Capita's 2021 Full Year Results Call

Jon Lewis:

Good morning, everyone. Thanks very much for joining us. It's rather nice to be here in person and to see friends of Capita with us in -- physically for the first time in a couple of years. I think we're all a little bored of presenting results and trading updates virtually. I'm joined this morning by Tim, our CFO, as well as members of the Executive Committee of Capita, all of whom will be more than welcome to chat after our prepared remarks. If we could have the next slide please?

As usual, I refer you to our disclaimer.

So, after the significant impact of COVID in 2020, a lost year, in which we focused all of our energy on protecting our colleagues, our clients, and the business, 2021 was the year in which we got back to completing the transformation process we started in 2018. And we have now addressed a long-term concern regarding Capita. Capita is now a much simpler business to understand. Two core divisions, with strong leadership divisions and attractive markets, clearly defined growth markets. The Public Service division has already turned the corner, delivering strong results in 2021. Importantly, we also expect the Experience division's performance to improve in 2022. Both divisions are now focused on providing clients integrated solutions, as opposed to selling a disparate range of products and services. And on the back of order book growth in 2021, a strong pipeline for 2022, and improving win rates, we expect to accelerate our growth into the year.

Our new operating model also offers opportunities to leverage the simplicity of our new structure to do things more efficiently and to improve productivity. You'll also be aware that we have exceeded our target of £700 million in dispose of proceeds, well ahead of schedule. Some 12 months ahead of when we originally said we would deliver that. This has allowed us to meet our cash and debt obligations, which 12 months ago, you'll remember, presented a significant hurdle. And I'm also very pleased that, from an accounting perspective, our pension fund is now in surplus, following £300 million in deficit funding contributions over the last four years. As we continue to dispose of the businesses in the non-core portfolio division, we expect net debt to be materially lower at the end of the year.

So having established that platform, revenue growth is now the key driver of Capita's ability to drive margins, cash conversion, and cash flow. We grew in 2021 for the first time in six years. Yes, it was not by much, but it was an inflection point after years of persistent revenue decline. Driven primarily, of course, by poor service delivery. The amount of contracted work one in year increased by 31 percent, pointing to our ability to offer our clients competitive and attractive solutions. As a result, we added 260 million to our order book, delivering order book growth for the first time since 2017. Perhaps more importantly, it is also an order book of much higher quality contracts. Our book to bill ratio at 1.2 times is the strongest it has been for several years, and now reflects a business that is pivoting to growth. And we have a healthy pipeline of new opportunities this year. We have already agreed a 456 million five year extension with the BBC, and we expect to announce some exciting new wins with new clients in the next few weeks and months. Year to date, we have won almost £700 million in contract value. And with the return to growth achieved in '21, we now expect to pivot to positive free cash flow in 2022.

Now, those of you who have been following our transformation will be very familiar with this slide, but this is the last time we will present it. Today, we are announcing that our transformation has ended. We have the platform in place now to drive revenue growth and improve financial performance. Our transformation focused, you'll remember, on simplifying and strengthening the business, what was an overly complex, failing, under invested, and overburdened group. We had a poor reputation with clients, a huge amount of financial debt, significant organizational debt, and a significant pension deficit. Four years later, Capita is now simpler, more focused, and more predictable. We have invested in leadership and governance, systems and processes, and our go to market capabilities. And we have significantly reduced the financial and organizational debt in the business. And as a result, we're now starting to see the signs of success. Our focus on being a purpose led business has been instrumental in creating a strong culture in doing the right thing for our people, our clients, and their customers. And we are delivering on our contracts, which in turn is leading to high retention rates, and growing scopes of new work from existing clients. Perhaps even more importantly, we're now starting to win more work from new clients.

But perhaps most importantly are winning more of the right sort of work, aligned to strategy, our purpose, on the right commercial terms, and based on increasingly standardized saleable platforms. There's still a way to go. There's lots more to improve, but we now have a platform to deliver competitive financial returns. And while we have delivered for the majority of our stakeholders, we have not delivered, of course, for our shareholders. And with the transformation phase behind us, this now has our utmost focus. Now, none of this would've been possible without the remarkable commitment, tenacity, and resilience of our colleagues, particularly as we navigated through the pandemic. Their support has candidly been humbling, and I would like to publicly thank all of our Capita colleagues for the fundamental role they have played in getting us to where we now are.

So what do I mean by having established a platform? Well first, our legacy challenges are behind us, and we are now focused on growing our two core divisions. One focused on public services, the other on customer experience. We're the market leaders in the UK in both divisions through our delivery of BPO and increasingly BPS solutions. Both divisions serve large markets that are growing at around 5 percent per annum, although segments are growing at multiples of that. Within these two markets, we're focused on a finite number of verticals: industry segments, or parts of government, where Capita has deep levels of expertise and understanding, built up over years, if not decades. We now serve these verticals with dedicated client partners, senior Capita executives who have a deep understanding of the challenges and opportunities in our clients' businesses, and importantly also well established relationships with their clients in these markets. With their understanding of clients' needs, their work with colleagues in their division -- they work with colleagues in their division, and our technology software services organization, to craft solutions that help our clients solve their business challenges through a powerful combination of our own IP together with that from third parties, such as Microsoft or Amazon Web Services for Cloud solutions, Salesforce for digital platforms, or Raytheon for Specialist training capabilities for the Royal Navy training contract. On the back of our reestablished reputation for delivery, this structure provides the means to drive revenue growth, continuously improve efficiency, and, as the core business starts to generate more cash, inflect to positive pre-cash flow. All based on what is now a stable and de-risked capital structure.

And on that note, I will pass you to Tim to talk you through the numbers. Tim?

Tim Weller:

Thanks, Jon. Morning, everyone. As Jon said, we've made good progress on our priorities, and in particular, the strengthening of the balance sheet with delivery of our £700 million disposal target ahead of schedule.

So turning to slide seven 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 of those businesses shown is held for sale at the year end. Of course, an over like for like comparison, and the 2020 numbers have been represented to exclude the 2021 business exits. Now, despite the ongoing impact of COVID-19, adjusted revenue has shown marginal organic growth in the -- for the first time in six years. We've seen significant improvement in adjusted PBT and EBITDA, which reflects the benefit of stable revenue and cost savings. Cash generated from operations reduced by 37 percent compared with the prior year, reflecting the unwinding in 2021 of accelerated public sector payment cycles and advanced receipts which you benefitted from in 2020.

Free cash flows decreased by 54 percent as a result of the reduction in cash generative operations and higher tax payments partly offset by lower capital expenditure and interest. We made good progress in strengthening our balance sheet by delivering a step reduction in our net debt, which principally reflects proceeds received in the disposal of ESS and Axelos offset by pension deficit contributions and the reversal of the third VAT payments. In summary, we delivered a solid performance in 2021, having turned the corner on revenues, and delivered step changes up in profitability and down in net debt.

Now turning to revenue on slide eight. The puts and takes that led to the revenue growth in the year shown in the chart. Contract losses halved year on year, reflecting sustained focus on retention and service delivery. The net reduction from scope and volume changes is primarily due to 2020 pandemic related work and other projects in Capita Experience, which did not repeat in 2021. We've seen marginal improvements in our transactional revenue, which is primarily driven by Experience and Portfolio. Contractual one offs include the early termination of our contracts with the co-op bank and the Carphone Warehouse within Experience and an agreed reduction in scope on electronic monitoring contract for the Ministry of Justice in Public Service. Wins in the year include the commencement of the Royal Navy training contract, the Job Entry Targeted Support contract, and the annualized impact of the Defense Fire and Rescue contract within Public Service. And there was some smaller wins in Experience, such as our contract with Irish water.

Moving on to the profit before tax bridges showing on slide nine. The first thing is to ensure our like for like starting point; we've adjusted for the 2021 one-off totaling 24 million, which included an onerous contract provision, contract asset impairments, and the deferred income releases arising from the contract terminations in that year. The margin effect of revenue losses, scope, and volume, contraction changes in contract wins was a net reduction of £26 million. This, however, was

a significant improvement over the prior year; we saw a net £160 million reduction. We've also shown the £12million impact of contractual one-offs in 2021. This includes the release of the deferred income and write-off of contract assets arising from contract terminations and settlements, including the mortgage services contract with the Co-op bank and the Electronic Monitoring scope change I mentioned earlier.

The transformation program continued to deliver substantial savings with the £123 million year-on-year benefit through continued focus on operational excellence, property footprint reduction, and supply chain efficiency. We also started seeing the benefit of the move to new divisional structure and the lean of corporate overhead, although the main benefit of these changes will fall into 2022. Transformational savings will partly offset by increases in other costs of £11 million, reflecting high general inflation, as well as prior year one-off cost reduction in this year's not repeating.

The final two blocks show the year on your impact of the reinstatement of the bonus scheme in 2021, with £31 million expensed in the year compared in the £17 million in release of the 2019 across 2020. And this has been partly offset by the reduction in the holiday pay accrual as our colleagues have used their world over holiday entitlement during the year. Overall, the focus on driving efficiency and catalyst cost base over the last few years, coupled with the stability we are now seeing in the group's revenues, has underpinned this substantial growth and profit delivered in the year.

Slide 10 summarizes the divisional financial performance. In Public, the strong revenue growth was underpinned by the major contract wins I mentioned earlier. Public's profit increase reflects a step up from 2020, which included first-year losses on the DFRP contract and contract-related revisions and impairments. More broadly, there was significant overall improvement in operational and financial performance across Public's contract portfolio during the year. In Experience, the division's declining revenue and profit is driven by contract expires and losses, including Tesco Bank and the Phoenix closed book life and pensions contract.

The reduction in operating profit is amplified by prior year COVID-19 savings, which have not been repeated in 2021, partly offset by one-off benefits in the year. The division continues to achieve high contract renewal rates, and we were particularly pleased to see the extension of our contract with the BBC, which was announced towards the end of February. In Portfolio, revenues grew in several businesses, including areas such as resourcing, technology, and enforcement. However, overall divisional revenue is brought in line year on year, primarily affected by the impact of COVID-19 on businesses such as Agiito, our travel and events operation. Portfolio's profit increased in 2021, driven by an improvement in margin mix and continued benefits from actions taken to right-size the division asset disposal program has progressed.

Turning now to slide 11, which reconciles our adjusted PBT measure with reported PBT. Business access reflects the ESS and Axelos disposals and classifications of businesses held for sale. It's worth noting here the Trustmarque results are included in adjusted results, as it did not meet the held for

sale threshold of 31 December 2021. We saw a step up in restructuring costs during the second half as new information in our new divisional structure. In addition, an impairment of £54 million has been reflected in the year, and accounts followed the decision to cease implementation of the replacement ERP system.

As we said previously, 2021 will be the last year below the line restructuring investment. As indicated in our pre-closed trading update, we recognize provisions and impairments of £43 million for contracts and are closed book life and pensions business. We've highlighted previously the structural challenges associated with the contracts in this business and reflected those challenges in the position we've taken for provisioning purposes at year-end. As you will appreciate the closed book life and pensions activities are one of the more significant drivers behind the ongoing suppressed operating cash conversion of the group, given that the annual net cash cost of service delivery in 2021 amounted to just shy of 20 million.

Overall, we're now carrying provisions totaling £55 million in respect to the closed book life and pensions contract portfolio, and we continue to look at opportunities to reduce the ongoing cash flow impact on the group. For the year as a whole, we've seen a £335 million swing from last year's losses to this year's £286 million profit, driven by the disposal program and the step-change in underlying trading profits.

Moving to slide 12, which summarizes the group's cash flow and net debt movements. Operating cash flow conversion fell to 63 percent in 2021, reflecting the shorter public sector payment cycles and advanced receipts in 2020, which I mentioned earlier, and which have unwound in 2021. Capital expenditure reduced reflecting transformation projects completed in 2020, such as our customer relationship management tool. There have been a number of other significant cash flow movements in the period, including the repayment of the majority of the VAT deferred in 2020, and we may insist financial payments to the group's pension schemes totaling £156 million in the year. We received £483 million in net proceeds on disposals, including £336 million on the sale of ESS and £137 million on the sale of AXELOS. Overall net debt has fallen by around £200 million to £880 million at the end of the year.

Turning to slide 13, we show the impact of the cash flow headwinds that we identified at the half-year. As you can see, the outturn for all three of the main headwinds are in line with the expectations provided previously. As mentioned on the last slide, we paid off the majority of the VAT deferral, made significant pension deficit reduction payments, and incurred restructuring costs related to the transformation plan, including the move to the new divisional organization structure. Overall, the reduction for cash flow headwinds is expected to move into 2022 is one of the key factors which underpins our expected transition to sustainable free cash flow.

Now turning to slide 14, where we set out the group's liquidity position and summarized some of the key steps taken to strengthen the group's balance sheet. Our existing RCF expires on 31st of August 2022. We entered into a new RCF for £300 million, covering the period from 31st of August 2022 to

31st of August 2023. Disposable proceeds of £483 million received in 2021 in respect to the ESS and AXELOS, and the further £95 million received to date in 2022 from disposable AMT Sybex and SSS. Further proceeds are expected over the next few weeks with £115 million from the disposable Trustmarque and the additional proceeds with respect to the Specialty Insurance businesses.

We, therefore, exceeded the £700 million target and disposals that we set out in March last year ahead of schedule. We've also commenced a disposal process in respect to number of other businesses in our portfolio division. Before the benefit of the post year and disposals, we had a liquidity of almost £400 million, and as I just noted, we're no longer confronted with substantial restructuring, VAT, and pension-related cash drags. We, therefore, have ample headroom to address the debt maturities arising over the next three years.

Now, turning to slide 15 and the outlook for 2022 and beyond. Our expectation for revenue growth in 2022 is built on strong contract performance in 2021 and a growing pipeline of new business supported by recovery and transactional business from COVID-19. In 2022, notwithstanding the margin benefit from revenue growth in the flow-through of cost-benefits from the divisional restructure, we expect profit margins to decrease slightly. This reflects the full-year impact of prior contract losses, and the structural decline in the closed book life and pensions business in Experience, operational changes in the Army recruitment contract in public service, as well as the cost of recruiting and training staff to support our growth.

Overall, given the phasing of contract revenues and the effective date of contractual indexation clauses in our core divisions, and the timing of recovery of the COVID impacted businesses in the Portfolio, we anticipate that revenues and profits for the group as a whole will be significantly weighted towards the second half of the year. Please note also that reported results will be materially impacted as we continue to execute the disposal program. At a group level, the rapid reduction in cash flow headwinds is expected to underpin our transition to being free cash flow positive in 2022. We anticipate a further substantial reduction in net debt as we push to complete the majority of the remaining portfolio disposals in the year. Looking into the medium term, we would target revenue growth, at least in line with the mid-single-digit range of our core markets. We're targeting for divisional EBITDA margins to increase to high single digits to low double digits, which translates to high single digit EBITDA margins at a group level. We're targeting to increase cash conversion to between 70 percent and 80 percent, and as a result, grow free cash flow. We'll also maintain a prudent approach to our capital structure and target to leverage ratio of net debt to EBITDA of around one times on a pre IFRS 16 basis. In summary, Capita's transformation is established the platform strategic focus needed to drive the group's revenue growth and improving financial performance into 2022 and beyond. So with that, I'll hand back to Jon.

Jon Lewis:

Thank you, Tim. Next slide. Thank you. So when we set out to transform Capita, we unapologetically put our purpose, creating better outcomes at the very heart of everything we did. It was then, and it's perhaps even more so now the right thing to do, and it's much more than just the mark of a progressive, stakeholder focused business, it is our license to operate, which is why

ESG metrics now constitute key non-financial metrics in our management bonus plan. We would not be doing business with government today unless we had a plan to get to net zero. In our case by 2035 and accredited by the Science Based Targets Initiative. All elements of our purpose contributed -- contribute to our social value score in government tenders, where we continue to aspire to be the government's most progressive purpose-led strategic supplier with the highest social value credentials. And as a direct result of our high social value scores, we have one work, such as the Job Entry Targeted Support Scheme in Scotland and the UK wide Turing scheme, over 30 million of revenue where other bid selection criteria, such as price did not differentiate us.

We remain committed to being a real living wage supplier and became fully accredited for being so in 2021. We continue to encourage all our clients to recognize this important commitment, and I'm proud to where we have got to on gender and ethnic diversity, particularly with our board and executive team. We are now redoubling efforts to improve our diversity and inclusion across middle management, where we still have more work to do. We continue to achieve high scores with our clients, albeit marginally down year on year. And we're committed to paying our suppliers promptly and so a further 3 percent improvement in our performance against the prompt payment code in 2021.

However, following two years of significant improvement, we were disappointed with the significant reduction in our employee net promoter score last year. While we were pleased to see our employees rate their managers on average 87 percent across our 10 manager commitments, which form a key part of our purpose, values and behaviors, we did not anticipate the degree to which the second year of pandemic and the final year of our significant internal transformation program would impact overall employee engagement. As you would imagine, we're now undertaking a comprehensive program of measures to ensure we address the issues raised, including the incorporation of employee engagement as a score in our management bonus plan as a metric in our management bonus plan.

We have now de-risked the business and established a strong platform for growth, as I mentioned earlier. Two years ago, I said it was costing more and taking longer than we expected. Candidly, we underestimated in Q1 2018 the quantum of change and remediation required. And there have been a significant additional challenges along the way, of course, not least of which was COVID. When we started, we had over 1.5 billion of debt and a significant pension deficit. Capita was failing its clients and failing its shareholders by bidding for contracts that it could never deliver at the price being committed to. The company was not investing in the management systems, the integration and the governance necessary to manage what was an increasingly complex portfolio of acquired businesses. We've now fixed this. We have repaid over 1 billion of debt and contributed over 300 million to the pension fund, which is now in surplus, as I mentioned. And we have spent around half a billion pounds fixing contracts, investing in people and appropriate management systems, as well as upgrading the resilience and competitiveness of our I.T. systems. And as a management team, we are now delighted to be at a point where we are no longer having to focus on preventing value destruction, but can pivot to value creation.

Operational delivery for our clients is now a core strength of Capita. As a fundamental part of the transformation, we focused on fixing failing contracts and reestablishing our clients' trust as a prerequisite to renewing existing contracts and winning new scopes of work. Our service delivery, as measured by our performance against client defined contracts, service level agreements, is now consistently high and has earned us a much improved reputation. One of the reasons why our Client Net Promoter Score remains so high at plus 29 points. It has also stemmed the drain of cash from those contracts where we were not delivering on our promises and where we were having to take very costly remedial action. And we are renewing contracts often with improved commercial terms and winning significant scopes of new business from our client base.

Our revenue momentum is improving, and the sheer number of positive statistics on this page gives us confidence for the future. 2021 was an inflection year in which we demonstrated we can win large scopes of work with competitive, attractive solutions that meet our customers' needs. We won £3.8 billion of work last year, an increase of 31 percent, as I mentioned. Interestingly, over 60 percent of this was from our key accounts, from whom we achieved a very high renewal rate and won materially new -- material, new scopes of work. And we have renewed a number of those contracts over the last 12 months with improved margins and reduced execution risk. 56 percent of the total contract value we won last year represented growth from new or existing clients. As a result, I wrote a book has grown for the first time since 2017 by £260 million and our book to bill, as I mentioned, is now 1.2 times again demonstrating a healthier platform for growth.

We continue to maintain a very high level of discipline around our approach to bidding, ensuring opportunities are deliverable at the price bid and represent an appropriate balance between margin and execution risk. And again, the average net margin on major contracts since we started the transformation remains in low double digits. As a result, Capita has a higher quality portfolio of long term contracts and is today therefore a better quality business.

So what does this mean for revenue growth in 2022? On the back of our order book growth last year are stable framework contracts, i.e. work that is not for accounting definition purposes get added to our order book, but that we know we will realize we have already secured around 65 percent of our expected revenue for the year. Our attrition rate has now also reduced to a lower normalized rate of around 3 percent with the Public Service exits behind us and Experienced losses mostly annualized. If you exclude the Royal Navy contract, which was effectively won in 2020, we have grown our unweighted pipeline 7 percent year on year to £9.4 billion. We are getting better at opportunity origination.

We have a number of large, high quality pipeline opportunities, some with existing clients, for example, the DWP and NHS England in Public Services, and some with new clients, for example, the utilities and financial services sector in Capita Experience. And through our sales incentivization plans, we're now targeting more new client work, which along with new scopes with existing clients, represents 68 percent of our '22 pipeline. Winning new scopes and not just renewals is, of course, fundamental to sustaining revenue growth.

And we're also originating opportunities with new clients in what are new key growth markets for us. Last year, the Experience division won a strategically important contract to support a European

fintech business and Experience are in the final stages of awards with two new clients in the tech and utility sectors displacing competitors, I hasten to add, in both instances. With a material contribution from the recent £456 million BBC contract renewal, we have now secured just shy of £700 million in contract awards year to date.

Now, throughout the transformation, we have delivered substantial cost savings and have a very strong track record of doing the same, which in 2021, as Tim mentioned, helped to drive the significant increase in profit. Cumulative savings to date have been over £425 million and focused on delivering services more efficiently, more effectively, reducing the cost of poor quality and reducing spans and layers in management, as well as reducing structural overhead costs such as the twenty five percent reduction in property footprint over the last two years. One particularly interesting stat is that our property cost per FTE (full time equivalent) is now down 39 percent year on year as we've moved our expensive locations in the southeast. However, we continue to focus on both variable and fixed costs. A new structure provides further opportunities for margin expansion. The consolidation of our delivery capabilities in each division into a single organization lends itself to greater standardization, delivering both cost and efficiency benefits that will make us more competitive. This will be further enhanced, of course, by the increased adoption of digital solutions. The flexibility provided by a hybrid home working environment is also expected to yield further gains. And with our new operating model now in place, we can significantly reduce the cost associated with the previous complexity of the group, in particular taking out legal entities and eliminating a cottage industry of intercompany transactions and charges, and ultimately having a leaner group structure. This will take a year or two to be fully embedded, but it is a key driver of further improvement in margins and cash generation in the medium term.

Now, in our December trading update, we talked about the prospective inflationary pressures we expected from the macro environment and the challenging labor market. I will come onto our investment in people shortly. But first, I think it is important to stress that we are well protected against general cost inflation, as you would expect from a long term contracting business. Around two thirds of our contracts have indexation clauses as a cost plus escalator built in. Another 22 percent a fixed price with indexation assumptions built into the contract terms. And we have just over 12 percent of our revenue that is transactional where we are naturally hedged. In the limited number of cases where specific contracts lack an ability to recover wage increases, for example, or they're not reflective of the current rates of inflation, we are engaging directly with those clients to discuss the implications for service quality. As a result, we currently expect the impact of inflation on Capita to be minimal this year.

As a business, we're only ever as good as the people who deliver our services, and an engaged and motivated workforce delivers higher quality services. This has been core to the transformation the last four plus years. And I mentioned in my introduction that we were disappointed with our overall employee engagement score in 2022 and have executed on a comprehensive program to assure we address the issues raised. At the heart of this must be a compelling employee value proposition, one that provides training and development, career progression, flexible working wherever possible, as well as competitive rewards, of course. And while there are challenges around certain competencies, we are still, however, a very attractive place to work. We hired 20,000 people last

year globally. That said, our single biggest risk currently given the nature of the labor market is our ability to attract and retain the talent required to execute on our strategy. And of course, there is a cost to this, primarily around hiring and training, which is one of the reasons why we are not seeing the improvement in margins in '22 we would wish for.

I'll spend a few minutes on each of the core divisions highlighting their potential and our strategy to generate significant more value from them. Capita Public Services is the number one strategic supplier of business process services and technology solutions to the UK government, with around 10 percent share of a market that's worth around 12.5 billion and is growing at around 5 percent per annum. It's a market that is shifting away from people centric lower tech BPO solutions towards faster growing digitally and data enabled services. We're well positioned to capitalize on this through a combination of our deep understanding of complex government processes and the technology capabilities we can bring to bear from our technology and software services organization and partners. As a result, we won £2.4 billion of new work last year, delivering an order book at the end of year of £3.3 billion. We were also successful last year in winning places on significantly more frameworks. We're now on 40 in total, giving us access to £25 billion of spend over the next five years. The division's 2022 weighted pipeline is worth £1.3 billion, and we expect healthy growth in 2022, with some particularly interesting opportunities in the Health and Welfare vertical.

Now, as I outlined earlier, our divisions are now focused on those vertical markets where we are growing and where we can leverage our specialist market knowledge and insights. Public Service is structured around five such vertical markets, Justice, Central Government and Transport, Defense, Fire and Security, Local Public Services, Health and Welfare and Education and Learning. This slide summarizes some of our offerings across each vertical, as well as the revenues we derive from each. Having now resolved legacy contract challenges and on the back of consistently strong service delivery, we have earned the respect of our clients and continue to win new scopes of work. An example of where we have done this, of course, -- is with Transport for London. During 2021, we expanded TFL's ultra low emission zone significantly and delivered one of the UK public sector's largest and most complex cloud migrations ever on budget, on time and to spec. We're now providing the ongoing monitoring, alerting security, service and system support for TfL and the steady state operations.

As previously outlined, Capita Experience is behind Public Service and its turnaround, but nevertheless now has the platform in place from which to return to growth, improved margins and cash conversion. As the number one UK player and in the top three in EMEA, the business as a strong blue chip client base, in particular in the financial services and TMT verticals, as well as utilities, travel and retail. The global customer experience market is worth around £244 billion globally and growing at around 5 percent per annum, although subsectors again are growing significantly faster than that. There's also a market in which only around one third of activities are outsourced, so there's plenty of additional opportunities as companies increasingly recognize how specialized the customer experience space is becoming. Our propositions are competitive and attractive. We would not be winning work if they were not. Perhaps more interestingly, both Everest's and ISG independent sector analysts position Capita in the higher segment of customer

experience digital operations, what they termed the leaders category, placing us, of course, in very good company.

Overall capital experience won £842 million of work last year, and our 97 percent renewal rate speaks to the high levels of trust and belief our clients place in us. We renewed contracts with two of our largest telecoms clients and won increasing scopes of work in financial services. And Experience got off to a good start this year, of course, with the renewal of BBC TVL and as I mentioned earlier on, new client contracts well advanced in utilities and tech sectors.

Capita Experiences consult, transform and deliver client engagement model is strategically important and fundamental to the division's growth in revenue and margin. The insight we derive from the consulting fees of client engagement enables us to deliver superior, more value added outcomes. For example, a consulting engagement at FSCS has led us to embed an artificial intelligence solution into their customer response processes, which drove a 68 percent reduction in call times and material cost benefit to the client and a 13 percent improvement in overall response accuracy. Of course, we're able to leverage this platform with other clients, the strength of our capabilities in the transform and deliver phases of a similar track record of outcome based value creation as evidenced on this slide. Having now consolidated all delivery capabilities and the single leadership, there is a significant prize associated with the standardization of an increasingly multilingual and digital capability, delivering improved customer experiences with a lower cost base. It may take another 12 months or so to properly embed the changes we're making in Capita Experience, but we are confident that there is significant upside to the current financial performance.

Capita Portfolio comprises the non-core businesses that we plan to dispose of, with a majority to be completed by the end of this year. We started the program last year and exceeded, as I mentioned, our target of 700 million ahead of schedule. We received £535 million of proceeds last year and we received another £80 or so this year, with another £130 expected imminently, particularly given BEIS' decision yesterday on Trustmarque. And the multiples achieved were on average, 6x EBIDTA, which we believe was a good price collectively for these assets. We have remaining around 340 million of revenue and 27 million of profit to sell, with some recovery also expected in our COVID impacted businesses through the year.

So bringing this all together, the transformation is now done. Capita is a simpler business to manage and to understand. It is also a better quality business and a reestablished -- with a reestablished reputation for delivery. We have addressed the financial, operational and organizational debt that was endemic in Capita four years ago, and we now have a competitive platform with which to take the business forward. We have strong market positions in large and attractive markets with opportunities to access faster growing parts of those markets. Our expertise in the focused verticals in which we operate is helping us deliver the client centric solutions that will drive revenue growth, at least in line with the growth rates in the markets we serve. Medium term, our operating model offers the increased efficiency and leverage with which to target growing EBITDA margins. And as we finalize the disposal of the Portfolio division, our debt will decrease further and materially so, enabling us to time a refinancing when terms are optimum. Growing profits and cash conversion, as well as the elimination of our remaining few cash commitments, as Tim mentioned, will deliver

increasing reported free cash flow. There still plenty to do, particularly as the financial improvements lag the operational achievements. And as I stated earlier, we are now keenly focused on delivering for the stakeholder group that is yet to benefit from the transformation, our shareholders. And on that note, Tim and I would be delighted to take questions from the audience and then from those listening online. Thank you for your attention.

Rob Plant:

Morning, it's Rob Plant from Panmure. There was a newspaper story in January saying there've been quite a few senior departures recently, the head of corporate affairs, corporate development, chief transformation officer. Was that correct?

Jon Lewis:

Yes. And some of that is a direct result of where we are in the transformation process. When you've completed the transformation, you don't need the chief transformation officer.

Suhasini Varanasi:

Good morning, Suhasini, from Goldman Sachs. Just a couple from me please. If you think about the growth outlook for '22, can you please discuss the inflation assumptions that you baked into your guidance specifically for the public service sector, where you are expecting growth to normalize to the mid-single-digit levels? And that's in line with the market growth. Given that the majority of your contracts actually have some protection from inflation, and given that inflation is in the UK, you would have thought the number should be higher. And then second one is on the EBITDA margin guidance in experience for the medium term. It's high single digits to low double digits. Is that not for best case scenario, because the peers in the market obviously had much higher margins? Thank you.

Jon Lewis:

One for you, I think.

Tim Weller:

Yeah, just in terms of inflation, you're right. If we're looking at most of the contract portfolio, there are indexation clauses that will be based around CPI, RPI. Clearly, CPI and RPI are running higher than mid-single digits, depending on how you round to mid-single digits at the moment. To be clear, when we're talking about mid-single digits of very much going over the medium term, that's what we expect in the long run across our divisions in the round, the two main core divisions. In the short term, it would be reasonable to assume that you could see for those contracts, we do have indexation a higher level of revenue increase arising for those indexation clauses. Of course, they cut in at different times of the year. There's quite a peak in terms of the timing in April and May, reflecting public sector year ends. But there's some spread out. I think if you asked me that

question six months ago, I would have said that mid-single digits seems pretty reasonable. Sitting were sitting at the moment, you might argue it's looking a little bit prudent.

EBITDA margin guidance, we're talking about the divisions as in Public and Experience. You can see from the reported results that actually experience that EBITDA margin is slightly higher than Public's already and be reasonable to assume that actually, in terms of that high single digit, low double digit guidance, that Experience will probably be outperforming public on a kind of enduring basis, particularly as it moves to enter into contracts with a greater technology content. Still means that at a group level post the group overhead costs that we expect to deliver high single digit EBITDA margins for the group as a whole.

Jon Lewis:

I think the only thing I'd add is that our assumptions on growth that we talked to today do not have the indexation built into them.

David Brockton:

Good morning, hi, David Brockton from Numis. Can I ask two, and they are slightly related to the two questions that have already happened? So apologies for that. Given that you recruited 20,000 people in the year, that would imply a relatively high attrition rate. Can you just talk about that attrition rate and how it breaks down between sort of longevity within the business, so to speak, just to give some reassurance there and the measures you're taking to improve, I guess the employee net promoter score? Sorry, that's quite a few in the first question. And then the second question just relates to that EBITDA margin guidance. You've just delivered 9.8 percent. So should one view that is the best that Capita can do? Or is that a, you know, a medium term aspiration that you hope to improve on?

Jon Lewis:

I'll let Tim do the second one. I'll do the first one. I think, as everyone in the company hopefully appreciate appreciates, I found the employee net promoter score results last year, deeply, personally worrying and disappointing. I think we underestimated the impact of working from home on the fourth year of significant change in the company and the impact that that was having on people. So we have taken a number of very significant measures to address that. They're all wrapped up in what we call our employee value proposition, but it's completely different levels of engagement. I sit down with a group of five or six people three times a week for coffee with Jon just to get the pulse of the organization. As one example of many different forms of engagement we now have with the organization, we're offering pay awards. We are spending more money on training and development materially, more so than the company has done historically, I hasten to add. So we've put together a set of actions to directly address the employee net promoter score.

In terms of attrition, you have to remember that high attrition is a common feature of customer management business. We have a lot of people who are working students who may be working with us over the summer or people who are between jobs. So typically that runs at a 30, 35, 40 percent,

even when there isn't the tightness of the labor market we have today. And therefore, as you might expect, that 20,000 people hiring the by far the bulk of that was in the customer experience business, we're not seeing the same levels of attrition in other parts of the business. That does not say I'm not worried about attrition, or I'm not worried about the attraction retention of talent. I think I've made that point quite clearly in the prepared remarks. We have the tightest labor market in this country since records began. And that is going to be a challenge going forward. The good news is, of course, we can pass on the inflation pressures to the majority of our clients as it relates to salary. But there will be a cost impact as it relates to recruitment and training.

Tim Weller:

On the, is nine point eight percent the best we're ever going to deliver, you'll appreciate the guidance we gave here over the medium term has to kind of cater for what the group is going to become as opposed to what it currently is. EBITDA in the Portfolio businesses in 2022 -- 2021 was 13.5 percent. That compares with 10.5 percent in Public Service and 11.9 percent in Experience. So that medium term guidance, you've got to reflect that there will be a dilution once you've exited the high margin portfolio businesses and therefore the kind of -- there's a sawtooth here of getting back up towards high single digit EBITDA over time in the two core divisions, plus the group center.

David Brockton:

Can I follow up? Just when you say that, 10 percent, is that an operating margin -- [inaudible].

Tim Weller:

It's an operating margin.

Paul Sullivan:

Yeah, hi, it's Paul Sullivan from Barclays. Just coming -- just talking about COVID recovery. I mean, you know, your profits were really hard hit by COVID from memory, and it doesn't feel like a lot of that's come back. So what is recoverable in your view? And then just talking about CX, do you think -- or do you how much confidence do you have that the margin will bottom this year? And can you remind us of the revenue within CX that is not backed by cash and how we think about that going forward? Thank you.

Jon Lewis:

Tim will deal with the second again, and I'll deal with the first. Paul, as you know, the two key businesses that got pretty hammered by COVID were enforcement, business in portfolio and travel and events business. And because of the fact that we were jumping in and out of lockdown last year, they never really recovered. We saw better recovery in enforcement than we did in travel and events, but certainly not back to 2019 levels. This year, we're seeing more encouraging recovery, particularly in travel and events from events had a much stronger February when we were

anticipating. And so long as we don't have any resurgence in the pandemic, then we do anticipate that those businesses will continue to improve through the course of the year. Now, whether they get back to '19 levels of performance in travel and events in particular is really dependent upon how society, how companies wish to travel, how businesses wish to operate. So there's a question mark over that, but we will certainly see stronger performance from that business out with another pandemic, another phase of the pandemic than we saw last year or the year before.

Tim Weller:

And on Experience in 2022, as we called out in the announcement, as I mentioned in the script of the slides. There's a couple of contractual effects that actually driving down margin between '21 and '22 and experience in particular from the close work life and pensions business and some of the contract losses where the impact and the income statement follows in subsequent years. Those aren't cash effects, so they're effectively P&L debits without a big hit in cash flow. Out of the total group working capital drag in 2021 of 125 million, 85 was in Experience. So that's where there is a big differential between the EBITDA and the operating cash generated. Over time, as some of those income statement impacts flow through and in particular, as we complete contracts that had big transformation programs a number of years ago, where we're recognizing profits, where cash flows were received in previous years, we would expect the cash dragging working capital and experience to reduce. So, I said it was 85 million in 2021. We'd expect that to significantly reduce over time or put another way experiences cash backed profits will increase over time. And that is one of the key factors behind the expectation we've got of improving positive free cash flow over the next three years.

Chris Bamberry:

Morning, Chris Bamberry, Peel Hunt. On the cash flow fronts, you're talking about a target 70 to 80 percent in the future. What are the assumptions behind that with regard to things like the cash backing in experience and capex against depreciation and assuming deferred incomes, you know, kind of flattened out by that point? Some of those moving parts would helpful thank you.

Tim Weller:

Yeah. Tucked away in it is the very last slide in the entire pack, slide 37 we've tried to work the call modeling assumptions, a bit directive, but we tried to kind of spell out some of the things that that you might also want to build into your model over the next two to three years. Moving up towards 70 to 80 percent from the, what is it, 63 percent we delivered in terms of cash conversion in 2021. Once again, that's 70 to 80 will be future capital after having sold the more cash generative portfolio businesses, there's a degree to which it will go down before going back up again. But implicitly, it is assuming a reduction in the working capital drag or an increase in cash backed profits. At the moment, and we've kind of quantified in the past, effectively, about £100 million a year of structural negative working capital from those old transformational contracts. Over time, that will reduce and more than halve over the next two to three years. There is still a job to be done, though, by management in respect of the close but life and pensions business, which, as I said in 2021, had a negative cash flow impact of 20 million and we need to resolve that issue to get beyond that 70 to 80 percent.

Stuart Morgan:

We've got some online questions. So going forwards when the portfolio has been disposed of, what's Capita's capital allocation policy? Is there any financial impact from the Ukraine? And finally, as capital growing or shrinking its offshore delivery?

Jon Lewis:

You talk about capital allocation, I'll talk about Ukraine. Let me deal with the Ukraine question first. You know, obviously immediately after events of a couple of weeks ago, we did a thorough review of our presence in Russia, Ukraine and Belarus. We have de minimis exposure. We have a few individuals who for whom we pay pensions that have now been resolved. I think more importantly, we made a material donation to the Red Cross, Appeal for Ukraine and also supporting our management in Poland, which is where the bulk of the refugees are coming in, of course, with humanitarian support, including, I hasten to add, where Ukrainians are coming in with competencies that we require, given everything I said about the tightness in the job market a few moments ago, offering these people free accommodation for a period of time and offering them jobs within Capita.

Tim Weller:

And on capital allocation or capital investment, the guidance we've given tucked away at the back of the pack is for capex in 2020 to be to be between 65 and 75 million. So a couple of percent of revenue. Quite naturally as we exit the portfolio businesses, we are assuming we will continue to invest at that level in absolute terms. And therefore de facto we'll be putting more money into the remaining core businesses than has been the case over the past couple of years. That is a step up from the capex that we saw in 2021 and we believe will enable us to perform in line with the expectations we've got. There was a sort of third question around the international footprint and the potential for that to expand or otherwise. Really, what we're looking at in terms of international is much more on the delivery side of things, making sure that we are optimizing where we have delivery resources, using an international footprint and the international thought process to make sure that we are as cost effective as we can be.

Jon Lewis:

I'll just build on that last point. We're expanding in some geographies. We've had a very successful franchise and capability out of our Cape Town operations in South Africa. We've just opened an office in Durban because we are seeing as a function. Actually, it was the tail end of COVID, but also the tightness of the labor market. We're seeing greater propensity on the part of our UK clients to shift work to those geographies. We have had a substantial position in India for many years. We will continue to maintain that, and I suspect for the same reasons that could well grow over time as well. And India is both in our technology and software services as well as our customer experience capability. And then lastly, because of tightness of the European market, we are looking at other European countries where we can establish bilingual, multilingual, sorry, not bilingual, multilingual capability. And we have been looking very closely at Bulgaria as one geography where we will do

that. So I think you can expect our international footprint to become actually a growing part of our delivery capability over the next several years.

Thank you very much for attending. It's great to see you all in person. Look forward to our conversations subsequently. Thank you.

[end of transcript]