Capita H1 Results 2022

Jon Lewis:

Welcome to Capita's first half results for 2022. First of all, I'd like to welcome those online as well as those of you joining us here in Gresham Street today. And as usual, I'm joined today by your Chief Financial Officer, Tim Weller, as well as a number of members of the executive committee, all of whom will be pleased to chat after our prepared remarks and questions.

Next slide, please. The first half of 2022 has been in line with expectations. We've grown revenue, we've delivered positive free cash flow, and we've reduced net debt. And with a stable revenue base now well established, we are better positioned to grow this year, but also into the future.

In terms of winning work, the Experience division has had a good first half, and our Public division is well set to do likewise in the second. Our operational performance has remained very strong and we continue to execute well for our clients. This continues to enhance our reputation as a reliable provider of complex outsourced services, something that has further improved our renewal rate, and created the case histories for winning new scopes of work with new clients. And we've made good progress on our recruitment and retention initiatives, and I'm pleased with the material improvement in our employee net promoter score as well.

Profit has improved, as revenue has recovered in Portfolio, and we benefit from the cost savings at the group level. Revenue growth, combined with further overhead cost savings and operational efficiency, will be core to growing margins in the future. I'm particularly pleased that free cash flow is now positive, having removed the burden of significant historic outflows. And as a result of the improving cash flow and the receipt of over £200 million in disposal proceeds in the half, we have reduced net debt materially over the period. Finally, across the group, we're starting to see positive results from our more focused, client-centric operating model. There is more to do, but I'm encouraged by the progress this has driven this year. And on that positive note, I'll pass you over to Tim.

Tim Weller:

Thanks, Jon. Morning, everyone. As Jon said, our first half financial performance has been in line with our expectations and we're on track to deliver further revenue and profit growth in the second half and to continue the rapid reduction in net debt as we approach the end of our disposal programme.

As mentioned on this slide, and consistent with previous presentations, we share our results on an adjusted basis. As we indicated at the full year results, in 2022, we have restricted the adjustment to those resulting from business exits, the amortisation and impairment of intangibles and goodwill, and financing fair value adjustments. We're simplifying our financial reporting and are no longer calling our restructuring costs and contract and litigation-related provisions as below-the-line items. The comparatives for the first half of 2021 have been represented on the same basis, and we provide a reconciliation to the previously reported numbers in the appendix to the slides.

Now turning to slide five for our financial highlights. Revenue is in line with our expectations. Contractual revenue growth from contract wins reflected the annualised impact of Royal Navy training and the Job Entry Targeted Support contract with growth in transactional business primarily driven by Capita Portfolio, including the Agiito and Enforcement businesses, which continue their recovery following covid-related constraints.

We've seen significant improvement in operating profit, profit before tax, and EBITDA, reflecting the benefit of stable revenue, completion of the restructuring program, and efficiency delivery. Cash generated from operations and free cash flows have also seen material improvements, reflecting the increase in operating profit, as well as reduced pension deficit contributions as we revert to a normalised contribution rate. This enabled the group to achieve its goal of generating positive free cash flow before business exits this half, a very important milestone. We have made good progress in strengthening our balance sheet by delivering a further step reduction in our net debt, reflecting the proceeds received from our disposal programme, and continued rationalisation of our property portfolio. Overall, we delivered revenue, profit, and cash flows in line with our expectations for the half.

Now, looking at revenue in more detail on slide six. The puts and takes that led to the 0.6 percent revenue growth in the period are shown in the chart. The impact of contract losses at £45 million was around £20 million lower than that seen in the first half of 2021, and resulted from prior period contract losses, including those set out in the slide. With contract attrition of only 3 percent, we are seeing a continuation of the high rate of contract retention, which is underpinning the stability of our revenue base. Scope and volume reductions reflect one-off pandemic-related work in 2021, which was not repeated in 2022. Revenue growth was also supported by indexation clauses within the Capita Public Service and Experience divisions, with the majority of these taking effect from the second quarter onwards. In Portfolio, we're seeing growth in transactional revenues as Agiito, our travel and events business, and our Enforcement business continue to see activity levels recovering in the wake of Covid-19. Contract wins reflect the annualised impact of contract wins in 2021, such as the Royal Navy training contract, and recent wins including the Turing scheme and the Northern Ireland Education Authority contracts in Public, together with smaller wins with the Capita Experience division.

Moving onto our divisional financial performance as shown on slide seven. Both the divisions and the corporate centre have seen improvements in operating profit from the successful completion of our restructuring programme in 2021.

Capita Public Service has seen growth in revenue and operating profit. Revenue growth is from the annualised contract wins mentioned on the previous slide offset by prior period contract losses mainly within our local government vertical as well as one-off COVID-19 projects which were not repeated in 2022. Public's operating profit has grown substantially from the first half of 2021, which was impacted by additional program costs on our electronic monitoring contract, and it reflects the benefit of the contract wins noted earlier. Whilst we saw a good level of cash conversion in Public, it was not at the same level as the first half of 2021, which benefited from one-off working capital movements, in particular from the implementation of TfL's ultra-low emissions zone contract.

Capita Experience has seen a small revenue decrease from attritions through contract expiry and prior period losses, such as for 3U.K. and Carphone Warehouse, a trend which should start to reverse as we move into the second half, with the benefit of recent wins, including ScottishPower and BBC. Experience's operating profit was down £10 million period on period, reflecting the revenue trend, one-off deferred income releases in 2021, and the £2 million accrual for furlough repayment committed to earlier in the year. Cash flow was very strong in Experience, mainly reflecting a step-up in customer advances received in the half.

In Capita Portfolio, we've seen continued recovery in the areas most affected by Covid-19, which is helping to drive an increase in revenue. We're also seeing cost actions taken in previous years creating efficiencies. However, overall, Portfolio's operating profit was in line with 2021 as the benefit effects of the revenue growth as in efficiencies were offset by the £2 million accrual for furlough repayment in the half.

The Capita plc line reflects the group's head office costs. Group centre restructuring charges in the first half of 2021 were around £21 million, dropping to nil in 2022, with the balance of the £32 million half on half improvement mainly reflecting efficiency delivery in the period. The much larger decrease in cash outflow from corporate costs results from the stepdown in pension deficit contributions in the period, which I'll address later in the slides.

Now turning to slide eight, which reconciles our adjusted PBT measure with reported PBT. As we announced with our full year results, 2021 marked the last year of the group's significant restructuring programme, and therefore we have not called out any below-the-line restructuring costs in this period and have re-presented the comparatives accordingly. As part of our drive for simplification of the business and strengthening the balance sheet, we continue to seek to dispose of a number of non-core businesses. During the first half of 2022, we completed disposal of the AMT Sybex, Secure Solutions and Services, Trustmarque, and the specialty insurance businesses. The business exit line reflects trading to the point of exit and the profit or loss realised on disposal. We also recognised goodwill impairments totaling £92.5 million in respect to the two pillars -- two of the pillars in Capita Portfolio, reflecting the difference between our current expectation of the outcome of the disposal processes underway and the historical book value of the businesses, which are built up through acquisition over a number of years.

Moving to slide nine, which summarises the group's cash flow and net debt movements. Operating cash conversion of 64 percent was up 7 percentage points period on period, with strong growth in

EBITDA and the favorable movement in working capital, partially offset by a step-up in other operating cash flows, mainly reflecting customer contract and restructuring provision expenditure.

The first half of 2022 saw the final settlement in respect to the pandemic-related VAT deferrals and a material reduction in pension deficit contributions, as we revert to the £30 million of regular annual contributions agreed as part of the 2020 triannual funding agreement with the pension scheme trustees.

Whilst in absolute terms, it was a relative £12.7 million, importantly, the first half of 2022 saw us reaching our goal of delivering bottom line free cash flow before business exits. This, coupled with the net effect of those business exits, enabled the group to reduce net debt to £710 million on the 30th of June, an improvement of £169 million on the year-end position.

Now turning to slide 10, where we set out the group's liquidity position at the period end. Notwithstanding the £82 million of debt maturities which were funded in the first half of 2022, we saw a small increase in liquidity from the year-end position to £424 million as the 30th of June, reflecting our undrawn revolving credit facility and unrestricted cash balances. During July this year, we extended our revolving credit facility by a further 12 months to August 2024. As you can see, compared with recent history, we have a relatively modest level of maturing debt over the next couple of years. In summary, given our robust liquidity position and the very low level of net financial debt, we anticipate the group having -- after completion of the current disposal programme -- we expect to be in a strong position to take a measured approach to any refinancing we might pursue in 2023.

So moving onto the second half of 2022 outlook on slide 11. Notwithstanding the current challenging economic environment, our markets remain strong, and continue to support growth in outsourcing services. In Public Service, we're expecting revenue growth within the Education & Learning, Health & Welfare, and Local Public Service verticals. In Experience, we anticipate a reduced level of revenue impacts from contract losses and growth from contract wins and extensions. We expect an increase in EBITDA margins in the second half of the year, reflecting the seasonal benefit from the holiday accrual unwind, and continued efficiency delivery partially offset by continuing attrition in closed-book Life & Pensions business. We continue to expect revenue and profit delivery to be weighted towards the second half in line with our previous guidance. Although given the working capital performance in the first half, we now expect operating cash flows to be more evenly spread over the year.

Moving into 2023, we expect completion of the disposal programme and our ongoing drive to reduce our property footprint will lead to a further step change down in the group's net debt.

And with that, I'll hand back to Jon.

Jon Lewis:

Thank you, Tim. Next slide, thank you. Becoming a purpose-led responsible business was core to transforming Capita. And it's one of the reasons why we always start my primary section with some comments on purpose. Given social value requirements on government bidding, it is also a key component of our overall competitiveness, and colleagues increasingly wish to work for a responsible business. In fact, this is cited as the primary reason of three why colleagues wish to work for Capita.

Given its importance to our business model, we took a key step recently in establishing an ESG committee of the board, chaired by our chairman. This will ensure that we have the right level of ambition and governance around our sustainability objectives. We have had a significant focus this year on our people. And we took action to address two things. Firstly, the high post-covid attrition levels, and secondly, our reduced employee Net Promoter Score. Both of which I'll actually come back to later. I'd like to thank our colleagues for their ongoing contribution to our improved performance. I am regularly humbled by their commitment to our clients, their customers or citizens, and to Capita overall. And again, thank you to colleagues for all that you do for us.

As a responsible employer, we remain committed to the Real Living Wage in order to help retain colleagues faced with the cost-of-living crisis, something that is particularly important in the current economic situation. And our sustainability focus also means that we have improved our EcoVadis score this period, and we are now embedding our net zero commitments into our business plan for the next year and beyond.

We have continued to demonstrate our competitiveness over the period through renewing 95 percent of those contracts up for renewal, the majority of which benefited from improved terms and scope. Such a high renewal rate also gives us the confidence to be able to be more robust going forward in some of the economic negotiations with our clients around pricing and margins, particularly given the quality of services we are now delivering.

Importantly, we're also winning new scopes with new clients. 26 percent of the TCV awarded in the first half came from either growth on account or from new clients. And I'll come back to this later given its importance to the acceleration of our growth. In the first half, we won £1.6 billion in Total Contract Value. Experience performed particularly well, winning almost as much TCV in the first half as it did in the whole of 2021, delivering a book to bill ratio for that division of 1.4x, its highest in many years. Public closed a number of significant renewals in the half, such as PCSE with NHS England, Entrust with Staffordshire County Council, and with the Northern Ireland Education Authority. Some of these have previously been, as you will remember, very challenging contracts. And our ability to renew them with improved economics and terms says a great deal, I think, about the materially improved client relationships we now have.

I think it's important to point out also that Public has not lost any major bids in the period either. Its pipeline is weighted to the second half of the year. It, however, also drove a good revenue growth with contract wins in prior periods, such as Royal Navy training. Now, excluding the impact of the rather large Royal Navy win last year, at the group level, we have grown first-half year TCV by 4 percent and In Year Review by 11 percent. Our win rate overall has increased to 83 percent. But more importantly, we're also getting better at winning, as I said, new scopes of work. If you exclude the Royal Navy contract, our win rate on new scopes year on year increased from 18 percent to 42 percent. We're also replenishing and growing our pipeline, which is up on the year end, and now stands at £14.4 billion. Our end markets remain positive, notwithstanding the wider economic uncertainty that Tim mentioned. Both our government and our private sector clients have an increased need for better services at lower cost invariably deployed through increasingly rich digital solutions, of course, our core competency. As a result of our achievements in the first half, we have confidence in our ability to grow revenue in the second and in the longer term.

I also want to emphasize that we continue to build a better quality portfolio of contracts. We continue to maintain the discipline of our contract review committee, which ensures the contract opportunities align with strategy, that margin objectives are maintained, and that execution risk is acceptable so that we're assured of delivery against our contractual commitments. Our contract review committee discipline combined with our materially strengthened execution capabilities has meant that since its inception in January '18, we have not had a single contract that has failed to deliver for the client.

Fundamentally, we need three things to happen to accelerate revenue growth. First, renewals provide foundational revenue, and as mentioned, we have a strong renewal rate of 95 percent in the first half. Frankly, great news for a professional services business, as it demonstrates that our clients trust us and want to continue to partner with us. But we're not just renewing on a like for like basis. We're invariably refreshing the solutions to support the evolving needs of our clients. This means we have added new scopes of revenue, and given the increased digital content of our solutions, we're improving the margin performance of those contracts as well. We have seen this on our largest recent renewals, where we've added £50 million in new scopes to these contracts associated with those renewal negotiations.

Second, we need to win new scopes of work on the back of existing contract awards. What we refer to as growth on account. And we've seen more of this in the last 18 months on the back of our strong operational performance and trust building partnerial relationships. For example, we've won more work with the University of Glasgow, the Bank of New York Mellon in the half, and we have now won £130 million of additional TCV on the Defence, Fire, and Rescue contract with the MoD award. That's a 25 percent increase on the original TCV value of that contract.

Third, we're starting to win more opportunities with new clients, this being the real accelerator of revenue growth, of course. Last year, we won the Fintech Trade Republic account in Europe, and this year we've won clients such as Scottish Power, Allianz, and HMRC.

We have more work to do in accelerating origination with new clients. But we have already doubled the weighted pipeline since the start of the year. And in our second half weighted pipeline of £3.7 billion, we have some interesting opportunities with DWP, the Cabinet Office, and some large financial services and telecoms clients, again, aligned to our industry verticals. Having stabilised renewals and therefore our revenue base, we have for the first time set sales commission targets specifically to drive growth on account and new business from new clients.

Looking further forward, our new operating model and enhanced digital capabilities will drive further pipeline and revenue growth. The majority of our work still remains in the delivery part of our consult/transform/deliver client engagement model, and this represented 75 percent of the TCV we won in the first half. But we're also starting to see encouraging green shoots in the Consult aspect of the same model. The establishment of our consulting business, of course, was severely disrupted by COVID as we went into a period of cash husbandry, but has always been core to our strategy. And in the first half we closed £40 million in consulting opportunities, mostly in the public services division with wins such as HMRC, and engagements with the Foreign Commonwealth &Development Office and the British Army.

A recent example in experience would be the consulting work we're doing for a major U.K. based client reducing their backlog and improving their prioritisation of customer complaints through the use of agile work processes and digital solutions such as automation, text analysis, analytics and conversational AI. Our strategic, long standing commitment to our consulting capabilities is helping to position us more as a BPS versus a BPO provider and encouraging people to consider us for opportunities associated with digital transformation.

We're also seeing benefits from our greater client focus, our industry verticals led by client partners with deep knowledge and expertise in their market sectors. Over the past 18 months, we have been awarded almost £3.2 billion in TCV, in just five key sectors: Central Government, Telecoms, Healthcare, Banking and Transportation, and almost £12 billion of our total pipeline, 83 percent of it relates to those same five industry verticals going forward. At the same time, we are developing our own products and services to align to our clients' needs in these specific segments, and I will speak more to these later on.

The final piece in the jigsaw comes in a more disciplined approach to sales management. It's not only the big deals that grow our revenue, and candidly, I'm not sure we've always had the right balance of focus with respect to allocating sales resource relative to deal size. We tend to be seduced by the larger deals when in fact 74 percent of the In Year Revenue won in the first half of this year came from deals of £10 million in value or less. Looking forward, the same deal size represents 86 percent of the remaining in-year revenue pipeline. So such deals have the added benefit, of course, of also having significant shorter sales cycles. We've therefore reallocated ourselves resource to give us greater confidence in the delivery of our growth targets for 2022 and beyond.

Digital enablement through capabilities such as automation, cloud migration, AI and data analytics is a core driver of both revenue and margin, and the market for digital solutions is of course, growing, as evidenced recently by the Government's commitment of an additional £8 billion over the next four years as it relates to their digital and data roadmap. Now in support of this, we are accelerating our adoption of and investment in digital solutions. In the Public division, we are standardising our technology platform and leveraging digital solutions from partner technology companies such as Microsoft, Salesforce and Amazon. Leveraging our industry specific workflow knowledge, this will drive productivity, improved customer experiences and incremental insights through the data analytics work we do on the back end. We will invest incrementally in these new digital capabilities going forward.

The Experience division already has a competitive digital platform and is now industrialising its processes and deploying new technologies such as our chat bot solution and our agent assist tool. The latter uses customer insight and speech recognition technology to make every customer conversation as productive as it can be, both for the customer and for our client. And we're winning increasing scopes of work based on our digital capabilities. Examples will be TFL's ULEZ Scheme, the Student Loans Company, Virgin Media O2 and Irish Water.

The next couple of slides highlight our digital capabilities. Our Turing scheme BPS contract, which is the U.K. replacement for the EU Erasmus scheme, is configured on our GrantIS benefits and grants processing platform. Two years ago we identified a market opportunity for such solutions and built a low-code/no code, highly automated offering, leveraging our decades long knowledge of our public sector clients' workflows. We started applying our grants platform to Turing in December of last year as an upsell when the prior technology provider failed to deliver. We launched the solution in February of this year with universities making applications in March and April of this year; we will be distributing funds through that same solution in September. So far, we have delivered well ahead of the Department for Education's KPIs, including applications numbers, which are up 25 percent versus the prior service provider.

On the right hand side is an example of the work we have started as HMRC's new automation Partner, having displaced a major digital transformation competitor in winning that work. The partnership which utilises, again, our Consult, Transform, Deliver Engagement model, will see Capita working with HMRC to develop, deploy and support robotic process automation software and other digital tools to make HMRC processes simpler and more efficient.

On this page, we have a case study of a consumer electronics client where we have driven excellent outcomes through a combination of business process innovation and technology transformation. We've changed the working model, committing to a virtual first hybrid working solution, where now 98 percent of colleagues on this contract work from home. We've invested in those same people and supported them through the deployment of our ACC assisted customer conversation tool. Which based on the conversation taking place, provides our agents with real time data to offer customers the best solutions. This makes our agents jobs easier, more rewarding, which results in better agent retention, which itself then correlates directly with increased quality of service for our clients. This means higher CSAT scores, which are now consistently in the 90s.

With our new structure and operating model now in place and the heavy lifting of the transformation behind us, we're now focused on driving further efficiency and cost targeting in the longer term, the EBITDA margins that our peers achieve. Operational efficiency is the primary means by which we can further enhance operating margins. First, this is about avoiding the early transformational phase mistakes that Capita used to make and which cost us billions of cost to -- millions, sorry -- to rectify. As mentioned earlier, we have not had any of these on any contracts since January 2018.

Second, once a contract is a steady state, it's about ensuring that we have the operational excellence to prevent material cost of poor quality and off-service charges associated with those engagements. And again, as previously presented in prior results presentations, our service credits are now a fraction of what they were in the past, but we still have scope for improvement there. From there, the process of continuous improvement will drive further margin gains, for example, reducing operational cycle times and enhancing process reliability through such things as automation or improving productivity through superior load balancing of resources across the integrated centralised delivery capabilities we now have in the two divisions. But even a small thing like the automation of cash matching processes in our finance team can have a material impact, saving us £300K this year.

Reducing our property footprint is another big driver of reduced cost and balance sheet liability. Over the past two years, we have had significant success in consolidating our property portfolio and so far this year we have disposed of 18 properties and closed a further nine with another 20 planned for the year end. Our group lease liability has reduced by 25 percent over the past couple of years and we're targeting a further 20 percent reduction in property lease liabilities by the end of 2023.

We've more work to do on overheads as our operating model embeds and becomes more stable and whilst we achieve good margins at the contract level, this benefit is of course diluted by the size of our divisional and group costs. This is getting renewed focus in the second half of 2022 and into the first half of 2023.

Lastly, we continue to work on simplifying how we run the business. And a good example here would be the work we're undertaking to remove unnecessary legal entities which will deliver material cost savings associated with statutory reporting and with the associated external audit fees.

Now inflation, as you might imagine, has been a major focus for management over the past 12 months as a result, and as messaged at the full year results, the impact in the first half has been minimal and we expect the full year to be broadly net neutral as well. And the reason is mainly timing when indexation was applied relative to when price rises were implemented. However, we continue to take proactive steps to mitigate inflationary risk, particularly to margins going into 2023.

We are training relevant colleagues to have the difficult conversations with our clients around price increases, irrespective of where we are -- what we are entitled to contractually. Where indexation is applicable, we're making sure it is sufficient to cover our actual cost inflation and that it is enacted in a timely manner. Well, we have no contractual indexation mechanism. We are engaging with clients to seek price increases. Just as importantly, we are not signing new contracts without inflation protection. Where there are caps on inflation indices, we're asking for these to be removed and we are not accepting inflation caps on any new scopes of work.

Where revenue is transactional, we're taking a programmatic approach to updating our rate cards much more frequently than we've done historically and where possible -- and we've had some successes here in recent months -- we're asking the client to accept inflationary risk, given its unpredictability over the next few years. Removal of cost inflation risk is a priority and we anticipate this will be a healthy revenue tailwind the back end of this year and into 2023.

In the second half of 2021, the business suffered from the tightest labor market in 50 years, accelerating salaries, particularly for hot skills such as cyber and a material reduction in our employee engagement score related to the restructuring work we undertook last year. As a result, we left money on the table by not staffing to 100 percent of our revenue potential, particularly in Q4 of last year. We've done several things to address this. First, we have invested significantly in our recruitment organisation and our employee value proposition, with initiatives such as our commitment to the Real Living Wage, a career path framework, hybrid working and our Manager Passport program. We're now recruiting the people we need around 2,500 per month 15,000 so far this year.

Second, we're using our virtual first hybrid working model to attract talent from new geographies. Not only is this, as I mentioned, a top three reason why people like working for Capita, we have the data that indicates colleagues who have such flexibility deliver better service quality to our clients' customers. Third, leadership has dramatically increased its communication with all of our colleagues across the organisation. As a direct result of these actions, our employing Net Promoter Score went up 16 points in our interim survey in June to just below its prior high. Attrition rates are dropping and we are now hiring to demand in the majority of our operations with a 21 percent increase in our staff fulfillment rates relative to Q3 of last year. Again collectively, this gives us greater faith in our ability to resource the growth potential of the business going forward.

Moving on to our strategy to strengthen our financial position. We continue to execute on our program to dispose of non-core businesses within our Portfolio division with strong momentum. Earlier this year, we received over £200 million in proceeds from AMT Sybex, Secure Solutions, Specialty Insurance and Trustmarque, taking total proceeds received to over £750 million. And earlier this week, you will have noticed that we announced that we have now agreed the sale of our real estate business to WSP. We expect to have launched the disposal processes for all of our non-core businesses by the end of this year, and we hope to have binding agreements by the end of the first quarter of 2023.

We've also recently launched the disposal of our Pay 360 payments platform. This has historically been a standalone software business and sits currently in the Experience division, but it's become increasingly clear that it is not core to the strategy of that division or to Capita. It's a great business with significant potential and is an attractive asset in a consolidating payments market. So we believe that the right thing to do is to sell it to further strengthen Capita's balance sheet. We will provide further updates on this process later in the year, but for clarity, we have no plans to dispose of additional businesses that reside outside of Portfolio, either in Experience or in Public.

Completion of our disposals program, as Tim has already mentioned, will result in very low levels of net financial debt early in 2023, and through the same process we will also have potentially prepaid plan pension contributions from 2024 to 2026, leaving the fund in a strong position. And as I mentioned earlier, the reduction in our property footprint has incremental balance sheet liability benefits as well, of course.

So in summary, the first half of the year has been in line with our expectations delivering growth, an increase in profit and positive free cash flow. While we have delivered a small increase in revenue in the first half, we expect this to accelerate in the second. Our longer term revenue opportunities are promising, particularly as we start to benefit from our new operating model. Our investment in digital capabilities and our focus on new work with new clients. Inflation risk in 2022 has been mitigated, and we anticipate the incremental inflation related actions I summarised will create a revenue tailwind in 2023. We're also leveraging the operating model to drive further efficiencies and cost savings within the divisions and also in overhead costs to target the longer term EBIDTA margin improvement I spoke of.

And we continue to make very good progress in our strategy to strengthen the balance sheet through the disposal program and property lease reductions. Lastly, we remain keenly focused on delivering on our full year expectations around revenue growth, positive free cash flow and a significantly stronger balance sheet. On that, thank you for your attention and we will open the floor to questions.

Robert Plant:

Robert Plant from Panmure, at the prelims, you were talking about the margin being slightly down, mainly because of the issue around attrition. It feels like attrition has probably got easier, but on the negative side, there's the point about paying back furlough. What's your outlook for the margin now?

Tim Weller:

Thanks, Rob. Yeah, the -- we remain consistent in our guidance. We expect the margins will be down over the full year between 2022 and 2021. You kind of picked up on the drivers and making the furlough provision is just an additional driver down. We have had better result on staff attrition towards the back end of the first half. And at the moment we're seeing a similarly improving trend. Clearly is a lot to play for in the second half, but I wouldn't disagree with the guidance, we expect margins to be down maybe a bit as opposed to the extent to which we are talking come the full year results.

Jon Lewis:

I think the only think I'd add, Rob, is that given the recessionary pressures we're heading into, I think we will find attrition will further reduce and we will find it easier to attract talent. We have been in a very unusual period in terms of tightness of the labor market and actually, compared to many companies, I think have done a pretty good job of attracting the talent we needed to attract. But it's not been 100 percent of revenue potential.

Chris Bamberry:

Morning. Three questions, if I may. You touched on some of the key performance improvement drivers in the second half, such as the milestones for Standard and Testing in Public and the transactional working in Experience. Could you please elaborate on those? Secondly, we've seen obviously an acceleration of M&A within a competitor set. Any comments on that? Guards of any fallout you're seeing or expect to see? And finally, you mentioned about asking customers to take inflation risk. I guess what success have you seen in that so far? And what's the quid pro quo on that? Thank you.

Jon Lewis:

Lots of questions. Let's start with the M&A question. I and the board is very impressed with the velocity with which the disposal program is being executed at, but it is not at the expense of valuations. You look at the multiple we got on our real estate and infrastructure and GL Hearn business that we announced earlier this week, it's a pretty healthy valuation. When we went through the restructuring last year, we debated long and hard what we wish to do with Pay 360. We wanted to give that business a period of stability, which is one of the reasons why we put it into Experience. We have subsequently concluded that actually that's not core to being a customer management and public sector, BPS digital transformation business -- great business, but it's not core to that. And given the consolidation that's taking place in the payments platform and the multiples that are being paid, I would rather recycle the capital associated with that into further debt reduction and or investment into core Capita, i.e. BPS digital transformation solutions for customer management, Capita Experience and for CPS.

Your comment about inflation no quid pro quo. I think a number of our clients are recognising that we and our competitors are not going to take risk on inflation. We are, therefore submitting bids with healthy inflationary risks. They are reviewing those and then revisiting themselves whether they want us to take the risk or whether they will take the risk. There was one other question --

timing on STA, I think. There was a little bit of noise on that contract a couple of weeks ago, but by and large, we've knocked that out of the park. In fact, I had a very good session with the relevant permanent secretary yesterday afternoon on this. We're delivering well on that contract and we anticipate the milestone payment being made in the second half.

Chris Bamberry:

Thank you.

David Brockton:

It's David Brockton at Numis. Can I ask a few questions, please? Firstly, in respect of the consulting headcount and that business, you're clearly now in a position where you're starting to grow that again. Can you give me some -- a feel as to where you are in terms of headcount and how quickly you intend to develop it, please? The second question, just in relation to the Life & Pensions business, I just wonder if you can just touch on how that's performed through the half and whether your expectations for that business have evolved. And then the final question just relates to sort of the broader uncertain outlook that we have. One would expect, particularly maybe within Experience that there are a lot of your customers are more consumer facing. And I just wondered whether you are seeing any signs either of increased demand for efficiencies or in terms of any deferrals in terms of new work? Thank you.

Jon Lewis:

Okay. I'll let Tim give an update on life and pension. I'll deal with your first question and your third question. We could grow our consulting business even more rapidly than we are currently growing it if we had more talent. When we talk about the tightness of the labor market, consulting skills are one of those areas where the market is particularly tight and it's not helped, candidly, by the actions of some of the larger consulting firms issuing really quite healthy pay awards this year. I mean, I don't think that helps the sector. It doesn't help the U.K. Economy either, by the way, in terms of getting a grip on inflation. But we are staffing the scope we have right now. And I think, again, that could be something we benefit from as we go into recessionary periods, as there is more opportunity to hire consultants and grow that business more rapidly.

I think the other thing I would say about that business is it's now embedded in the divisions. It's led by the industry vertical partners. And we are using our consulting capabilities much more effectively as a tool to change client perceptions of us as a BPS and digital transformation player, but also to position us for long term contract opportunities. We're getting involved, in other words, David, in the sales cycle much earlier on than we would historically have done, and some of you heard me say this in the past, but, you know, I've been in B2B all my professional career. I've never operated in a B2B business that didn't have a very effective consulting capability for the reasons I've just mentioned. And we will continue to invest in that going forward.

You asked about growth rates. I'm not going to go there, I'm afraid. But, you know, clearly, I think I've conveyed a sense of how important our businesses to the future. And we have every expectation that we will. Growth happens to also generate some pretty healthy margins, of course. In terms of the uncertain outlook, I mean, we're a diverse business and therefore the impact on different clients is similarly diverse. Let's start with the public sector. You know, demand for performance improved -- sorry, Personal Independence Payments demand for Universal Credit payments, demand for hiring numbers in the Army, training of the Royal Navy, Defence, Fire and Rescue. None of those are going to be impacted by recessionary pressures. I mean, one -- you might argue that we're kind of a cyclical as a direct result, and that's a chunk of the revenue. Same could be said for our local government work as well, of course, that's a chunk of the revenues. For the company, it's -- we're dominant and dominates the revenues in the Public Services.

In Experience, it's mixed. Look, could you argue that the support we provide to Telcos will result in people buying less mobile phones because they can't afford them? Yes. So we may see less demand for support around helping people, you know, with extra SIM cards, new phones, et cetera. But similarly, I suspect we're going to see more of those clients having debt problems. There will be more collections opportunities which with our recognised approach to dealing with that, particularly as it relates to vulnerable citizens, I think represents a potential upside for us as a company. I think there are other areas of Capita Experience. What we do in the pensions arena, for example, you know, managing pension funds is not going to change the demand and the opportunity there is not going to change as a function of recessionary recession pressures.

And I think the last generic statement I would make is, and again, this reflects several decades in B2B. In my experience, companies that can offer productivity improvement, efficiency gains, better customer experiences, see more opportunity when such difficult decisions are forced upon our clients because they have no option. And guess what? Recession drives those forced discussions in ways that, you know, when everything is hunky dory, perhaps it's in the too hard to do box.

Tim Weller:

Pensions. So, I mean, to be clear, pensions administration is absolutely a key and core part of Capita's service offering. We have a small number of contracts in our closed book life pensions arena which we called out in the year-end 2021 accounts as particularly challenging and made a big onerous contract provision in those year-end accounts. That had a top up in the first half of this year as we implemented a new accounting standard. About another 10 million was added to that particular closed book Life and Pensions provision bringing the aggregate provisions around £70 million. The small number of contracts we have are burning around £20 million a year of cash. We continue to look at opportunities to improve the efficiency of our management of those contracts and to seek a commercial resolution to the ongoing challenge we have of the cash burn. And we will update the market later on this year about our progress on that particular exercise.

Jon Lewis:

The only thing I'd add to what Tim has said is, you know, that is the last of the legacy challenges in the business since, you know, we started the turnaround back in 2018. It has a lot of focus today and it's not an easy problem to resolve. But we are we are looking much more aggressively at all of the potential avenues than we have done at any point to date. Paul?

Paul Sullivan:

Yeah, it's Paul Sullivan from Barclays. Could you firstly give us your initial thoughts on the shape of growth into next year? It feels like visibility should be improving given the inflationary backdrop and, you know, pipeline starting to take up a little bit, attrition starting to tick down a little bit. That would be helpful. Secondly, do you have line of sight on positive free cash flow at the core now? And if so, by when? And then thirdly, could you give us an update on your divisional margin targets? And sort of -- can you sort of shape the shared savings or the shared service initiatives from here? Thanks.

Jon Lewis:

So I'll let Tim cover the last question on divisional markets. Tim will probably also want to cover free cash flow. Though I will make one statement there and that is that in structuring future Capita the way we did, we obviously looked very keenly at the capacity of that business to generate sustainable, free cash flow and we remain on track to do that. Tim can give more colour.

With regard to growth. Look, there's what we control internally and there's what we don't control within the market. If we look at what we control internally, remember the three pillars: renewals, growth on account, new work, new clients. We are proactively progressing each of those avenues of revenue growth and they sort of, you know, think of think of renewals as the base foundation. You layer on another element of growth on account, you layer on another element of new work from new clients. And I think the £50 million that we built that I mentioned in the prepared remarks on renewals so far this year, the 150 we've appended to Defence Fire and Rescue, I think speaks to the ability to grow on account. And the fact that we have so much pipeline now with new clients for new scopes is also encouraging.

Secondly, our book to bill is one; greater than one. It's 1.1 at the end of the half. That pertains to growth, of course, and we have a very healthy pipeline of opportunities. If we look at the pipeline for the second half of this year, unweighted 5.5 in TCV, unweighted in year revenue 500 million. And if we then look out to 2023, we have an expanding pipeline of opportunities for that period as well. It's in excess of 6 billion, some of which is a result of deals this year moving into that period. So you add all of that up: reputation, getting the basics in place with regard to how we grow, incentivising the sales team and allocating sales resources appropriately on the pipeline. And yeah, we are increasingly confident in terms of the actions we are taking to grow the business. Now, what could prevent that from happening? Well, it's the macroeconomic environment. If the Bank of England does see GDP shrinking by, I think it was 12 percent they cited yesterday in 2024, that will have an impact on the business. Secondarily, though, this is becoming a lesser problem, our ability to close deals efficiently through our sales activity. And then lastly, our ability to resource those same deals.

So as again, as I mentioned, I think that problem is going to become less challenging as we go into recessionary periods. Tim?

Tim Weller:

On the margin targets one first. So we set out the long term margin targets for the group at the year-end results. So divisional EBITDA margins in the low double digits over the medium term and the group EBITDA margin in the high single digits. We're not demurring from that guidance. We have sort of talked a few times about the incremental opportunities we see as we complete the portfolio disposal program. And now Pay 360 has been added to that to drive down the overhead of this organisation. And therefore, in terms of is that a potential under promising medium term margin guidance? It may well be. There is definitely opportunity to run this group more efficient than we currently do.

On the free cash flow for the core. And I recognise that whilst we're doing a lot to simplify our reporting through the reduction in number of below line items we're calling out and so on, until we complete the Portfolio programme, it will still be a little bit hard to model core Capita. You will have noticed in today's results announcement that actually the portfolio businesses were cash consumptive in the first half of the year, they had a cash outflow. So it's arguable that actually the answer to your question is that core Capita actually delivered positive free cash flow in the first half of the year. That's quite sporty because there's a whole lot of other moving parts. And I wouldn't necessarily say that is a sustainable level of free cash flow from core Capita. So if Portfolio didn't exist, if Pay 360 didn't exist within our numbers in 2022, we would show a small free cash flow negative number still. As you move into 2023 with what Jon's talked about in terms of market opportunity growth, the efficiencies, we know we're doing in the organisation. We would expect that point in time in 2023 when you would start to see core Capita generating bottom line free cash flow.

Arthur Truslove:

Hi there. Arthur from City. So three for me, if I may. The question one. How is the M&A landscape developing? I know someone touched on when we spoke at Pre Close, but just interested to see how that is developing. Second, how should we think about the spread of contract anniversaries through the year? I guess inflation indexation kicks in on those anniversaries, so just keen to get a bit of understanding of how that spreads out through the year. And thirdly, has there been any change in the competitive landscape at all in terms of the bids that you're seeing and more people interested? Less people? Is it still disciplined? Thank you.

Jon Lewis:

Let's talk to -- I'll talk to M&A landscape. Tim, you do the second one. I'll do the third one. M&A landscape, the universe of buyers is both trade and financial PE. We are seeing even on processes that we've kicked off in recent weeks, a continued healthy interest from a sufficiently broad group of potential buyers that we believe we can have a competitive process that leads to a fair valuation for our assets. That said, there is no doubt the financial buyers, the PE firms are finding it harder to raise debt and that will result in some of those having less capacity to participate in processes going forward. But to counter that a little, you know, we're selling some good assets. REI Real Estate and Infrastructure, GL Hearn cases in point. FERA another one, Pay 360 another. And to the extent that some of the PE firms we're in conversations with are dipping into their funds to fund these as opposed to leveraging the deal at this point in time. So yeah, it's going to become harder for some of the potential buyers, but we're not seeing it negatively impact timing or valuation of deals currently, which is why we reiterated our commitment to complete the signing of disposals by the end of the first quarter of next year. Tim?

Tim Weller:

So the subtext of the question around contract anniversaries coming up is actually when is there a peak in terms of application of indexation clauses? Yeah, we've actually been through the peak. So it's around April time and that's largely driven by the public sector year end, more than necessarily the end of anniversaries of particular contract awards. Outside that public sector hump, it's actually readily smooth in terms of when other indexation clauses take effect. And that's why because that happens to be also when a pay increase is happening across the organisation in salary increases. Coincidence means that actually we're in quite a good position to say with confidence that the inflation is a score draw in the current calendar year because you've kind of been through the peak and we know what our pay rises have been. They've taken effect. You roll forward into 2023, of course, you've got another peak of indexation clauses taking effect in the contracts in April 2023. The chances are on average that the inflation measure that gets applied in that contract will be two, three, maybe four months earlier than that particular point in time. So the key question is what's inflation going to be in November, December, January? And that's what will take effect when we move into 2023. Of course the benefit we've got is we'll know the answer to that, as in what the inflation clauses will have built into them at the time within contemplating what our pay rises should be for 2023. So the ability to manage the cost base in line with the revenues is helped by the phasing of when a lot of these indexation clauses take effect.

Jon Lewis:

So I think we've done well on indexation. I think we've got more work to do in negotiating price increases in contracts where we don't have indexation or with our rate cards on our transactional work. And I think we all need to remember that, you know, some of us are old enough to remember 20 percent interest rates on our mortgages and what inflation meant for how we ran businesses, particularly in the '80s. We have a generation of managers and Capita today; we have a generation of managers in our clients who have never experienced inflation and we are having to train our people in terms of how they have those conversations with our clients. And I think our clients in some instances are learning how to deal with those conversations with regard to our requests for inflation as well.

Tim Weller:

I think we might be in the minority in that age banding, dear boy.

[laughter]

Jon Lewis:

It's how you feel, Tim.

[laughter].

Tim Weller:

What else?

Stuart Morgan:

There's just one question online. Do we think we're going to complete the three disposal processes currently in train by the end of the year?

Jon Lewis:

I'm not going to be drawn at that -- on that at this stage for the reasons we've already articulated. We have good momentum. We're in a -- we've done first round on a number of them. Processes are well advanced, but as I said, our guidance is that we will complete disposals by the end of the first quarter. And as a result of that have negligible net debt. You have no idea how much pleasure it gives me to make that statement given the journey the last four years.

Tim Weller:

Very low net financial debt.

Jon Lewis:

Thank you. This is why you have a CFO. Okay. Thanks very much, everyone. Really appreciate your interest. And for those of you who are taking some time off, many in this room, enjoy your deserved time off as well. Thank you.

[end of transcript]