan is another foundational success factor. First, it speaks to a more mature, disciplined, and lower risk execution capability, and second, delighted clients generate incremental growth opportunities. We have already won over £80 million of incremental TCV on the Royal Navy training and Defense Fire and Rescue contracts since their start, with further opportunities in the pipeline of over £300 million, and we look forward to building on this trend.

Now, we have updated you at every set of results since 2018 on our problematic legacy contracts. These were costing us our reputation, client relationships, our time, and most of all, our cash. This year, we will complete the resolution of the final two, Electronic Monitoring and PCSE. Along with Army recruitment and mobilcom-debitel, these four contracts have to date cost Capita £230 million in lifetime cash. This compares to the planned £280 million of cash contribution Capita expected at the time these contracts were signed, between 2012 and 2015. This gap encapsulates why we have put such emphasis on bid discipline and contract execution.

We're now 98 percent of the way through digesting the cost of these contracts, and we'll be finished by the end of this year, and from next year, we expect their cash contribution to be positive. In the case of Army recruitment and PCSE, we have now also won extensions with superior commercial terms. If we look at the four largest contracts won since the start of the transformation, representing £1.9 billion of TCV, through our more disciplined bidding and stronger operational control, our forecast for cash generation is slightly ahead of that expected when they were bid.

We have made consistent progress on removing cost from the business over multiple years and have delivered £79 million in savings year to date. But historically, this has not been sufficient to protect margins after the impact of historic revenue decline. I see it as another important milestone for the transformation that in H1, the impact of these sustainable cost savings is positively impacting the bottom line. Day to day cost competitiveness will remain an evergreen part of our culture and there remains more we can do, and through the remainder of '21 and into '22, we will see the next wave of efficiency benefits from simplifying our organization, and we remain on track to deliver £50 million per annum in cost savings next year.

Now, earlier this week, we switched to our new operating model with its two core divisions. Capita Public Service is focused on serving the UK public sector market, while Capita Experience is focused on customer experience solutions for the UK, Irish, German and Swiss markets. Our core divisions have demonstrably competitive market offerings and are strong players in their respective markets, and while both operate the same consult, transform, and deliver business model, they will address their respective markets and client needs separately.

Our third division, Capita Portfolio, houses our non-core operations, and we will exit these businesses over the next couple of years.

The new structure will have several benefits over our previous one. First, having industry verticals and their associated clients as the primary axis of our operating model, will drive greater client focus and support improved revenue performance and accountability. Second, the simplified operating structure increases efficiency and presents further cost-out opportunities through a reduction in spans and layers, it also simplifies our P&L accountability. Third, lean overheads support sustainable cash generation, while the heavy lifting of the transformation period is now largely behind us, we're now able to maintain governance and oversight with a normalized central cost base and more efficient shared services.

Ahead of the full-year results in early 2022, we will report in the new structure for the first time, and we will also provide you with the full comparative financial information on a pro forma basis. Before then, let me give you some additional insight into each division, starting with Public Service. Capita Public is the market leader in providing business process services to the U.K. government across key Whitehall departments, in the regions and to hundreds of local authorities. Through our public sector work we're proud and privileged to serve millions of the U.K.'s citizens, including many of society's most vulnerable and recognize the responsibility this brings. The legacy issues in some of our contracts, as I've already said, are now very much largely behind us, and we have a reputation for delivery. And this is a growing market, around seven percent per annum according to the latest industry statistics, as government strives to deliver superior citizen services for less cost, increasingly leveraging digital technology to achieve this. We grew at 8.6 percent pro-forma in the first half of this year.

This is the direct result of our investment in fixing contracts, improving operational delivery and efficiency, standardizing core digital technology platforms and building an improved understanding of specific client needs. In particular, we're starting to see the benefit of being on many more government frameworks and since 2020 we have won positions on 24 frameworks, giving us access to 23 billion of governmental spend. And so far, this year we have won positions on framework contracts with the Department for Education, the Department of Work and Pensions, and the Crown Commercial Service, and a further £13 billion of frameworks remains in our pipeline to bid. From seeing declines in its revenue, order book, and margins over many years, the outlook for Public Service is now robust and we expect revenue and margins to continue their improved trajectory.

A good example of where Capita Public Service can succeed is the Royal Navy training contract, where our approach has always been one of collaboration, both with the client and with our partners, to bring together the competencies and technology to deliver a modernized, technologically advanced, and efficient training capability. Indeed, we have already won praise and recognition from the client for the seamless transition of service from the prior provider and the improved quality of service we are providing. Capita Experience brings together a number of our scalable solutions from Customer Management, People Solutions and Software. We are a significant player in the U.K., Ireland, Germany, and Switzerland, focusing on serving our client's customers across five main areas of expertise: financial services, telcos, transport, utilities, and retail.

With the increasing move to customer self-service this too is a growing market, and our digital omni-channel platform, very importantly our sector expertise, and our efficient resource base means we can offer attractive transformation and delivery propositions. However, as Tim has already stated, Capita Experience is earlier in its transformation journey than our Public Service division. Revenue declined in the first half, and we expect that trend to persist for at least the rest of this year as the impact of recent losses with the likes of Debenhams and FirstGroup take effect. However, we have a solid pipeline of opportunities, and some notable recent wins for Tesco Mobile and a major European telco announced earlier this year, and we remain confident in our ability to grow this business. There is also a clear plan in place, to improve profit and cash generation through our new operating model and through reduced overheads in property.

A good example of where we bring all of this together is in our work for Southern Water. Domestic and business Southern Water customers engage with Capita for all aspects of their service, from the reporting of leaks, to bill printing and mailing, to revenue collections. Such broad scopes of work create significant opportunity for our full range of customer experience solutions, giving us the scope for greater transformational efficiency and customer service improvement. By partnering with the client to establish agreed outcomes and providing our colleagues with the right digital and data support tools, we have been able to deliver significant improvements in operations and customer satisfaction as evidenced on this slide.

Those businesses that did not fit into either Capita Experience or Public Service for strategic reasons have, of course, been put into Capita Portfolio, including the remaining assets of the Specialist Service division, and off-the-shelf software assets. This division also includes the most COVID-impacted parts of Capita, specifically our enforcement business and our corporate travel and events agency -- recently rebranded as Agiito. We are executing on a plan to dispose all of these businesses over the next couple of years, and to simply simplify both the day-to-day management and the sale processes, we have organized them into seven logical bundles, as outlined on this slide.

In 2020, the assets now in the division recorded revenue of around £550 million. In additions to the disposals we announced in March, which are ongoing, we're currently preparing further assets for disposal later this year or early next. The combined 2020 revenue for all the disposals currently underway was around £200 million. We have already received 75 percent of the 700 million of disposal proceeds we -- proceeds we targeted in March and as we mentioned earlier, we expect to meet this target in the first half of 2022. Thereafter, with timing to some extent depending on COVID recovery rates, we will still have more than £350 million of revenue to dispose of.

So, in summary, we have made tangible progress on our strategy and the priorities we set out in March. We can see the first signs of revenue growth and the benefits of operating leverage that follow, ahead of any COVID bounce back. We have made material progress on the balance sheet through the significant disposal proceeds received and by extending the RCF. This means we already have the liquidity in place to meet upcoming debt maturities, whilst pressing ahead with an accelerated disposal program. We will therefore take a measured approach to any potential refinancing to ensure that the longer-term balance sheet solution is one that is best one for the company, and with a simpler, more efficient, more client focused operating model now in place, we look forward to driving sustainable growth and cash generation for the long term. Thank you, and for that, Melissa, we will open it up -- with that we will open it up for questions.

Female Speaker:
Of course. If you would like to ask a question, please press star followed by one on your telephone keypad, and if you do change your mind, please press star two. And when preparing to ask your question, please ensure your phone is unmuted locally. We do have a couple of questions that have come in, our first question comes from Paul Sullivan of Barclays. Paul, please go ahead.

Paul Sullivan:
Yes, good morning, everyone. Firstly, on people, Jon, I mean, can you talk about how you are -- how you're attaining and motivating the strategic hires you made at the very beginning of the process and what do you think is sort of working and what's sort of still not working from a -- from a big picture perspective? Secondly, just looking at sort of the profit expectations for next year, it looks like the market has taken sort of this year's profit expectations and just threw a -- thrown in the £50 million equating to your additional savings. Is that still the right way to look at it in your view, as it doesn't seem to give you much credit for underlying improvement of this core business? And then, finally, on free cash flow, I think you've refined the definition there a little bit, but in terms of the bottom line, you know, when we think of cash and net debt reduction before disposals, should we be looking at net debt reduction, or should we be seeing net debt reduction and before disposals in 2022? Thank you.

Jon Lewis:
Paul, good morning. Thanks for those questions. I'll let Tim address the 2022 profit and free cash flow definition, let me start with people. Look, I -- as I think you know when we hired the leadership team to execute on this transformation, we were very transparent with regard to what that would entail and what it would take, and we put particular emphasis, not just on ensuring we had people that had the competency to perform the work, but that they would have the resilience and long term commitment to stick with what we knew would be a multi-year transformation.

And that is very much proven to be the case, we have an excellent executive leadership team in place today who are very committed to seeing the transformation of Capita, and obviously, results such as those which we have presented today give all of us faith and encouragement in our ability to do that. If we look more broadly across the organization, we are seeing some uptick in voluntary attrition, but I don't think that's unique to us. We're seeing an increase in attrition in some of our I.T. sectors in particular, and that's broadly reflective of what's happening in the market overall.

I think to your second question, about what's working, when first and foremost we had to drive cultural change, as we said right at the outset, and our commitment to being purpose-led has arguably been the single biggest positive lever of change there. The culture at Capita has changed really quite dramatically over the course of the last three years, but I think also, I would suggest that our focus on delivering for our clients, being there for our clients, fixing problematic contracts, renewing reputations, has been instrumental in creating a foundation for growth. And the fact that we have seen the renewal rates on contracts improve to the extent that they have, and the fact that we have seen a further marked reduction in the level of regular attrition this year, I think speaks to how well we are now serving our clients.

With a move to the new operating model, we sort of put that on steroids; having an industry vertical focus, having the client-centric focus, I think we give ourselves an opportunity to be even more focused on delighting our clients which is an expression I use regularly, and ultimate, as a result of that, realizing further growth opportunities. Tim?

Tim Weller:
Yeah, on the 2022 regression, the market may well be just factoring in the flow through of the cost savings and, as you rightly say, we've identified £50 million of additional cost savings coming from the future Capita structure. But I guess, in terms of our strategic development, clearly we are looking for revenue grow and in particular margin expansion from the richer mix of products and services we provide to our customers. And therefore, we would have an aspiration that this is a profit progression driven by more than just the cost reduction program. And then, in terms of free cash flow, to be clear we haven't changed the definition of free cash flow, that remains the same.

But what we are saying, for 2022, is we should be measured by reported cash flow as opposed to adjusted cash flow. And the big adjustments that have been made in moving between reported and adjusted have been the reversal of pension deficit contribution and restructuring costs. So, essentially, historically, adjusted free cash flow has always been better than reported free cash flow in respect to those two elements. So, if you like, by moving from adjusted to reported, and saying that that is the number in 2022, that will move into positive territory. We are giving ourselves a higher bar to cross, it is a more stretching target because of the addback of the pension contributions and restructuring costs that have been made to date in moving from reported to adjusted, but the target is going to based on our reported results.

Paul Sullivan:
And so, that points to net debt reduction next year before any more disposal processes, is that -- is that the objective?

Jon Lewis:
That would be logical because essentially the number I'm talking about is the cash flow available to repay debt.

Paul Sullivan:
Yeah, great. Okay, that's very clear. Yep, got it, thank you.

Tim Weller:
Thanks, Paul.

Female Speaker:
Our next question comes from David Brockton of Numis. David, your line is now open.

David Brockton:
Good morning, all. Can I ask three as well, please? Researching respective Capita Experience, how far do you think we are before growth inflects for that division, and to what extent is there still excess attrition that could play a part? The second question is on the transactional business and the recovery that you, I guess, you haven't seen so far this year. To what extent are you expecting some of the £80 million to recover over the near term, or is the message today one that is of the winds you've had and the progress you've made elsewhere, also the supporting map and actually further COVID recovery could be more upside? And then the final question, just related to that question around ex-staff attrition, just keen to understand to what extent you've seen any inflation repressure to date through the business and how you're responding to it, thanks.

Jon Lewis:
David, good morning, and thanks for the questions. So, let's start with Capita Experience, you know, that is a business that we're still in the progress of improving the competitiveness of, both in terms of the solutions we're able to take to market, and our cost competitiveness, so we have a very clear set of plans we're executing upon to get that business onto a growth trajectory, in the same way that we executed, of course, on our Capita Public Service business. I don't want to be drawn on a time frame within which we will inflect to growth again, but I am nevertheless encouraged by the pipeline -- of opportunities we have.

We were talking about Capita Experience. So, I don't want to be drawn on a time frame, but we have a healthy pipeline of opportunities there as I mentioned, and we're demonstrably competitive, we're winning work at each of the geographies in which we operate. But there's more work yet to do on our overall competitiveness, and I think what also gives us encouragement there is this secular trend to customer self-serve as more of us move to the [unintelligible] from purchasing decisions. Clearly that creates more demand for the sorts of services we offer. I'll let Tim come back to the COVID businesses later on, and in terms of the financial impact, but I would simply say that we are not betting either on the second half of this year or initially in our plans for the first half of next, that our COVID-impacted businesses will come back to their -- the revenue and peak of performance that they delivered in 2019. Some might very well experience, as a result of COVID structural change, in those and I'm thinking about travel and events business in particular.

In terms of staff attrition, I actually think I answered the question earlier on, we're not seeing attrition levels are that are out with that within the industry, particularly in tech, is seeing in general, and with your -- the question with regard to salary inflation, you know, we budgeted three percent for salary cost inflation this year, which we have implemented, but we also, in the majority of our contracts, have indexation for salary inflation built in, so either they pass on cost to our clients in many of the contracts we have, so we're less exposed to that than perhaps some are. Tim?

Tim Weller:
Yeah, on the COVID-impacted businesses, we're -- in the first half we'd be -- certainly seen a -- sort of characterizes a small net negative, so there is some recovery in some of the more directly impacted businesses, just in transactional volumes. But in terms of the kind of one-off work we saw in 2020, that has steady disappeared, and therefore we are still net negative, and that's still

the case in Q2 as well as early as Q1. Moving into the second half of the year, you know, there are some, if you like, green shoots that we're seeing in terms of volume increases in July, but it will be pretty optimistic to expect us to be getting what's back to 2019 levels in terms of those transactional volumes across the remainder of the year. So, don't set in terms of where I am thinking, we are still expecting us to be trading at the level, much lower than historically, as a result of the ongoing factors that's COVID.

Jon Lewis:
And David, just to be very clear, you know, our belief in our ability to grow through the second half is driven much more by the contract wins we already have on the orderbook and are in your revenue performance year to date, and, of course, the pipeline of opportunities we see. So, we're not banking on COVID recovery to deliver the share of the revenue growth in the second half of the year.

David Brockton:
Thank you very much, that's very clear.

Female Speaker:
As a reminder, please press star one with a flag icon if you've joined us online. Once we wait for any further questions to come in, we do have a webcast question I'm going to read out. This is from Andrew Brook for Tim, can you talk about capex expense, there was a low spend in H1, especially against previous years? What do you see as sustainable level?

Tim Weller:
Yeah, capex in H1 -- was only £22 million and as I mentioned, when talking through the slide, there was a significantly higher level of capex in the first half of last year, and the step down between the two years was driven primarily by a number of transformation projects completing in 2020, including, for example, our CRM customer management system, with investment coming to an end. So, to the degree a lot of their transformation investment has stepped down. What I did point to in the second half of the year is an increase in capex and suggested that capex in H2 would be between 35- and £45 million on top of the £22 million spent in H1, and that reflects capex associated with the growth aspirations that got in the business. Probably for trying to model a sustainable capex number into the future, I certainly wouldn't want to double the first half capex number, I'd probably be inclined to double the second half capex number. So in other words, we're expecting to revert to a normalized level of capex in the second half of the year at between 35 and 45 million for the half.

Female Speaker:
We do have a couple of questions have come in on the phone line, first question comes from Christopher Bamberry of Peel Hunt. Christopher, the line is yours.

Christopher Bamberry:
Good morning. Could you please elaborate on some of the larger opportunities in the pipeline and rebids for contracts coming up on the next six to 12 months? Thank you.

Jon Lewis:

Christopher, good morning. Be happy to do that. So, let's take them division by division, starting with Capita Public Service. So, we have a healthy pipeline of opportunities there, I mentioned earlier on in our prepared remarks the framework opportunities that we will be bidding upon over the next year or so, totaling about £13 billion of governmental spend, but some of the other key ones would be a £200 million TCV opportunity we have with the Department of Social Protection, we have a £35 million opportunity with the Department for Education, we're looking at an opportunity around medical record digitalization with NHS England, with a value of around £105 million, a further extension to PCSE of £91 million, and then the Department of Finance in Northern Ireland has an opportunity that we're progressing with a value of around £70 million.

That's in the remainder of this year and, Chris, if we look out to 2022, you know, we have the renewal of the Department of Works and Pensions opportunity at £750 million, Transport for London, £300 million, Department for Work and Pensions Contact Center opportunity, £200 million, and we hope to make an announcement shortly on our position on the framework for Contract Center, something we've not been on for a number of years I hasten to add, and then we've got an opportunity with TFL for £200 million, and the Ministry of Defense for £170, so an encouraging set of opportunities there. If we turn to experience, the big one in the remainder of this year is renewal of BBC TV licensing that's at £400 million. We have a number of other opportunities with Royal London, Bord Gais, Scottish Power, which are around the 40, 50, 60 million range.

Going into 2022, one of the most significant opportunities is with Lloyds Banking Group, with their Connect partnership for £165 million, we've got another opportunity with them of an equivalent value. The renewal of Telefonica, the British Airways, around £100 million, the BT. Group around £70. So, those are examples of some of the most significant opportunities, combination there of renewals, of course, and new scopes of work.

Christopher Bamberry:
Thank you.

Female Speaker:
We have a question --

Jon Lewis:
I should add -- I should add, Christopher, that, you know, if we look at the unweighted pipeline of opportunities, and the pipeline coverage, we have more than 100 percent weighted pipeline coverage for our targeted revenue in the second half of the year. And if we look at the unweighted pipeline in the two divisions, we have, in Capita Public Services, unweighted, around £9.8 billion of opportunities, and in Capita Experience, about £5.1 billion in unweighted opportunities.

Female Speaker:
Before we proceed with our final question, as a reminder, please press star one for any final questions. Our last question comes from Suhasini Varanasi of Goldman Sachs. Suhasini, your line's now open.

Suhasini Varanasi:
Thank you. Hi, good morning, everyone. Just one from me, please. From a medium term, appreciate there's a lot of uncertainty for the near term, but very helpful to see the see the market growth rates that you've given for the two different divisions there. How do you think about the growth opportunities for you, the growth rate, on average, in the medium term that you expect to achieve, and should it be in line with the market growth, the cost, the position of the market, can you make it in line with the market of which you're targeting? And then on the profitability as well, how should we think about the profitability of those two divisions? Appreciate it's very early days, but anything on the target of the medium term would be helpful. Thank you.

Jon Lewis:
Suhasini, good morning. So, let's talk to growth first, and Tim will probably say something about profitability. Look, any self-respecting CEO is going to want to grow their business at least at the rate at which the markets we're serving are growing, and that's absolutely our ambition. And we outlined this morning third party estimates of what we believe both the Capita Public Service market and the Capita Experience market will be growing at, and in fact as you will have noticed in the first half of this year, we actually outgrew the market in Public Service, it's growing at about six to seven percent, and we grew at 8.6 percent, year on year. So, that is very much our objective and, you know, it's great to have the very substantial market share positions we do in the two divisional areas. We can build on that strong market share position to ensure with the solutions we have that we can sustain our growth over the long term. I'll let Tim say something about profit, but it is absolutely our intention, at a Capital Markets Day, the timing of which we'll announce subsequently, to get into a lot more detail on the market opportunities by division, their growth rates, and our propensity to achieve those.

Tim Weller:
I suppose the question around profitability probably goes back to Paul's question around the progressions in 2021 to 2022 in terms of improving margins, and, you know, going beyond 2022, you got a couple of effects around margin. Number one quite naturally is operating leverage. So as revenue grows up and we continue to operate with the efficient support functions that are being created through the future capital reorganization, you're naturally going to get operating leverage driving the bottom-line progression and therefore margin improvement. Of course, the other point goes back to the richer mix of service offerings we're creating for our clients, and all of which should expand the operating margins in the two client-facing ongoing businesses. So, both of those affects are what should lead us to a higher level of margin than the business is currently delivering.

Jon Lewis:
Suhasini, thank you.

Suhasini Varanasi:
And just as a follow --, if I may. I suppose what the market would be, just your understanding is it obviously public services work, you're probably bidding on contracts only if they offer high single digits or low double digit margins, and understand that Experience hasn't yet reflected to growth yet, but we do have market data from other peers who are probably doing high single

digit, double digit margins. So, should we think about, in the medium term, that both these divisions can ultimately reach the double digits EBIT margin level? [unintelligible] think about [unintelligible].

Jon Lewis:
Well, I mean, I think some of our competitors in that space for example clearly benefit from global scale. The Teleperformance's of this world in particular, of course, we just do not have their scale, and I think, you know, it's fair to say that they were well positioned because they were on the right framework contracts to leverage that scale through COVID in particular. But whilst we not -- might not be able to achieve their margins, we should be able to get very close to them once we have executed on what we talked about earlier on, which is the further improvement of our cost base, and the further improvement of the digital offerings we offer the markets to grow that business. It's back -- and so, it's a combination of cost space and the value we deliver for the client, and -- that ultimately, then, creates the margin enhancement trajectory that we're aspiring to deliver.

Suhasini Varanasi:
Thank you very much.

Jon Lewis:
Are there any other questions?

Female Speaker:
As we don't have any further questions, I'm just going to hand back to Jon and Tim for any closing remarks.

Jon Lewis:
I'd just like to thank everyone this morning for their interest in Capita, thank you.

Tim Weller:
Thanks so much.

[end of transcript]